Administration – Budget/Financial Implications

Review of Options

In developing a start-up strategy, Administration worked with consultants to evaluate a range of financial models that were developed in the review of the Municipal Development Corporation concept.

Financial models considered activities from minimal property enhancements and sale to full development of properties using joint venture agreements and sale or leasing of the completed projects.

The following table summarizes and compares the financial projections for the “MDC Superlight”, “MDC Light”, and “MDC Heavy” models and the City provided resources required for each model.

The option of the City providing resources to enhance in-house expertise in real estate and private sector development and to further address land inventory was not modeled.

City of Edmonton
Municipal Development Corporation
Financial Models

Model	**MDC Superlight:**	**MDC Light: Land Preparation only**	**MDC Heavy: End to End development**
Description	Land value is enhanced but no servicing or development costs are assumed; enter into projects with developers	Land value is enhanced but no servicing or development costs are incurred; enter into projects with developers	Land is fully developed into residential, commercial or industrial properties through projects with developers; properties are leased/rented to tenants

City provided resources

Properties	5 sites	6 sites	4 sites
Appraised Fair Market Value of Land	$17.9 million	$27.5 million	$26.05 million
Cash Grants	$3.75 million over three years	$4.90 million at inception	$15.88 million over four years
Paid in Capital	-	-	$48.5 million over four years
Financing guarantees	$1.0 million cumulative for working capital	nil - working capital provided by initial cash infusion	$128.14 million cumulative maximum

Projected Financial Outcomes to City

	MDC Superlight sample proforma with property enhancements; no servicing or development costs included	Based on most financially favourable MDC Light model proforma	Based on most financially favourable MDC Heavy model proforma
Equity position held in MDC	$32.4 million in equity share/MDC assets value in year four	$40.1 million in equity share/MDC asset value in year six	$78.75 million in equity share/MDC asset value in year seven
City Building Objectives	CBO written into land transfers and agreements with developers	CBO written into land transfers and agreements with developers	$6.87 million investment in CBO
Dividends	No dividend payments initially; earnings reinvested during startup	No dividend payments initially; earnings reinvested during startup	No dividend payments initially; earnings reinvested during startup
Repayments	Repayments for the transferred land are not included in the four year proforma and are dependent on future MDC cash flow and profitability Any working capital loans are repaid	Repayments for the transferred land are not included in the six year proforma and are dependent on future MDC cash flow and profitability	Repayments for the transferred land and for City startup loan to the MDC begins in year six. Continuing income stream from rental properties drives future MDC cash flow and profitability
Projected Internal Rate of Return including projects with private sector*	6% - 9% IRR	3.1% IRR	2.0% IRR

* All Internal Rates of Return projections are based on the assumption of private sector participation in the development of each project

Sources: Information for the proformas was provided by the Real Estate Expert Consultants and Deloitte

Properties

The inventory of property available for transfer to the Municipal Development Corporation is detailed in the corresponding private report (September 15, 2015, Sustainable Development report CR_1920). City staff and real estate expert consultants reviewed the list of over forty properties and assessed at a high level the potential financial return and suitability of the land for the Municipal Development Corporation concept. Properties were reviewed for issues and those that could not be declared surplus at this time, or those with a limited potential return were excluded from further evaluation.

The most financially promising sites were identified and chosen for individual proformas and included in further analysis. Assumptions regarding property uses reflect the highest and best use as identified by the real estate expert consultants. Development costs and timelines were provided by real estate experts and Deloitte through industry standards.

Fair Market Value of Land

The transfer of land is assumed at appraised fair market value.

Land transfers to the Municipal Development Corporation may be immediate or may be staged but all models include the assumption that land must be transferred to the Municipal Development Corporation before any enhancement work commences to allow the Municipal Development Corporation to show the value of the enhancement. Enhancement work while the land remains with the City would increase the fair market value for the transfer and lower Municipal Development Corporation profitability.

City Grants

Cash grants to the Municipal Development Corporation are not assumed to be repaid.

Financing Guarantees

Under the Municipal Government Debt Limit regulation the City calculates the debt limit as though its controlled corporations are part of the municipality, as such, Municipal Development Corporation revenues will form part of the calculation of the debt limit except to the extent revenues are derived on transactions between the Municipal Development Corporation and the City of Edmonton. Financing guarantees required by the Municipal Development Corporation are treated as City debt and will be included in calculation of the City's debt limit except to the extent that such guarantees are between the Municipal Development Corporation and the City of Edmonton.

Projected Financial Outcomes to City of Edmonton

No cash repayments for the initial transfer of land or for dividend payments to the City are anticipated in the initial years of the Municipal Development Corporation, or until the Municipal Development Corporation is profitable and has sufficient cash flow for repayments.

Any repayments from the Municipal Development Corporation to the City assume no interest charges.

The equity position held by the City in the Municipal Development Corporation as the sole shareholder includes the projected value of projects entered into with the private sector and the value of any cash, land, or developed property held by the Municipal Development Corporation, net of liabilities.

