Attachment 7

REAC Public Responses

In working with the Real Estate Advisory Board (REAC), a number of questions arose for clarification around the Land Governance Strategy Council Report, CR_7122, presented to Executive Committee on November 18, 2019. This document answers the questions that do not disclose information harmful to economic and other interests of a public party or advice from officials. The remainder of REAC's questions are answered in Attachment 7, REAC Private Responses.

QUESTIONS SPECIFIC TO PwC REPORT

1. **It is understood that four percent was used as the discounted rate in a Net Present Value calculation. Can you explain why Administration feels this is an appropriate discounted rate for evaluating land development? If using the City's WACC, how is the risk of the investment represented in the calculation?**

   PwC uses a four percent discount rate in their analysis. This is consistent with models PwC has developed for other municipal land development programs. PwC believes a four percent discount rate is appropriate as the City's land development program does not incorporate debt as part of its capital profile. Only the cost of equity applies. The risk associated with the development of land is therefore not encompassed in the discount rate, but rather is illustrated in the estimated "hurdle rate" of a required investment Internal Rate of Return (IRR) or net margin calculation. PwC's model for the City's land development program differs from a model where debt is used, which is the typical model used by a private developer. In discounting cash flows in a model where debt is used, weighted average cost of capital is normally used as the discount rate.

2. **Impact Assessment – when evaluating the options, are special dividends being discounted (NPV)?**

   In the November 2019 PwC report, the Special Dividend analysis is not discounted for a Net Present Value. The updated February 2020 report however does discount the Special Dividend to its Net Present Value.

3. **Market metrics used in the report are based on Conference Board of Cda and appear to be based on their Spring 2019 outlook. The fall outlook is more current and most economic forecasts have been downgraded (some substantially) since last year. Is the City and PwC comfortable in the market metrics assumed in the analysis and has a sensitivity been done in a lower growth scenario?**

   PwC incorporated the Fall 2019 outlook into the updated report, included as Attachment 4. While the short term economic forecast has changed, the medium to long term forecast has not. PwC has concluded that the changes do not support adjustments to their medium and long term forecasts for the land development projects. However, PwC has made some timing changes in the first five years of the analysis to account for these downgrades in macro economic forecasts. Administration is comfortable with the recommendations from PwC.

4. **For Goodridge Corners (Page 27), why does Option 3 – Quick Sale have a high negative cash outflow in 2020? And why is spending more than in scenario 1 and 2?**

   The negative cash flows for Goodridge Corners in 2020 are due to the front-ended infrastructure costs spent to date on the servicing infrastructure. For the development scenarios, this is accounted for entirely in the Stage 1 results, because costs are not shared across stages. As the City is the only landowner in the Neighbourhood Structure Plan and a Permanent Area Contribution (PAC) basin does not exist, these costs are covered in future stages in the proforma calculations.

   For the quick sale options the front-ended infrastructure costs are accounted for since they service the future lands and value of those lands is partially based upon the front-ended serving that exists here.

5. **The report states that adjustments were made to assumptions for the development budgets and cash flow models for each of ELD's greenfield residential land development projects. What adjustments were made for the cash flow models?**

   The adjustments described in the PwC Report refer primarily to the timing and staging of development and land sales under the alternative scenarios explored by PwC (any scenario that is not considered "status quo"). For instance, in any "Accelerated Development" scenario analysis, PwC adjusted the ELD development and sales timelines forward to a market driven pace. Land values were also adjusted based on recent market comparables collected by PwC. Additionally, estimated revenues and development expenses were inflated two percent per annum to incorporate expected sales and expense growth over time (two percent and three percent per annum, respectively).

6. **What is the difference between the $278M used in the City report vs the Impact Assessments amount in the PwC report ($278M v $181M) and can a reconciliation be provided? Please clarify which numbers are and are not discounted.**

   The $181 million referenced in the Impact Assessment of the PwC report refers to the consolidated 'Net Income' or 'Net Profit' of the Recommended Disposition Options of the three residential land development projects. $181 million is net of land acquisition costs, development hard and soft costs and municipal fees and assessments (assuming the return of over expenditures).

   The $278 million presented to Executive Committee on November 18, 2019 (also found within the PwC Impact Assessment), relates to the estimated future cashflow available to be paid by ELD to the City, under the 'Special Dividend' scenario recommended by both PwC and Administration. These funds encompass all of ELD's holdings (residential and industrial) and future development timeline.

   Neither dollar amount was discounted back to a Net Present Value in the PwC report presented to Executive Committee in November 2019. These have since been discounted to a Net Present Value in the updated February 2020 PwC report.

