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Municipal Development Corporation

Strategic Plan

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Strategic considerations

Strategy is the touchstone that keeps management grounded, employees aligned toward core objectives, and resources allocated effectively. A cohesive strategy provides clear assumptions of a company's view of the future. When new trends or events emerge that are inconsistent with those underlying assumptions, the company can react with agility and address these new factors without impeding forward momentum.

Strategy can be thought of as an integrated set of 5 choices that answer these 5 critical questions:

1. What is our winning aspiration?
2. Where will we play?
3. How will we win?
4. What capabilities must be in place?
5. What management systems are required?

Background

In February 2014 City Council asked administration for a report outlining business model options for land development and examples of other Municipal Development Corporations ("MDCs"). That report to Council in June of 2014 was followed by a request to administration for a report on the establishment of an MDC and further requests to create a detailed business plan and a detailed list of City land assets suitable to transfer into an MDC.

In alignment with The Way We Grow and The Way We Finance, this document outlines the details for the establishment of an MDC.

Terms of Reference

Council has previously expressed interest in establishing a municipal development corporation to:

1. Help unlock the value of surplus City-owned land;
2. Leverage non-City funding for land development projects;
3. Increase capacity to lead focused development efforts;
4. Reduce political involvement in land development; and
5. Improve access to private sector land development expertise and financing.

Mandate

The MDC will be an independent City owned entity that creates financial return and works to enhance the fulfillment of city-building objectives ("CBOs"). The MDC will focus on the value uplift of surplus City-owned properties in collaboration with leading private sector developers.

Areas of focus

The MDC will operate within the City of Edmonton and will focus on performing value-generating activities on surplus City owned property, as dictated by the initial list of properties transferred and the overall opportunity in the market. To manage the investment of resources into the MDC, the organization will work with a small number of properties at its outset.

Potential High Level Principles

The values outlined below are a combination of analyses on the current list of potential properties, detailed examination of other similar entities, and direction from Council:

1. Activities that balance ROI & CBOs

Although the MDC will focus on generating profits and a return on investment ("ROI") through uplifting land value, the MDC will strive to achieve City Building Objectives ("CBO"), identified by the City, when negotiating agreements with developers.

2. Unlock land value

The MDC will work with the City to develop sites that have been vacant or underutilized for many years or that have some complex development constraints that have prevented previous development.

3. Collaborative operations

The MDC will work with other businesses, government, or non-profit agencies to maximize the MDC's benefit while minimizing risk.

4. Create a Real Estate Centre of Excellence

The MDC has the potential to form a centre of excellence in terms of the City of Edmonton's real estate operations. This augmentation of experience and expertise would positively impact the City's other real estate projects.

Objectives

Key objectives for the MDC can be classified under Financial, City Building and Collaborative working relationships:

1. Financial
    - Become profitable within 3 years of incorporation
    - Generate a reasonable overall return on investment
2. City building
    - Undertake value-uplift activities that influence CBOs
3. Collaborative working relationships
    - Be seen as a valuable ally to the private sector

- Achieve an appropriate balance between risk / reward

Land acquisition strategy

The initial source of land will be the transfer of specific surplus City of Edmonton properties. The MDC may also seek to acquire land adjacent to existing sites or required to support key redevelopment options on existing MDC or City owned properties. In both scenarios, the potential properties will be assessed to determine whether they meet the key objectives of the MDC.

Evaluation of acquisition opportunities

Assets transferred to or acquired by the MDC should hold the potential for value creation through rezoning, planning, engineering or development. It is critical, particularly at the outset, that the MDC not be burdened with properties that do not have a potential upside.

Land will be transferred / acquired at the as-is fair market value, with this valuation critical to measuring the success of each project. As such, a thorough analysis must be undertaken in order to ensure that the property supports the objectives of the MDC.

The feasibility analysis should be made taking in to consideration any value that the MDC is able to create. For example, a project that presents a unique opportunity for the MDC to promote CBOs while achieving a target rate of return should be considered more attractive than an investment achieving the target rate of return alone.

Transfer of surplus city properties

It is expected that the City could initially transfer surplus City land to the MDC. The City of Edmonton holds a number of surplus properties that may present opportunities for value creation. The value uplift on each particular surplus parcel of land in the City's surplus inventory varies significantly; some parcels hold the potential of generating large returns, while others only present a minimal or even negative result.

