Land Governance Strategy Update

Enterprise Land Development Program Update - Additional Information

Recommendation

That Executive Committee recommend to City Council:

1. That reinitiation of Enterprise Land Development greenfield residential development for the 2019-2022 budget cycle, based on the recommended disposition strategy outlined in the February 24, 2020, Financial and Corporate Services report CR_7122rev, be approved.
2. That $7.5 million be transferred from capital profile CM-16-2025 (Residential/Mixed Use Land Development Acquisition) to capital profile CM-16-2020 (Residential/Mixed-Use Land Development) to support a market driven residential land development disposition option, and that remainder of funds held for Capital Profile CM-16-2010 and Capital Profile CM-16-2020, be released.
3. That Attachment 8 of the February 24, 2020, Financial and Corporate Services report CR_7122rev remain private pursuant to sections 24 (advice from officials) and 25 (disclosure harmful to economic and other interests of a public body) of the *Freedom and Information and Protection of Privacy Act*.

Previous Council/Committee Action

At the November 18, 2019, Executive Committee meeting the following motion was passed:

> That the November 18, 2019, Financial and Corporate Services report CR_7122 be referred back to Administration to:
>
> 1. Provide an analysis on the return of an $85 million investment, based on a typical civic investment scenario, and
> 2. Offer to work with REAC to provide additional analysis on the land development program options and financial model.

Other previous motions related to the Land Development Program are included in Attachment 1.

Executive Summary

Administration continues to review the City's corporate real estate strategy and Enterprise Land Development (ELD) through the lens of the strategic goals outlined in ConnectEdmonton, the Corporate Business Plan and the draft City Plan. Under the *Municipal Government Act,* a land development program is one of only a few revenue tools available for municipalities. The review of Edmonton's ELD program included ongoing engagement with the Real Estate Advisory Committee (REAC) and insight from third party consultants on the program's remaining holdings.

With the help of third party expertise, Administration considered disposition options for the ELD program's remaining greenfield residential land. Options ranged from developing the land and selling lots at a market driven rate to selling the land as-is. The third party's recommended option is that the City develop its remaining greenfield residential lands at a market driven pace. This approach is estimated to generate $204 million over a 30 year horizon, with a Net Present Value (a measure of future revenue in today's dollars) of $123 million. This value includes all costs for developing the land but does not include the original land cost. Sale of the land as-is would generate approximately $85 million in gross sale revenue over two years.

In response to the motions made at the November 18, 2019 Executive Committee meeting, Administration further evaluated investing $85 million from short term sales into a civic investment vehicle. Three investment types were considered, including the Ed Tel Endowment Fund. Any investment scenarios that withdraw funds before 2049 generate lower Net Present Values than the Net Present Value of continued greenfield residential development.

Based on the compared return on investment, Administration recommends Council approves reinitiation of the City's residential land development for the 2019-2022 budget cycle. Administration also recommends transfering funds from the land acquisition capital profile to the development profile. As per the third party review and input from industry members, the City does not plan to acquire any new land for residential development. The additional release of industrial/commercial and residential/mixed-use land profiles will allow the City to meet its 2019-2022 Budget projections and fund outstanding contractual commitments. Administration will regularly evaluate success and projections for its remaining land inventory, and will provide business cases to Council about options to continue development or sell assets in the future.

Report

Background

Throughout 2019, Administration led a comprehensive review of the remainder of Enterprise Land Development (ELD) land holdings. A map of holdings is included as Attachment 2. This included consultation with the Real Estate Advisory Committee (REAC) and advice from external consultants PricewaterhouseCoopers (PwC) and Ernst & Young (EY) to determine how the ELD program can:

- Align to the strategic goals outlined in ConnectEdmonton, the Corporate Business Plan and the draft City Plan;
- Attract private investment to the city; and
- Catalyze key city building areas such as the River Crossing, Exhibition Lands or Quarters Land Development Projects.

The November 18, 2019 Executive Committee report CR_7122 Land Governance Strategy Update provided:

- Proposed updates to the Land Development Policy (C511) with a focus on mandate, governance and development guidelines in addition to support for climate resilience and affordable housing;
- Proposed updates to the Enterprise Dividend Policy (C516B) to support payment of a special dividend to fund city building initiatives;
- Summary of Administration’s consultations with REAC (Attachment 3).
- REAC’s advice on the Land Development Policy (C511) and the residential disposal options, as generally captured in PwC and EY reports, Attachments 4 and 5; and
- Information on Special Economic Zones (Urban Reserves).