7. **Did IRR calculations done in the variations options within the PwC report use book value or current market value of land for the projects?**

   The Internal Rate of Return (IRR) calculations used in the PwC analysis used historical book value of the lands, inflated annually from the time of acquisition.

8. **Please provide cash flows for each project analyzed (either ELD's or PwC's that is used in the analysis).**

   The cash flows for each option calculated by PwC are detailed in Attachment 4 (see page 19 for Schonsee, page 23 for Aster and page 26 for Goodridge).

9. **At committee the consultant represented to council that the development of the three projects by ELD would yield an annual return over 20 percent. Can you please provide the math and backup information used for this calculation?**

   The cash flows and IRRs calculated by PwC are detailed in Attachment 4. The IRR of the consolidated cash flows of the three residential development projects (Goodridge, Aster and Schonsee) equates to approximately 21.8 percent over the 30 year time horizon of the analysis. This was calculated by consolidating the annual cash flows (the income and expenses) for the three residential development projects for every year between 2020 and 2049.

The math and backup information used for this calculation are not provided as doing so will disclose information harmful to economic and other interests of the City.

10. Please provide input numbers for 'Financial Analysis' chart on Slide 4 of presentation to committee.

	2020 - 2023	2024 - 2028	2029 - 2033	2034 - 2038	2039 - 2043	2044+	TOTAL
Land Enterprise Dividend (A)	$4.8M	$13.3M	$16.6M	$9.7M	$5.6M	$1.8M	$52M
Special Dividend (B)	$0	$78.2M	$56.6M	$49.6 M	$41.8M	$0	$226M
Total Dividend (A)+(B)	$4.8M	$91.5M	$73.2M	$59.3 M	$47.4M	$1.8M	$278M
ELD Quick Land Sale	$85M	$0	$0	$0	$0	$0	$85M

All proposed numbers were prepared by PwC.

The ELD Quick Land Sale option sells all the programs remaining greenfield land over two years. PwC anticipates sale of these and revenue to be received within two years. This is an aggressive timeline for a quick sale scenario.

11. What are the terms on the lot sales assumed in the cash flow models used? What is the rationale behind an accelerated cash flow model? Did PWC also prepare a decelerated model?

The accelerated development scenario is meant to act as a proxy for the pace at which Industry would typically develop, service and sell residential lots in the market. Historically, ELD has intentionally slowed the pace of development and lot sales to lag behind industry. This was done to minimize ELD's market share and to limit direct competition with industry. A deceleration scenario was not prepared by PwC.

12. PwC Recommendation notes total dividends over the course of their option would be $51.7M over the course of the remaining development. Is that correct? And why isn't this compared to the disposition option which would provide total proceeds of $85M (in near term, vs the dividend accumulated over 30 years)?

The Land Enterprise Dividend of $51.7 million is based upon the current dividend policy, which mandates a payout formula of disbursing 25 percent of the Net Profits from any ELD development and/or sale. These Net Profits include the book value of the land, plus any costs associated with the development and/or sale. ELD's operating costs (overhead) are also netted against these Net Profits. If the same dividend policy was applied to $85 million, the applicable dividend payout would be in the range of $15 million.

PwC has recommended the implementation of a Special Dividend to pay any excess funds (above a $30 million threshold held by ELD) to the City in addition to the Policy C516B dividend at the end of any given fiscal year.

13. Can you quantify the City's holding costs for land on a tax basis over the duration of a project and compare it to what would be generated from the same projects if owned and developed by private industry? Please reference both property & incomes taxes.

City owned properties are not subject to property taxation. PwC's analysis includes the property tax impact of ELD owning these lands versus a private developer(s) for each of the three projects in question.

PwC also notes their assumptions in calculated estimated property taxes payable for each project: "municipal taxes generated from each disposition option were also calculated. In this regard, it was assumed that while the lands were under City/ELD ownership, the lands would not be subject to property taxes. Upon their sale to a private developer or individual, the lands would then give rise to municipal property tax obligations at the 2019 rate of $350 per acre of assessed value for farmable agricultural land, with non-farmable land assessed at market value. The resulting assessed value would then be taxed at the City's municipal tax rate for residential/farmland of 0.64737 percent".

The City does not pay income taxes.

GENERAL LAND DEVELOPMENT PROGRAM QUESTIONS

14. What does ELD use as the financial metric for making acquisitions? Stage servicing decisions? Or other investment decisions?

When making land acquisitions (other than for the purposes of purchasing remnant lands to make contiguous land development parcels), and stage servicing decisions, the City has typically used a profit margin of approximately 20 percent. However, the City has also considered non-financial metrics when deciding whether to invest in land or to invest in stage servicing.

