ADVANCING GROWTH: EAST AND WEST KEYSTONE FINANCING AND FUNDING PROPOSALS

EXECUTIVE SUMMARY

Administration has worked collaboratively with the developers on terms for the borrowing bylaws and Construction and Financing Agreements (CFAs) related to capital infrastructure advancement in the East and West Keystone areas. Both groups are in general agreement on the terms, although the operating cost calculations are still being resolved.

As directed by Council, the viability of "gifting" infrastructure as a funding option has been reviewed, and was deemed as an inappropriate tool for advancing development.

Administration recommends that Council provide direction to finalize the CFAs, and prepare the supporting borrowing bylaws and budget appropriations for the East and West Keystone areas to implement once Administration and the developers have agreed on the operating cost methodology. Although Administration supports moving forward on these agreements, this process has revealed several risks with using CFAs as a mechanism for advancing development ahead of planned capital budget expenditures. As a result, applying a comprehensive and strategic approach to resolving issues related to accommodating growth is required in order to achieve effective and financially sustainable solutions.

ADMINISTRATION RECOMMENDATION(S)

That the Priorities and Finance Committee:

1. Direct Administration to prepare the following bylaws for East and West Keystone according to the terms outlined and attach them to this report prior to going to the 2014 November 17 meeting of Council:
   a. Borrowing Bylaw 12B2014 for the interim debt required to a maximum amount of $25.8 million in self-supported debt for East Keystone;
   b. Borrowing Bylaw 13B2014 for the long-term debt required to a maximum amount of $25.8 million in self-supported debt for East Keystone;
   c. Borrowing Bylaw 14B2014 for the interim debt required to a maximum amount of $10.5 million in self-supported debt for West Keystone;
   d. Borrowing Bylaw 15B2014 for the long-term debt required to a maximum amount of $10.5 million in self-supported debt for West Keystone;
   e. Borrowing Bylaw 16B2014 for the interim debt required to a maximum amount of $6.7 million in self-supported debt for East and West Keystone combined;
   f. Borrowing Bylaw 17B2014 for the long-term debt required to a maximum amount of $6.7 million in self-supported for East and West Keystone combined.

2. Recommend that Council:
   a. Approve capital budget appropriations for 2014 in programs 895-000 (Collection Network) of $15.4 million, and 897-000 (Drainage Facilities & Network) of $10.4 million for East Keystone;
   b. Approve capital budget appropriations for 2014 in programs 895-000 (Collection Network) of $8.8 million, and 897-000 (Drainage Facilities & Network) of $1.7 million for West Keystone;
   c. Approve capital budget appropriations for 2014 in program 892-000 (Water Distribution Network) of $6.7 million for both East and West Keystone;

d. Approve exceeding the drainage debt servicing limit of 40 percent of revenues from 2014 – 2024 to a maximum of 53 percent for the sole purpose of entering into Construction and Financing Agreements associated with the East and West Keystone Financing and Funding Proposals;
e. Direct Administration to finalize and execute the Construction and Financing Agreements associated with the East and West Keystone Financing and Funding Proposals only if provisions for the payment of operating costs by the developers are included in the agreements;
f. Give first reading to the proposed Bylaw 12B2014, Bylaw 13B2014, Bylaw 14B2014, Bylaw 15B2014, Bylaw 16B2014 and Bylaw 17B2014 for interim and long-term debt for East and West Keystone and withhold second and third reading pending the execution of the Construction and Financing Agreements associated with the East and West Keystone Financing and Funding Proposals.

PREVIOUS COUNCIL DIRECTION / POLICY

On 2012 October 15, Council adopted PUD2012-0690, approving the Principles and Guidelines for Financing and Funding.

On 2013 December 16, Council adopted PUD2013-0772, directing Administration to "work with industry on both alternative funding and financing agreements which may consist of the permanent area contribution (PAC) hybrid and/or a modified construction financing agreement (CFA) with the end goal of zero costs to the City."

On 2014 July 28, Council adopted PFC2014-0568 directing Administration to:

1. Investigate the viability of landowner "gifting" proposals in Keystone West and East, with the intent of having no cost to The City now or in the future, including any potential impacts on off-site levies; and to report back to the Priorities & Finance Committee as part of the reporting back on construction financing agreement and borrowing terms; and,
2. To proceed with negotiating construction financing agreements for East and West Keystone for an area not to exceed 1400 units in total; and report back through the Priorities & Finance Committee by 2014 October 28 at the latest, on the terms of the agreement including dollar amounts, impacted budget programs, repayment terms, and impact on the debt.