Enterprise Land Development (ELD)

ELD is a self funded program, operating within the financial structure of Land Enterprise, that acquires raw land and invests in planning, engineering and servicing to create serviced lots for sale. ELD’s activities are conducted in accordance with the Land Development Policy (C511). Pursuant to the Land Enterprise Dividend Policy (C516B), revenue from lot sales fund program operations, including future land acquisitions and development of existing land. The program also provides an annual dividend to the City that offsets tax levy requirements. Under the *Municipal Government Act,* the program is one of only a few revenue tools available for municipalities.

<u>Industrial Commercial Lot Development Update</u>

CR_7122 also provided an update on industrial land activities in 2019. The Gateway Boulevard property continues to be subject to a sales contract and is expected to transfer to the buyer in 2020.

Greenfield Residential Lot Development Update

As outlined in CR_7328, Sale of Land Below Market Value, in July 2019, Council approved the transfer of six remaining ELD held residential lots in Hollick Kenyon to Habitat for Humanity - Edmonton Society for $1.00. By transferring the land at $1.00 instead of the estimated market value price of $1.1 million, the City forfeited a potential dividend of approximately $230,000.

The City's residential lot development in the Laurel neighbourhood, The Meadows of Laurel, is now largely complete; final construction and warranty work will occur until 2022. Lot sales commenced in 2019 and will continue annually until 2022 through a staged draw process. Two thousand registrants entered into the 2019 lot draw and all lots offered for sale were sold. The results of a questionnaire completed by registrants and a profile of the Laurel development are included in Attachment 6.

The Real Estate Advisory Committee (REAC)

In response to the motion made at the November 18, 2019, Executive Committee meeting, Administration and PwC worked with REAC to address questions and concerns about development options and PwC's financial model.

During this recent engagement, industry members submitted the questions outlined in Attachments 7 and 8 (Private). Administration's responses are also included in the attachments. Financial terms are defined in Attachment 9. Industry members' specific concerns about PwC's analysis included: industry employs a higher discount rate, revenue projections should not be increased annually, market value instead of book value should be used in Internal Rate of Return calculations, and that maximum cash value at risk should be identified within PwC's report.

Recommended Disposition Strategy of City Owned Greenfield Residential Development lands

The recommended disposition strategy includes an updated Land Development Policy (C511) that outlines a moratorium on new residential greenfield land purchases. The next stages of residential lot development will continue at a market driven pace. To support this, Administration recommends the release and transfer of capital funding for the 2019-2022 budget cycle. This will allow advancement of the next stages of residential lot development in Schonsee and Goodridge.

While PwC's recommended option is to develop the remaining greenfield residential lands over the next 30 years, the City budget cycle only allows funding approval until

2022. Administration has outlined an updated governance model in CR_7122, that includes opportunities for Council and industry member feedback, in addition to a more robust reporting structure and regular reviews prior to the commencement of future stages of lot development, considerate of market conditions and maximizing return on investment.

PwC's recommended option for developing remaining greenfield residential lands is estimated to generate $177 million in total net profits and $204 million in future cash over a 30 year horizon, with a Net Present Value of $123 million. Details of their evaluation are included within Attachment 4, which has been updated since the November 18, 2019 Executive Committee meeting to include:

- Applicable start dates have been adjusted from 2019 to 2020;
- The Market Overview reflects the most current market information; and
- Net Present Values have been updated and reflect additional feedback from REAC.

To maximize return on investment and access to funds for City Building objectives, PwC continues to recommend development of the remaining greenfield residential land. If the remaining greenfield residential lands are sold as-is without further development, PwC projects gross sales revenue of $85 million over the next two years, assuming all sales revenue is paid to the City and no revenue goes back to the development program. Based on the timing of the project sales, the Net Present Value of $85 million is $78 million.