15. **Has the cost or impact as a result of ELD goals around affordable housing, green development, etc, been factored into the proformas? The comment was made by admin at committee that some pursuits of these initiatives would impact the profitability of the projects, *while others would not*. Can you be specific as to what initiatives to affordable housing and/or green development could be added to the ELD mandate that would not impact profitability?**

    The requirements of the current Land Development Policy (C511) are factored into ELD's proformas and PwC's analysis. Any new Land Development Policy requirements are not factored into ELD's proformas or PwC's analysis. If Council approves the recommendations within the report, Administration will prepare a revised Land Development Policy based on the recommended policy themes in Attachment 5. Affordable housing and green development requirements will be factored into the proformas at the time of project planning, balancing financial impact with City priorities.

    Affordable housing and green development initiatives may impact profitability. However supporting initiatives such as near market affordable housing, first time home buyers, solar readiness or green built forms may only have negligible impact or may not impact profitability at all.

16. **Can you provide a detailed inventory of all serviced (but unsold) lots in Laurel Greens?**

    Laurel Greens was a joint venture with Dream Development in which the City's portion of the land created 166 single family lots and a multifamily lot. The City lots are fully sold out and the project is in its close out phase.

    The Meadows of Laurel is the City's most recent and final subdivision in the Laurel neighbourhood. It includes 304 serviced residential lots, which will be sold in phases over four years. The first phase sold in 2019, and consisted of 77 lots. Over the next three years, approximately 75 lots will be sold annually. A profile on the Meadows of Laurel development is included in Attachment 2.

17. **In the Aster proforma there is an approximate budget for $160,000 worth of overhead. Can you please provide the background on how this number was determined, and confirm the approach for which all overhead is distributed throughout the project budgets?**

    The approximate $160,000 included in the Aster proforma is an estimation of property tax amounts that would be incurred by a private developer. Although the City doesn't pay property taxes, the cost is included in the draft proforma to support a comprehensive list of costs.

City overhead is not calculated on a per project basis. Instead, it is accounted for, and approved by City Council, in the program's annual operating budget as an expense against net revenue.

18. Can you clarify the IRR on the Ed Tel Endowment?

Following the City's sale of Ed Tel Inc to TELUS in March 1995 for $470 million, the Ed Tel Endowment fund was created to serve as a long-term and stable investment vehicle. Since its inception, the fund has earned a compound annual rate of return of 7.9 percent. This 7.9 percent Compounded Annual Growth Rate can be used as a proxy for the historical IRR.

19. What is the number of staff within ELD and the total annual overhead associated with the staff?

City Council approved the following personnel budget for 9 full time equivalent employees within Enterprise Land Development within the 2019-2022 Operating Budget:

2019 Budget	2020 Budget	2021 Budget	2022 Budget
1,158,000	1,167,000	1,170,000	1,174,000

20. What is the overhead or annual cost of non-ELD City of Edmonton employees contributing towards ELD projects? Is the cost allocation for overhead the same method used for the development reserve?

In addition to being self funded and paying an annual dividend, Enterprise Land Development supports the City's Operating Budget by paying approximately $1.14 million of costs annually to other business areas that contribute to ELD projects, supporting personnel space rental and parking. This contribution totals $4.59 million in addition to a projected Policy C516B dividend totaling $4.407 million over the 2019-2022 budget cycle.

Costs are allocated in a similar way for the Planning and Development Reserve.

21. What was the total cost for the work completed by the two consultants (EY and PwC) as part of the Land Governance motion?

The amounts outlined below represent the amount paid to EY and PwC, up to and including the November 18, 2019 Executive Committee meeting:

PwC	$109,105.50
EY	$86,295.79
TOTAL	**$195,401.29**

22. For the Exhibition Land project, can you confirm current estimated cost to service a first stage in the SW corner of the site, construct the new LRT station directly NW of Borden Park, and demolish Northlands Coliseum?

Work to estimate costs to service the first stage of the Southwest corner of the Exhibition Lands Site is ongoing and not yet completed.

The planning and design of the 115 Avenue infill LRT station was identified in the Fall 2019 Supplemental Capital Budget Adjustment as an unfunded project with a budget estimate of $750,000. This funding would ensure planning and design to the Project Development and Delivery Model (PDDM) Checkpoint Three. In the Exhibition Lands pro-forma, Administration identified an estimate of $25 million (2019 dollars) for the construction of the LRT station. These estimates are pre PDDM Checkpoint One and do not include potential impacts on mainline signalling and Light Rail Vehicle fleet requirements.

The most current estimated cost to demolish Northlands Coliseum is approximately $25 million.