

## COUNCIL REPORT

M&C No.	2019-333
Report Date	November 28, 2019
Meeting Date	December 02, 2019
Service Area	Develop Saint John

His Worship Mayor Don Darling and Members of Common Council

***SUBJECT: Fundy Quay – Develop Saint John***

### **OPEN OR CLOSED SESSION**

This matter is to be discussed in open session of Common Council.

### **AUTHORIZATION**

Primary Author	Commissioner/Dept. Head	City Manager
<b><i>Jeffrey Cyr</i></b>	<b><i>Steve Carson</i></b>	<b><i>John Collin</i></b>

### **RECOMMENDATION**

1. That the City of Saint John enter into an Option Agreement with Fundy Quay Developments Inc. regarding the site known as Fundy Quay in the form as attached to this M. + C. No. 2019-333; and
2. That the Mayor and Common Clerk be authorized to execute said Option Agreement.

### **EXECUTIVE SUMMARY**

The purpose of this report is to outline the structure and provisions of an option agreement for the Fundy Quay and the draft business and financial terms for a ground lease agreement. Additionally, this report outlines both the process unfolded to select a developer and the technical analysis undertaken in support of preparing the attached agreements for the Fundy Quay.

*There are two formal legal agreements attached to this report. The first is an option agreement for the eventual lease (to-own) of the site. The second agreement is included as schedule "B" of the option agreement, and is the draft business and financial terms for the ground lease for the property. The Ground Lease is still in draft form, and will be completed in the following 3 months.*

### **PREVIOUS RESOLUTION**

There is no previous resolution on this project.

### **REPORT**

At the heart of the City of Saint John sits the Fundy Quay development site. This prime waterfront property represents the best and highest profile development opportunity on the nation's Eastern seaboard and is a phenomenal opportunity to create an iconic and dynamic destination for people to gather, live, learn, play, grow and celebrate. A reimagined Fundy Quay will serve to enhance the Saint John urban experience through an eclectic mix of uses such as retail and commercial space and services, specialty shops and boutiques, residential condominiums and apartments, hospitality, entertainment, cultural and educational uses, green spaces, cafes, and waterfront amenities that will truly make the site a vibrant catalyst for future activity.

In late 2018, the Proposed New NB Museum planned for the site was cancelled by the Province and DevelopSJ began evaluating alternative options to move forward the Central Peninsula Neighbourhood Plan's vision for the Development of the Fundy Quay. This has culminated in an agreement on the primary business and financial terms for an option and ground lease (to-own) agreement with the Fundy Quay Developments Inc. (FQD) (part of the Elias Management Group of Companies).

### **THE CALL FOR EXPRESSIONS OF INTEREST**

In April 2019, Develop Saint John issued a call for expressions of interest for the development of the Fundy Quay. This process solicited two formal responses from capable developers interested in the project. An evaluation committee was established by Develop Saint John and included City and DevelopSJ staff, members of the Develop Saint John Board of Directors, and other strategic community members.

The call for expressions of interest envisioned the Fundy Quay being re-imagined as an eclectic mix of uses such as retail and commercial space and services, specialty shops and boutiques, residential condominiums and apartments, hospitality, entertainment, cultural and educational uses, green spaces, cafes, and public spaces that will truly make the site a vibrant catalyst for future waterfront activity. The expression of interest call established a clear set of criteria for selecting the proponent best positioned to bring this vision to life. Following a rigorous proposal review process, the Fundy Quay Developments Inc. was recommended as the successful proponent for the development of the Fundy Quay and subsequently approved by the Board of Directors of Develop Saint John on June 6th, 2019.

### **DUE DILIGENCE COMPLETED**

Both during and following the the call for expressions of interest process, considerable due diligence has been completed to allow Develop Saint John to better understand the site and the best options for the City moving forward. This work included:

- Retaining Cushman & Wakefield to support the site valuation and financial analysis efforts;
- Engineering analysis by CBCL & Conquest Engineering to support the Bi-Lateral funding application and to better understand site conditions and their fiscal impact on development;
- An analysis of the economic impact and business case by TCI management consultants;

- Detailed analysis of project economics, including pro-forma and discounted cash flow modeling for multiple scenarios; and
- A thorough analysis of the City's opportunity cost to support the development of a strategy for structuring the option agreement.