All models included sensitivity analysis and consideration of risks.
The realized internal rate of return (IRR) will vary. Financial sensitivities/risks are significant when working with a small number of properties: variances with the return on projects with developers or in the enhanced value of a single property will affect the overall return. For example, a 5% change in the fair market value assumptions in MDC Superlight could change the IRR by 1.4%.

All models assumed timely provincial approval for the Municipal Development Corporation.

Recommended Approach

Of the financial models developed, Municipal Development Corporation Superlight minimizes the risk level to the City and provides a more favourable projected financial return to the City through a lower initial investment and tighter planned timeframe than the other models.

If the MDC Superlight model is approved, pre-incorporation startup funding of $0.75 million for 2016 and operating funding of $1.25 million per year for 2017 and 2018 will be requested through the operating budget process 2016-2018, for a total of $3.25 million. The third year of operating funding will be requested in the operating budget process for 2019.
Startup expenses are not included in the financial models and were previously discussed in CR_1708 Municipal Development Corporation Business Plan.

The model projects MDC Superlight will borrow up to $1.0 million in total. As identified earlier, all borrowings and guarantees will be included in the calculation of the City's debt limit.

The MDC Superlight model also assumes the transfer of City owned land with an appraised current fair market value of $17.9 million in exchange for shares of the Municipal Development Corporation.

The MDC Superlight model projects a positive cash flow beginning in the second year of incorporation, after the sale of properties begins. When sales are completed in the fourth year, MDC Superlight assets are projected to consist of $10 million cash and an unrealized $22.4 million invested with developers. No cash reimbursement to the City for the transferred land is included in the four years modeled. The timing and process to cash out the equity investments with developers will affect payments to the City. Although the City is the single shareholder, the Municipal Development Corporation Board will determine dividend payments and may also choose to reinvest earnings in the corporation.

Separate from the Municipal Development Corporation model, the City of Edmonton Land Enterprise Dividend Policy (C516B) requires Land Enterprise to pay a 25 percent dividend to the City when land is sold. However, the transfer of the properties to the Municipal Development Corporation provides preferred shares to the City rather than any cash payment that would allow Land Enterprise to provide the Land Enterprise Dividend. An exemption from Council policy will be required.

The MDC Superlight model, as well as the other models, assumes that the Land Dividend will be waived.

There are non-financial benefits in the form of city building objectives to creating the Municipal Development Corporation as a new vehicle to transfer land from City inventory to developed properties that have not been quantified. These benefits may include but are not limited to creating value in underused land and adding to the City's tax base, or supporting in-fill development, affordable housing or green initiatives.

The level of return for MDC Superlight is an estimate only and will be dependent on development decisions made the Municipal Development Corporation Board as well as overall economic conditions.

The MDC Superlight financial model (sample proforma) has a number of associated risks including but not limited to the following:

- The City is not repaid for the land in this model but depends on an equity share in future private developments for a favourable return over the long run.

- The Municipal Development Corporation initially develops a small number of sites. Enhancement activities on the five sites are assumed to proceed quickly enough to allow all five properties to be complete in four years. Unexpected delays or difficulties with a single site will affect overall returns.

- Supply of suitable land: the sites chosen for the sample proforma are not representative of all the surplus sites reviewed and were chosen as having the most financial potential; other sites were not profitable to develop. Remediation expenses are possible with some of the properties identified for transfer. The models make no assumptions for remediation. Any remediation required would represent added costs.

- If the Municipal Development Corporation is to continue operations after the development of the sites, additional promising land would need to be identified and purchased from the City at fair market value after year three.

- Depending on the actual performance of the MDC, some level of contribution from the City may be required for the future supply of land.

- The City's requirements of city building objectives need to be considered in collaboration with the Municipal Development Corporation Board at the time of the transfer of land for effective delivery of the intended outcomes. As an example, the city building objectives could be built in as a condition for transfer of land to the Municipal Development Corporation and may be written into projects with developers or reflected in zoning changes.

- Both city building objectives and profitability are objectives of the Municipal Development Corporation and will need to be balanced for the best outcomes. Additional City funding for specific projects could be requested.

- Private project participants may face financial or other issues not controllable by the Municipal Development Corporation, which could have a negative impact on the value of the Municipal Development Corporation equity investment.

- Future valuation of projects uses industry assumptions but is dependent on equity agreements, types of development, timing, participants and economic factors and may not be reflective of actual results.

- Investments with private developers are not liquid; there is some uncertainty around the process of liquidation if the Municipal Development Corporation is to be closed after the initial period or whether the MDC will require cash from these assets for continuing activities.

- The projected range of return for MDC Superlight has some level of risk and is dependent on the decisions that Municipal Development Corporation will make regarding development of the properties and the ability of the Municipal Development Corporation to enter into favourable project agreements.

- MDC Superlight projected return of 6 percent to 9 percent also has a level of risk related to the outside economic forces affecting property development within a single city.

- As a comparison only, the widely and globally diversified Ed Tel Endowment Fund recent return was 9.7 percent over 2011-2014; expectations are that the fund will return a range of 5.0 percent to 6.5 percent annually through the next ten years.