PwC also evaluated the entire development portfolio for how it could best support the City's access to funds. The assessment assumes the program would develop all its existing holdings, with industrial land development continuing as planned and residential land development proceeding as recommended. With this approach, the land development program would pay the City a special dividend out of surplus revenue to catalyze other key city building areas.

The special dividend would be paid out in addition to the dividend paid under the current Land Enterprise Dividend Policy (C516B). In order to create a special dividend, Policy C516B must be updated, as outlined in CR_7122. This approach would generate approximately $274 million in total dividends until 2049, when all the existing land within the program will have been developed and sold. The Net Present Value of $274 million is $171 million. All projections are estimated within a 10 to 15 percent range of certainty. The proposed revisions to Policy C511, which include an updated governance model and regular discussions with REAC, were also outlined in CR_7122. These changes would enable the land development program to better respond to changes to the market.

Civic Investment Vehicle

In response to the motion made at the November 18, 2019, Executive Committee, Administration evaluated the potential of approximately $85 million in sales revenue if the remaining greenfield residential lands were sold as-is in the short term. The evaluation included three civic investment fund models applying scenarios of:

1. Investment with no cash withdrawals;
2. Investment with annual cash withdrawals equal to accrued interest; and
3. Investment with annual cash withdrawals equal to the total dividend (special and existing dividend under the Land Enterprise Dividend Policy (C516B)) proposed by development of the remaining greenfield residential land.

Generally as investment risk increases, the expected rate of return increases. Higher rates of return also often require a longer period of investment. Administration considered the following civic investment funds with varying rates of return and risk:

- A portfolio of primarily money market investments is projected to return 2.5 to 3 percent per year. The fund typically requires a minimum investment time of one year. Investment in this type of portfolio will reduce market volatility, be more predictable and consistent, but will limit expected investment returns.
- The City's Balanced Fund is a long-term investment vehicle for operating and capital reserve funds, deferred revenue accounts and other similar funds. It is projected to return between 5.5 and 6 percent annually over the next 5-20 years. The fund typically requires an investment time of greater than five years to improve the likelihood that the projected returns will be realized. There is greater flexibility to withdraw money invested in the Balances Fund, but these funds are subject to capital market volatility year-over-year.
- The Ed Tel Endowment Fund operates pursuant to the Ed Tel Endowment Bylaw 11713, with a dividend paid based on a prescribed formula. An amendment to Bylaw 11713, including a non-statutory public hearing and public advertising, will be required to allow for investment of $85 million into the Ed Tel Endowment Fund. Strategic access to the funds will also be limited. While the Ed Tel Endowment Fund has returned 7.9 percent on average annually over the past 25 years, projected future returns are between 6.5 and 7 percent, assuming an investment time of 10 years or more.

The following table outlines the Net Present Value (NPV) of each investment option and scenario to 2049. As noted earlier in this report, the Net Present Value of developing the greenfield residential land is estimated at $123 million. All projections are estimated within a 10 to 15 percent range of certainty.

	Scenario 1 - No withdrawals until 2049 (NPV)	**Scenario 2 - Withdrawals equal to Accrued Interest (NPV)**	**Scenario 3 - Withdrawals equal to special dividend (residential portion only, NPV)**

Money Market Fund	$56.9 million	$63.5 million	$76.1 million[1]
Balanced Fund	$129.6 million	$104.1 million	$87.8 million[2]
Ed Tel Endowment Fund	$169.7 million	$117.7 million	$92.9 million[2]

[1] The fund runs out of money in 2028
[2] The fund runs out of money in 2032

If funds are withdrawn from the investment vehicle to support city building objectives, the return on the investment would not be as high as development of existing greenfield residential lands. The dividend and special dividend paid from continued development will provide a higher return than any investment scenario that withdraws funds before 2049.

Next Steps

Administration will return to City Council in Q4 2020 with updates to the Land Development Policy (C511) and the Land Enterprise Dividend Policy (C516B) to facilitate the special dividend. A timeline is included in Attachment 10. Administration will initiate the recommended disposition strategy and continue residential lot development during the 2019-2022 budget cycle, with regular updates to REAC and City Council. Industrial/commercial lot development will continue as planned. Regular reporting will enable responses to market changes, including evaluations of whether to sell or develop specific holdings in the future.