***Key Findings:***

The detailed analysis undertaken by Develop Saint John and its consulting team resulted in both re-affirming the Fundy Quay Developments Inc. as the preferred option for the development of the Fundy Quay, as well as providing the following critical findings with regards to the viability of site development:

- **Density is Critical**
  - Piling costs are fixed on the western portion of the site, so a project must maximize the return on that investment
- **Phasing Significantly Increases Viability**
  - As density is important for the viability of future projects on the Fundy Quay, the ability for the market to absorb new development in phases is critical. An inability of a proponent to phase the project will likely result in the need to secure large government leases and extremely high rental rates. For this reason, having a developer committed to operating in Saint John increases the likelihood of project success.
- **Residential Development Can Absorb the Piling Costs**
  - At 6 - 8 storeys, standalone residential projects were viable at rates in line with rental trends in the Uptown.
- **Maximizing Residential Development is What Will Make the Fundy Quay Viable**
  - The current market depth of the Central Peninsula is projected at 1,200 units from 2018-28, which could accommodate significant residential development on the Fundy Quay.

In addition to these key findings, work with Cushman & Wakefield also identified alternative options worthy of consideration as a fallback option, should FQD choose not to exercise their option. More specifically, given the strength of the residential market, it was advised that should an integrated mixed-use project (as proposed by FQD) not proceed, that market demand exists to subdivide the property into 6 parcels for sale as single residential development projects. While not as beneficial to the City as an integrated mixed use project, this does provide the City with a Plan "B" to generate a return on its investment in infrastructure such as the seawall.

**PRINCIPLES GUIDING THE AGREEMENT**

Based on the information outlined in this report and the previous feedback from both the EOI review committee and the Develop Saint John Board of Directors, the following principles were developed to guide the preparation of the option agreement framework:

- We want a real project, no more false starts
- An iconic and transformational development
- Collaborative, & development focused process
- A fair price for the land
- The real money is in the tax base
- Flexibility to change course, should the project not progress as planned
- We don't have a development-ready site at this point

### **THE OPTION AGREEMENT**

As negotiations moved forward with FQD, it was determined that the best approach for the site was the signing of an option agreement. In previous efforts to develop the Fundy Quay, no formal agreements of this nature were signed, resulting in drawn out and undefined processes for negotiation and due diligence. The signing of an option agreement provides a number of benefits for both the City and the Developer. This includes:

#### **City of Saint John Benefits**

- Sets a clear and pre-defined timeline for due diligence, and allows for the establishment of stage-gates;
- Includes payments for the option, to create key decision points for the developer and mitigate any risk of speculation;
- Allows the City an opportunity to prepare the site for development, maximizing the value of the land; and
- It supports the City's infrastructure funding applications, by making the project more "concrete".

#### **FQD Benefits**

- Supports FQD in having more effective discussions with regards to tenants, investors, and in pursuing project financing;
- It allows FQD the opportunity to complete further due diligence and to build the business plan for the property; and
- It provides certainty for FQD to begin investing resources into project planning and design.

### **TIMELINE FOR THE OPTION AGREEMENT**

The proposed option agreement will cover the period of 2020 and 2021, and is structured to encourage the developer to move the project forward, while establishing clear milestones where FQD must increasingly commit to the project. The timeline for the option period is established within attachment 1 of this report.

During the option period, the City will be undertaking the infrastructure work required to prepare the site for development, subject to the approval of federal and provincial

infrastructure funding required to close the agreement. During the first year, FQD will work closely with Develop Saint John to support political efforts to secure the infrastructure funding (which are currently underway), while also completing their own due diligence, which will include:

- Assembling a project team with the experience necessary to complete the development;
- To prepare concept plans and complete a minimum of one public engagement in coordination with Develop Saint John and the City;
- To complete the business and project plans demonstrating viability and proposed phases for the project; and
- To acquire the Provincial portion of the property.

In addition to the due diligence requirements above, to extend the option agreement into the second year (2021), FQD will be required to provide a non-refundable \$250,000 deposit to the City before December 15, 2020. This will act as a critical decision point for FQD to move the project forward or to return control of the property to the City. Should FQD provide the deposit, this will provide the City confidence that the project is moving forward. Should FQD choose not to provide the deposit, the City will have the flexibility to pivot and pursue alternative options for the site. At the end of 2022, FQD will be required to exercise the option or forfeit their \$250,000 deposit.

### **THE GROUND LEASE (TO-OWN)**

Upon FQD exercising the option agreement, they will enter into a ground lease (to-own) agreement with the City of Saint John. The ground lease will last for a maximum of up to 25 years, with FQD required to purchase the site by the conclusion of the 25<sup>th</sup> year or at an earlier date.

The ground lease model provides a number of advantages which support the viability for the development of the Fundy Quay. Primarily, it offsets challenges in financing large land acquisitions, which typically require substantial down payments and have high interest rates. With the site challenges that already exist on the Fundy Quay, this approach helps to improve project viability and to best position the development for success.