An initial group of surplus City land was modelled and analyzed and cumulatively resulted in single-digit positive approximate returns. The outcome from this financial analysis is indicative of the quality of the surplus land in City inventory. The most promising sites from the City's surplus inventory have been selected collaboratively by City administration and real estate experts and are considered to be the higher-potential assets that the MDC can use to establish itself.

These sites will be transferred to the MDC in order to maximize the value that the MDC can offer to the City. The transfer of properties to the MDC from the City of Edmonton should come with minimal conditions and development constraints that limit their value. For example, specific site conditions that limit density, height, built form or are subject to other title constraints will make the viability of the MDC very challenging.

The proposed MDC, with a relatively small board and operating structure, may initially only have capacity to perform value-enhancing activity on a limited number of sites. This plan will be refined and finalized in the next phase of the implementation of the MDC.

Acquisitions of properties on the open market

Open-market acquisitions of land may be made to enhance existing opportunities. For example, the MDC might acquire land adjacent to an existing MDC or City owned property in order to complement or enhance the development scope of a project.

CBO identification mechanism

CBO's will be identified through a collaborative process between the City and the MDC board, and the board will strive to achieve CBO's on parcels where opportunities exist.

City Building Objectives (CBO's) may be identified through a collaborative process between the City and the MDC using broad macro objectives. The Board and staff of the MDC will then strive to achieve CBOs through negotiated agreements with developers on a site-by site basis. It is critical to strike a balance in this process where excessive development constraints or unrealistic financial objectives required to fund CBO's are not placed on the transfer conditions of specific properties.

The inclusion of CBO's in the value uplift of specific properties might be accomplished through various mechanisms during the project planning phases and could include conditions in project documents during the bidding and negotiation process.

Sources of revenue

In order to meet its goal of developing into a profitable venture, the MDC could generate revenue through the sale of uplifted land and the retention of an equity interest in projects.

The MDC will generally realize return through two primary avenues. The first is the sale of value-uplifted property, and the second is through a retained equity share of projects. This equity share will grow through the development of a site and will be converted to cash upon the project's completion.

Sale of value enhanced land

The MDC's primary source of revenue could be the sale of property with which the MDC is able to add value. This value may come from a variety of activities. Primarily, the MDC would undertake zoning changes and the lifting of constraints on properties. Depending on the property, the MDC may choose to also complete the development permitting process to sell or collaborate on a "shovel-ready" product.

Holding equity share in projects

The MDC may choose to retain a share of equity in development projects, as opposed to realizing the entire cash value of enhanced land at the time of sale. When retaining value, the MDC could participate in a value-uplift from the development activities, with a significantly reduced burden of cost and risk compared to undertaking end-to-end development independently or by retaining most of the equity in the project. The MDC may then sell back its share in the development upon the project's completion, realizing, at this time, the cash value of the equity share. The return on this equity share will depend on market conditions, expertise and the development's asset class.

Timing

The timing of revenues and phasing of development will be critical to support the objective of becoming profitable within 3 years of incorporation.

Timing of revenue

The MDC will need to actively manage the timing of revenues in order to achieve independence and profitability. At its outset, the MDC will pursue projects with shorter turnaround times, leading to an initial stream of cash flow from property sales. Cash flow will be required to cover operating and holding costs, and to ensure that the MDC remains a going concern.

Phasing strategy and management of holding costs

High-value properties have been identified for inclusion in the MDC. Due to limited resources, the activities undertaken on these properties could be staggered. In order to manage holding costs and the timing of cash-flows, the MDC must engage in thorough planning of its pipeline.

The MDC may take title to properties when required, when the organization has the capacity and intention to work with them so as to minimize holding costs within the MDC. Should the City decide to transfer properties in advance of the MDC's requirements, the MDC may require additional funds to cover holding costs.

It should be noted that these holding costs will either directly be incurred by the City or indirectly by the City through the MDC. From that consolidated City perspective the timing of transfer is less material.

In-house expertise vs outsourcing

The MDC may need to outsource a number of responsibilities to third party consultants to help support the lean operating model in early years.

With a lean operating structure, The MDC - particularly at its outset - may not have the full composition of skills required to complete its range of work. In certain situations, the organization may choose to outsource certain activities to third party consultants. It is important, especially early in the organization's formation, to determine what skills are essential to hold or develop in-house. This assessment may drive human capital and training decisions. Additional in-house competencies will be developed as the MDC matures.