BACKGROUND

In 2012 October, Council approved the Principles and Guidelines for Financing and Funding to help mitigate The City's risks and to give direction to developers about the items to be addressed in their financing and funding proposals. The intent of offering alternative financing and funding options, including CFAs, was to allow development to proceed ahead of schedule without affecting The City's capital and operating budgets by transferring the risk and cost of development to the developers.

In 2013 October, Council identified that the East Keystone Alternative Funding and Financing Proposal be used as a demonstration case to determine if it is an effective tool for funding the cost of advancing land development at no cost to The City. Council provided direction to

Administration in 2014 July to proceed with negotiating the terms of CFAs for both East and West Keystone.

The Growth Management Framework aligned The City's capital plans by determining the ideal timing of infrastructure investment based on absorption, land supply, and Municipal Development Plan (MDP) alignment. CFAs allow a developer to advance growth ahead of the timing established in The City's capital plans. Developers advance this timing by agreeing to fund the cost of the infrastructure required to initiate development. The City agrees to pay back the developer at a future date that aligns with when this infrastructure is scheduled in the capital plans. The developers also pay the interim operating costs based on the Principles and Guidelines for Financing and Funding. If the borrowing is approved and the CFAs are executed, development will be advanced in East Keystone by five years (from 2020) and in West Keystone by nine years (from 2024).

A growth management overlay was placed on the Keystone Hills Area Structure Plan (ASP) since the funding for the required infrastructure had not been budgeted. According to the Keystone Hills ASP, "a portion of the overlay may be removed by Council by means of an amendment to Map 4: Growth Management Overlay". In this case, should Council approve the proposed borrowing bylaws, and when the CFAs are executed, the growth management overlay may be removed for the area shown in Figure 1. This area was determined by superimposing the catchment boundaries for utility servicing, transportation capacity and the 7-minute fire response time for both the East and West Keystone proposals. There are additional conditions for development within the overlay removal area that include:

- A 1400 single-family equivalent (SFE) unit constraint on capacity exists for all of the Keystone Hills ASP, as the transportation upgrades required for development beyond this number of homes are not scheduled for funding at this time.
- Units north of 144th Avenue NW will require fire mitigation measures to the satisfaction of The Calgary Fire Department since the fire station required north of 144th Avenue NW is not scheduled for funding at this time.
- A study is required to confirm how much additional development can be supported, beyond the 1400 SFE units, in the Spy Hill East Pressure Zone prior to the construction of the Northridge Feedermain and Reservoir.

These conditions will need to be addresses to allow for additional development within the proposed overlay removal area.

On 2014 October 06, Council approved first reading to amend the ASP to remove the growth management overlay as shown in Figure 1[1]. To remove more of the growth management overlay, additional capital investment will be required. Details of the infrastructure types and costs are identified in the Keystone Hills ASP and include items such as a fire station,

[1] The new alignment of 144th Avenue NW will be revised though and ASP amendment. The map in Figure 1 does not reflect the required amendment.

interchanges and water reservoir. The proposed timing of this infrastructure has been identified in the later part of the 2015 – 2024 capital plans.