Budget/Financial Implications

Land development programs are one of the few revenue tools available to municipalities. The ELD program is projected to pay $1.9 million in annual dividends over the 2019-22 budget cycle in accordance with Policy C516B. If current land development activities are stopped, Administration must determine an alternative funding source to offset the reduction in projected dividend payments starting in 2022. Decreased land development activities will also impact the Operating Budget tax levy as the levy recovers approximately $1.14 million of costs annually from the program ($4.59 million total over the 2019-22 budget cycle) for lease costs, parking, real estate and financial personnel support.

The current pause on greenfield residential land development activities has caused a lost year of residential lot development activity, delaying projected revenue and the 2022 ELD dividend payment.

Council’s release of the remainder of CM-16-2010 and CM-16-2020 will enable ELD to continue land development activities, achieve 2019-2022 Budget projections and fund outstanding contractual commitments. Transfering $7.5 million from capital profile

CM-16-2025 (Residential/Mixed Use Land Development Acquisition) to capital profile CM-16-2020 (Residential/Mixed-Use Land Development) will support the recommended residential land development disposition identified in Attachment 4. If the recommendation is approved, the remainder of capital profile CM-16-2010, Industrial-Commercial-Investment Land Development, and the remainder of capital profile CM-16-2020, Residential/Mixed-Use Land Development, will be released. These capital profiles are funded by ELD's retained earnings within Land Enterprise and do not require tax levy funding.

Public Engagement

Public engagement was not completed for this report. However, the recommendation to Council is based on a comprehensive program review informed by research and insights from two external consultants, as well as feedback from REAC. The report is also informed by an optional, confidential online questionnaire completed by all registrants as part of the 2019 residential lot draw process (Attachment 6). As the program continues, Administration will continue to involve stakeholders to enhance the City's land development decision making.

Corporate Outcomes and Performance Management

Corporate Outcome: The City has a resilient financial position			
Outcome(s)	**Measure(s)**	**Result(s)**	**Target(s)**
Land sales generate revenue that supports City program delivery. The City of Edmonton has a resilient financial position.	Annual dividend payment.	2018 - $0 2017 - $3.393M 2016 - $4.139M 2015 - $2.708M	2019 -$0 budget / $977,000 actual 2020 - $497,000 budget / $2.127M current projection 2021 - $759,000 2022 - $544,000
Land sales create new tax proceeds that support City program delivery.	Number of developed sites sold.	2019: 77 residential lots sold and 5 commercial lots sold	2019: 77 residential lots sold and 5 commercial lots sold

Risk Assessment

Risk Element	**Risk Description**	**Likeli hood**	**Impact**	**Risk Score (with current mitigations)**	**Current Mitigations**	**Potential Future Mitigations**
Risks if not approved						

Financial	Changes in funding from ELD projects could impact City funding sources	4	2	8 - Medium	Administration will need to determine an alternative funding source for ELD funded costs	None
Financial	Changes in funding could restrict the City's ability to fulfill existing contractual obligations	4	1	4 - Low	Termination clauses in existing contracts	None
Risks if approved						
Economic	Changes in real estate market will affect financial outcomes of ELD projects	3	2	6 - Low	Research and understanding the real estate market and land sale values	Same as current mitigation measures
Competition	The City will no longer have a share of the residential land development market	4	1	4 - Low	Policy C511 updates will guide land development activities	Mandatory Review of Policy C511 every 5 years

Attachments

1. Other Previous Council Actions
2. Map of ELD's Holdings
3. Real Estate Advisory Committee (REAC) What We Heard
4. PwC Land Disposition Options Report
5. Recommended Themes for an Update Policy C511 - Executive Summary
6. Meadows of Laurel Profile
7. Response to REAC's Additional Questions (Public)
8. Response to REAC's Additional Questions (Private)
9. Definitions Document - Supporting Definition Document Alongside Land Governance Strategy Report
10. Timeline Diagram

Others Reviewing this Report

- C. Owen, Deputy City Manager, Communications and Engagement
- G. Cebryk, Deputy City Manager, City Operations
- K. Armstrong, Deputy City Manager, Employee Services
- R. Smyth, Deputy City Manager, Citizen Services
- S. McCabe, Deputy City Manager, Urban Form and Corporate Strategic Development
- B. Andriachuk, City Solicitor