### **THE STRUCTURE OF THE AGREEMENT**

The agreement is structured to ensure the development has the greatest opportunity to succeed, while also ensuring that the City receives a good price for the land and has the flexibility to change course should FQD decide not to proceed. This section of the report provides a high level overview of the primary business and financial terms agreed upon with FQD. The detailed draft agreement is included as schedule “b” of the option agreement, and will be finalized and brought back to Common Council for approval within the next 3 months.

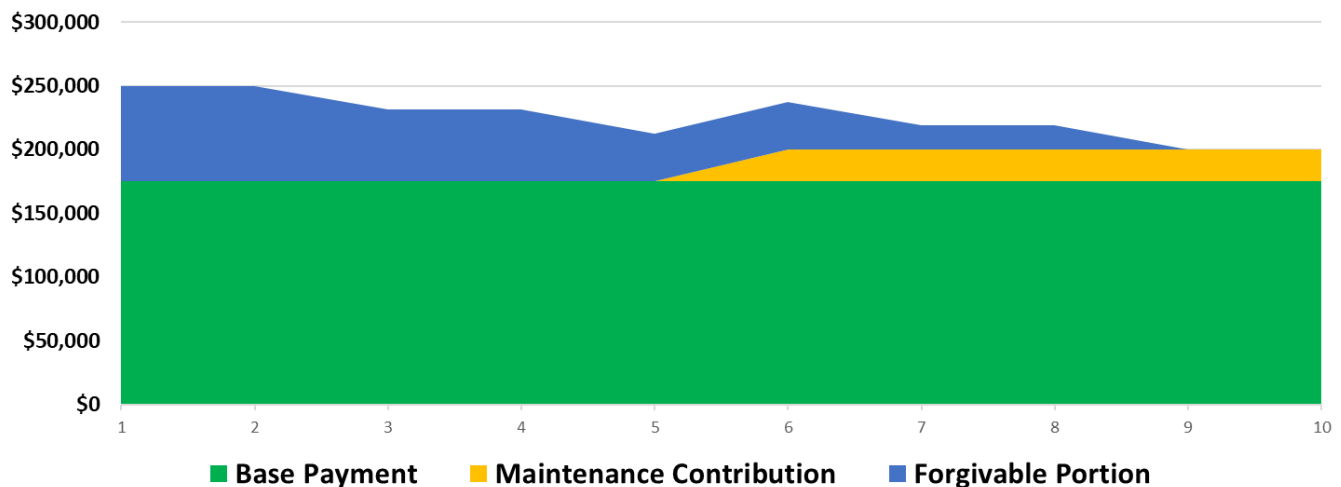
***A Strong Valuation, Balanced with Performance Incentives:*** To encourage the development of the site, while managing the risks of locking down the property for a long period of time, both parties have agreed to a strong valuation of the property at \$6.45 million (\$35 psf). This is balanced with performance incentives that reduce the price as the developer achieves the build-out of the project. Should the development exceed an investment in buildings of over \$100 million, the price for the land can be

reduced to a valuation of \$3.6 million (\$19.45 psf), which is comparable to the previous deals for the Museum and Rank Inc. In this scenario, the reduced price would be significantly offset by increased tax revenues.

**Lease-to-Own:** The deal will be a lease-to-own arrangement, over a period of 25 years. At the end of the 25-year period, FQD will be required to purchase the property. The City will apply a low interest financing charge, intended to support the project and still provide the City with a strong return on its investment. Additionally, FQD will be provided options to buy-out the lease on an annual basis throughout the 25 year period. A breakdown of the lease payments are outlined in schedule “b” of the Ground Lease.

Lease Components	
<b>Base Payment: \$175,000</b>	Paid for the duration of the lease, unless FQD exercises its option to buy-out the lease.
<b>Maintenance Contribution: \$25,000</b> <i>(Indexed to CPI and adjusted every 10 years)</i>	Matched contribution to support maintenance of the seawall and public space. Begins in year 6 and continues to year 50, regardless of whether FQD exercises its option to buy-out the lease.
<b>Forgivable Payment: \$75,000</b>	The forgivable portion is a built-in incentive. This payment declines proportionally as FQD reaches the minimum performance target of \$100 million invested in buildings.

**Lease Payment Structure**



**Obligation to Purchase:** In addition to the lease payments, FQD will be provided with options to purchase the property on an annual basis over the 25 year period. The property must be purchased by the end of year 25.

The pricing for the purchase options are in alignment with the valuation and incentive structure of the lease payments. For this reason, the cost to purchase the site changes based on the number of years FQD has made lease payments and the amount of tax

revenue that the City has received or is projected to receive over the 25 year lease term. A table outlining the purchase option pricing is included in schedule “b” of the Ground Lease.