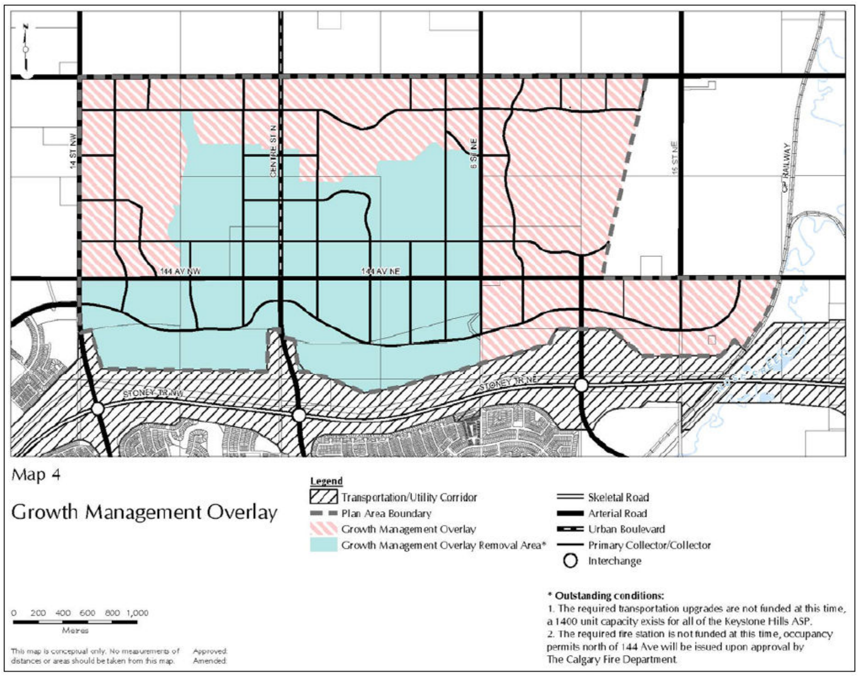

Figure 1 Growth Management Overlay Area for both East and West Keystone Funding and Financing Proposals

INVESTIGATION: ALTERNATIVES AND ANALYSIS

The purpose of this report is to investigate the viability of 'gifting' and to provide an update on the negotiation of the construction and financing agreements for both East and West Keystone. Specifically, Council requested a report that detailed the terms, including dollar amounts, impacted budget programs, repayment terms, and impact on the debt by 2014 October 28.

'Gifting'

Neither the East Keystone nor the West Keystone Developers formally submitted a proposal to 'gift' infrastructure during this process. Council directed Administration to consider whether The City should accept gifts of infrastructure. A 'gift' is considered "a voluntary transfer of property to another without compensation". Three elements must be present for a gift to be created intention to donate, acceptance of the gift and delivery.

A true gift arises when the donor is willing to give away the object of the gift voluntarily. The Alberta Court of Appeal has recently indicated that altruism is a consideration when a gift from a developer to a municipality is contemplated. In the present case, the gift of infrastructure is being contemplated in exchange for the removal of a growth overlay and a financial benefit derived from the resulting development of the land. The absence of altruism, therefore, may be sufficient to show that true intent to give a gift is lacking. If the intention of the donor becomes questionable, then the gift may be set aside and create a financial liability for The City. Even if the proposed gift is irrevocable, there are other important factors to consider that would indicate that The City should not proceed with gifting of infrastructure. There are issues and risks associated with future liability where there is no ability to condition and control the construction details of the infrastructure. The City would want to control details such as the design specifications and materials, but doing so may impeach the validity of the gift. Another concern is the appearance of bias. A situation where only those developers able to afford gifts of infrastructure are able to proceed with development or are seen to gain preference is insupportable. It is for these reasons that Administration is not recommending the gifting of infrastructure as an option.

Terms of the Construction and Financing Agreement (CFA)
Administration analyzed various alternatives for each of the terms that will form the CFAs. There was also a discussion on how to determine the operating costs methodology and if endeavours to assist could be included in the CFAs. Administration and the developers approached these elements by answering the following questions:

1. What infrastructure will be advanced?
2. What are the cost estimates for this infrastructure (this informs the limits of the borrowing bylaws)?
3. When will The City pay the developers back for this infrastructure and what are the triggers for this payback?
4. What is the impact on The City's debt and debt servicing by entering into these borrowing bylaws?
5. What methodology will be used for calculating the operating costs that will be covered by the developers during the advancement period?
6. Should endeavours to assist be used as a tool to assist the developers with recovering some of their advancement costs from other developers?

The following answers to the questions provide the basis for the terms of the agreements.

1. Capital Infrastructure

The East and West Keystone developers have asked to advance the timing of the sanitary and storm infrastructure required for their development. They have also agreed to protect the alignment for the water feedermain along Centre Street N and 144 Avenue NW and pre-install the water feedermain when it is required. The timing of the water-feedermain construction will align with the timing of the road upgrades.

2. Infrastructure Estimated Costs

Proceeding with both the East and West Keystone proposals will advance $43.0 million for infrastructure. This includes $15.4 million for the sanitary trunk and $10.4 million for the storm trunk for the east half of Keystone and $8.8 million for the sanitary trunk and $1.7 million for the storm infrastructure for the west half of Keystone. A water feedermain will need to be pre-installed when the road upgrades proceed along 144th Ave NW and Centre Street N. This will cost approximately $6.7 million ($5 million for the 144 Avenue alignment and $1.7 million for the Centre Street N alignment) if both the East and West Keystone developments are advanced. The East and West Keystone developers have agreed to share the cost of the water feedermain. If only the East or the West Keystone proposal is advanced, the pre-installation of the water feedermain along 144th Avenue NW will not be required at this time and only the right-of-way will need to be protected. Details of the cost breakdown for the different scenarios are shown in the attachment. These cost estimates are conservative due to increased contingency to ensure that risk is mitigated. It is anticipated that the actual costs will be reduced through efficiencies during the detailed design stage.