Opportunities exist to outsource activities that the MDC can't perform internally, or those activities that aren't essential to the organization's value-chain. The MDC must have the ability and expertise internally to manage any activities that are outsourced. Without a base level of knowledge, the MDC will be unable to gauge cost and quality of outsourced product, and will have difficulty holding outsourced parties accountable.

Collaboration strategy

The MDC could retain equity in certain projects in order to benefit from the potential value lift on properties, undertaking minimal risk and while participating in tangible engagement with the private sector.

Private sector participation in projects will be leveraged by the MDC in order to maximize return with a reduced risk. The MDC will be able to contribute a portion of the land value to these projects, while the private sector developer will manage the development and contribute additional equity.

The MDC will be required to identify developers through a public RFP process. This will allow the entire private sector the opportunity to participate in the process and will also allow the MDC to evaluate and select the partner with the right expertise for each project.

For the MDC to be successful, a strong engagement process with the local and national development community will be essential. Without a commitment to engaging with the private sector, the local development community will be highly critical of the role that the MDC plays. There has already been some concern expressed by the private development community in the feasibility stage and they have been actively engaged by the team of Real Estate Experts with the key message that the full involvement of the private sector development community in Edmonton is critical to the overall success of the MDC.

Striking a balance in relationship with City

The MDC will be required to maintain its independence as an arms-length entity while at the same time achieving objectives that benefit the City.

Benefits of independence

Acting as an independent entity allows the MDC to operate in an entrepreneurial manner. This separate governance structure would allow the MDC to maximize its value and best achieve the City's objectives for the municipality. This independence would also result in the MDC having the ability to be nimble and flexible with decision making. By virtue of being independent, the MDC would also have the flexibility to direct decisions towards maximizing return, rather than being tied in to politically driven directions for development.

Considerations of relationship with City of Edmonton

There are many factors affecting the MDC that could arise as a result of their relationship with the City of Edmonton. Potential CBOs will be considered on properties that the MDC undertakes, pushing forward the City's vision for the future. As the MDC may have limited control over the development or projects, CBOs will be incorporated in the earlier stages of planning where it is practical to do so. The MDC should consider how to best leverage its relationships with the City in order to maximize the value it can provide while developing opportunities.

The MDC presents an opportunity to incubate a centre for real estate excellence within the City of Edmonton's corporate reach. Not only will the organization aim to unlock value in surplus sites, there is the potential to positively impact other City of Edmonton real estate interests and activities.

Key performance metrics

The performance of the MDC will be judged by a number of key performance metrics. The ability for the City, the general public and the private sector development industry to understand these metrics will contribute to the potential support for the MDC.

The establishment of the Edmonton MDC will lead to a series of potential benefits for the City of Edmonton. Identifying and tracking key performance metrics is vital to enable an organization to be successful. These metrics will allow the MDC to track progress towards its goals and objectives. The MDC has been designed around two goals, the first is profitability and financial return, and the second is the execution and incorporation of City Building Objectives. Below is an example of performance metrics, to which the board may add in the future.

Financial and operating metrics

Metric	Target	Value
IRR for City	TBD	The IRR on the City of Edmonton's investment in the MDC will allow the City to compare its investment in the MDC to other potential investments, in order to assess the value of the MDC from a quantitative, financial perspective.
IRR for MDC	TBD	The MDC's IRR will allow for the organization to track and assess value it creates on its combination of projects in order to evaluate return.

Sum of Land Value Unlocked	TBD	The total amount of land value that the MDC is able to unlock in each year, and on a cumulative basis, will be an indicator of the level of impact that the organization is able to deliver.
Net Income	TBD	The MDC will have targets for net income in order to ensure the effective management of both costs and revenues. The net income will be critical to the MDC achieving its goal of profitability by year 3 and the future ability to provide dividends to the City.
Time to Realize Benefits	TBD	The MDC must operate with an efficient use of resources, indicated by the amount of time required for benefits to be realized on a per-property basis.
Value of CBOs Achieved	TBD	Recording the value of CBOs that are achieved by the MDC will allow for insight in to the MDC's benefit beyond financial return. This value might be measured by assessing the cost that would have been incurred by the City to achieve the same outcomes that the MDC incorporates into projects.