**Project Infrastructure:** The property valuation used in this deal is based upon the City providing FQD with a development ready site. This will require the City to complete the following infrastructure:

- Repair and raising of the seawall (funding already secured);
- Remediation or management of contaminated soils (included in bi-lateral application); and
- Regrading of the site to raise the elevation an additional 1.5 metres (included in bi-lateral application).

The completion of this infrastructure is conditional upon the City obtaining federal and provincial funding support. As the seawall has already been approved for federal funding, this requires at a minimum the soil remediation and site regrading funding to be approved in the City’s Bi-Lateral funding application. In addition to these items, public amenity infrastructure funding will be required to ensure the development of public space can be coordinated with the overall development of the property. Should the City’s Bi-Lateral funding application not be approved, the viability of the development of the site is uncertain, however, FQD has committed to work with the City of Saint John in exploring all possible options.

In addition to the infrastructure projects identified above, there are additional components included as part of the Bi-Lateral funding application which are not requirements or responsibilities of the City. Instead, these are recognized as possible components of the project which would add value, but will need to undertake further evaluation to determine the business case.

Infrastructure Required to Close	Infrastructure City is Responsible for	Optional Infrastructure
<ul style="list-style-type: none"><li>• Seawall repaired &amp; raised</li><li>• Contaminated soils addressed</li><li>• Site raised 1.5 metres</li></ul>	<ul style="list-style-type: none"><li>• Harbour Passage extension</li><li>• Loyalist Plaza</li></ul>	<ul style="list-style-type: none"><li>• District Energy</li><li>• Pedway connection</li><li>• Underground parking</li></ul>

**Infrastructure Maintenance Fund:** As part of FQD’s rent contribution, an annual maintenance contribution will be matched by the City of Saint John for a 50 year period. This fund will allow the City, working collaboratively with FQD, to ensure that site infrastructure is proactively maintained, significantly reducing future capital costs for the City. Eligible uses of the infrastructure maintenance fund will be for capital maintenance and repairs to the sea wall, and long term capital maintenance projects for Harbour Passage (along the perimeter of the site) and Loyalist Plaza.

***City's Right to Re-Purchase the Site:*** Should FQD exercise the option to enter into the lease agreement and no development proceed within two years, the City will have the ability to terminate the lease, subject to a 6 month cure period in which FQD has the opportunity correct the issue. Should the City terminate the lease, \$250,000 (one years lease payment) will be refunded.

***Additional Key Provisions:*** In addition to the main business and financial terms agreed upon with FQD, the following minor terms are also agreed to form part of the agreement for the property. This includes:

- Parking and site revenue will be under the control of the City during the option period. Once the ground lease is in effect, commercial parking must be operated through agreement with the City's parking commission until development has begun.
- FQD will be responsible for internal site infrastructure above and below ground, excluding harbor passage and the seawall.
- Upon the purchase of the property, FQD will subdivide and transfer harbour passage and the seawall to the City.
- FQD will be responsible for all property taxes & utilities during the ground lease period.

#### **NEXT STEPS**

- Common Council approval of the option agreement;
- Mayor and Clerk execute the option agreement with the Fundy Quay Developments Inc.;
- Finalization of the Ground Lease over the next 3 months;
- Preliminary results from the City's Bi-Lateral Funding Application expected by late 2019 / early 2020; and
- Common Council approves and authorize the execution of the Ground Lease in the first quarter of 2020.

#### **STRATEGIC ALIGNMENT**

The development of the Fundy Quay is aligned with Council's priorities of Fiscal Responsibility, Growth and Prosperity, and Vibrant Safe City. It is also a strategic Growth Concept identified in the City's Central Peninsula Neighbourhood Plan.

#### **SERVICE AND FINANCIAL OUTCOMES**

The development of the Fundy Quay will be an important tax base generator and transformational project for the City of Saint John.

#### **INPUT FROM OTHER SERVICE AREAS AND STAKEHOLDERS**



The City's Finance and Risk Management departments have been consulted regarding the structure of the deal and feedback has been incorporated into the draft agreements.

The Growth and Community Development Service has been consulted heavily throughout the process, and were included in the proposal review committee for the selection of a developer.

The City's Infrastructure Service have been consulted and have advised on infrastructure capacity required to support a project of this magnitude.

The City's Legal Department have been consulted and are actively managing the preparation of the agreements for the option and ground lease for the Fundy Quay.

#### ***ATTACHMENTS***

1. Presentation
2. Option to Lease Agreement