3. Payback Timing

The use of triggers based on population and build out rate was considered for these CFAs but it was concluded that any associated benefit did not justify the additional effort and complexity to track the progress of development. The developers agreed to a reimbursement that aligns with The City's capital plan. Therefore, the East Keystone development, payback will occur in 2020 and for West Keystone development, the payback will be in 2024. The payback timing for the pre-installation of the water feedermain will also be in 2024. The City will issue short and long-term debt to repay the developers.

4. Debt and Debt Servicing Impacts

An additional $43.0 million of debt will be incurred under the combined East and West CFAs. While the payback periods for the interim financing are 2020 and 2024, CFAs are structured debt and are subject to the Municipal Government Act (MGA) proration rules for debt limits and servicing ratios. The estimated additional debt for these projects can be accommodated within the Council mandated 80 percent of forecast MGA debt and debt servicing limits.

There are also Council approved financial limits for debt and debt servicing for water, sanitary and storm infrastructure. In 2014, Council gave approval to exceed the storm debt servicing limit from 40 percent to 48 percent. With the approval of the borrowing bylaws, the debt servicing limits for storm will require another increase to 53 percent until 2019. For water and sanitary infrastructure, the indicative rates were developed for Action Plan 2015 – 2018 to stay within the financial plan debt limit of $2 billion. With the approval of these borrowing bylaws, the remainder of the debt servicing envelope will be spent by 2019.

5. Operating Costs

In October 2012, Council approved principles that stated that developer advancement of development would require zero cost impacts to The City relative to revised timing of infrastructure construction. As a result, developers have offered to fund operating costs to advance development through Alternative Funding and Financing Proposals. The intent of these proposals was for the developer to take over the risk of advancing the infrastructure by carrying the upfront capital costs, and the increased operating costs resulting from the advancement period.

A number of methods were analyzed for calculating the operating costs, including two proposed by the developers of East and West Keystone. Although these models had merit, they were complex due to the variables and assumptions that would need to be made, and as well, they would require significant resources to administer once in place. Administration proposed a third methodology based on a simple calculation using budget information on operating costs per capita and this method is currently being discussed with the developers. Through this review and analysis, and due to the complex nature and systems approach to capital costs, it is not feasible to develop a model that accurately captures the true incremental cost differences.

Administration and the developers have agreed on the principles that the calculation methodology should be fair, simple and transparent. More discussions are required to determine a methodology that both Administration and the developers can agree to.

6. Endeavours

The developers requested that Administration consider the use of “endeavours to assist” to help recover from other developers some of the costs incurred in East and West Keystone prior to being paid back by The City. Administration determined that this is not appropriate due to the structure of the current off-site levy bylaw because:

a. The current method of calculating offsite levies already includes costs for future City funded infrastructure; therefore, this approach could lead to double charging for the same infrastructure.
b. The East and West Keystone developers have voluntarily entered into these agreements. An endeavour would require other developers to be tied to this agreement without their consent. There is no legal mechanism for The City to enforce payment by other developers in this context.
c. There is increased risk to the municipality and additional administration time required to ensure funds are distributed fairly amongst various developers.

Conclusion

Administration and the developers have reached general agreement on the terms that would form the basis of the Construction and Financing Agreements; the operating cost methodology still requires further discussions. Execution of these agreements and approval of the supporting financing bylaws would allow development to advance in both the East and West Keystone areas ahead of The City’s scheduled timing in the 10-year Capital Plan.

Working through the Keystone demonstration case identified significant lessons. Although advancing growth in this area would help to reduce the pressure on land supply, it does increase the risk to The City. The most significant risk is the loss of flexibility to adjust budgets in response to market or other economic changes, since budget commitments have been advanced ahead of schedule. As well, advancing the timing does not allow for adequate planning for the infrastructure, limiting the ability to explore the use of new and innovative solutions such as low impact development. There is also the risk that the cumulative effect of several CFAs could lead to fragmented development and inefficient use of infrastructure. This initial development will cost $43 million and further investment will be required to proceed with more development in the Keystone Hills ASP area.

Processing these agreements has taken up considerable administrative resources for 12 percent of the annual citywide housing supply, or 17 percent of the annual suburban housing supply. A more comprehensive and strategic approach is required to advance additional land supply to accommodate faster growth. This would ensure that administrative resources are focused on developing the most effective short and longer-term solutions for accommodating increased growth, including a new Standard Development Agreement.

Stakeholder Engagement, Research and Communication

Administration has worked collaboratively with internal departments and the developers to establish the terms of the Construction and Financing Agreements for the East and West Keystone Funding and Financing Proposals. Administration met bi-weekly with Brookfield, Mattamy, Genstar and the Hong Family. Weekly meetings were also held with an internal coordinating team including Law, Finance, Water Resources, Transportation and Corporate Growth Management. Directors and General Managers from the related business units and departments also provided input and direction.

Strategic Alignment

Through the Growth Management Framework, the Keystone Hills Area Structure Plan was planned for capital investment beginning in 2020 for the east half and 2024 for the west half. Advancing this development to begin in 2015 does not align with The City's proposed timelines that consider land supply, absorption rate, population forecasts, MDP alignment and capital costs.

Social, Environmental, Economic (External)

Advancing development in this area by providing the sanitary, storm and water infrastructure does not address the services identified in the Area Structure Plan that should be brought on to develop complete communities in a reasonable timeframe.

Financial Capacity

Current and Future Operating Budget:

The infrastructure for East and West Keystone is outside of the 2015-2018 period, therefore operating costs for these areas will not be included as part of Action Plan 2015-2018. To minimize the impact to the current operating budget, Administration and the developers have discussed methods to decrease the gap between the timing of when a developer wants to proceed and when funds are allocated in The City's operating budget. Annual adjustments will be made to the operating budget as increases in operating costs are quantified.

Current and Future Capital Budget:

Consistent with the Growth Management Framework, the infrastructure for East and West Keystone has been indicated for 2020 and 2024 in The City's 10-year capital plan. Council approval of the 2015 capital budget appropriations and the related borrowing bylaws for interim financing and long-term debt funding is required to accommodate the earlier construction of the infrastructure. This interim financing will accommodate the construction until The City, based on the timing identified in the capital plan, assumes the long-term debt. Further infrastructure, including transportation upgrades, a fire station and water reservoir will be required to allow for further development in the Keystone Hills area. These costs are significant and have been included in the 10-year capital plans for 2015 - 2024.

Risk Assessment
Working through this process for West Keystone and East Keystone (as a demonstration case) has allowed Administration to identify risks associated with entering into CFAs as a tool for advancing growth.

The most significant risk is committing funds for infrastructure ahead of when it was scheduled in the capital budgets as it reduces the ability of The City to adjust its priorities in response to changes in growth trends. The risk of this would increase cumulatively if The City committed to several CFAs.

The intent of the Keystone Hills ASP was to pursue greener infrastructure solutions for stormwater, such as low impact development (LID). With the condensed timeline, there is a risk that The City will be unable to obtain the required right-of-way for LID solution resulting in the use of a conventional conveyance system. The developers have agreed to consider green infrastructure solutions if The City is able to obtain the land in the adjacent ASP area.

To manage The City's risk, the infrastructure cost estimates have been mitigated by using a higher contingency, as they are not based on detailed design. The actual infrastructure costs are anticipated to be lower once the alignment and infrastructure designs have been finalized.

Since there is pressure on land supply, and the Keystone Hills Area Structure Plan area is one of the next areas identified on the Growth Management Sequencing list, the risk that this land will not be absorbed is low based on population forecasts. However, continuing with a strategic approach to accommodate growth is optimal to ensure effective and financially sustainable solutions.

The available capacity within the overlay removal area will be allocated on a first-come-first-served basis. Currently, there are four outline plans submitted within the overlay area, which could result in approximately 5000 SFE units. There is significant risk to The City that there will be pressure to approve land use and other development applications beyond the cap.

REASON(S) FOR RECOMMENDATION(S):
Council directed Administration to proceed with negotiating CFAs for East and West Keystone. Administration supports moving forward with these CFAs, and the associated borrowing bylaws, since the terms have mitigated as much as possible the risks to The City.

ATTACHMENT(S)
Term sheet for East and West Keystone

Approval(s): Stanley, Rollin concurs with this report. Authors: Dietrich, Kathy / Alexander, Sarah