



City of
Peterborough

To: **Members of the General Committee**

From: **Jeffrey Humble, Director, Planning and Development Services**

Meeting Date: **February 26, 2018**

Subject: **Report PLPD18-004**
Cleantech Commons: Head Lease Principles, Management
Structure and Financial Model

Purpose

A report to present the key principles of the Head Lease with Trent University, the proposed management structure and the financial model for municipal participation.

Recommendations

That Council approve the recommendations outlined in Report PLPD18-004 dated February 26, 2018, of the Director, Planning and Development Services, as follows:

- a) That Council endorse the six key principles of the Head Lease with Trent University for Cleantech Commons as follows:
 - i. Trent University is the Landlord and the City is the tenant;
 - ii. City is the Developer with a Shared Term lease Arrangement with Trent University;
 - iii. The Head Lease allows certain lands to be conveyed to the City for municipal roadways and parkland/open space;
 - iv. Limiting the City's Risk and Responsibility to those of a municipal authority reflecting a Partnership Relationship between the City and Trent University;

- v. Ground Leases Recover Capital Costs; Taxes Recover Operating Costs; and
 - vi. The Landlord/Tenant Relationship will be evaluated and may change over time.
- b) That staff be authorized to finalize the detailed language of the Head Lease in keeping with the principles outlined herein, and that a by-law be passed to authorize the Mayor and Clerk to execute the Head Lease;
- c) That the management structure for Cleantech Commons, as outlined in Section 2 of Report PLPD18-004, be endorsed; and
- d) That the financial model for Cleantech Commons for ground lease rates, as outlined in Section 3 of Report PLPD18-004, be endorsed.

Budget and Financial Implications

By signing the Head Lease, the City is committing to be the developer of Cleantech Commons (formerly the Trent Research and Innovation Park). The capital budget forecasts a total cost for internal servicing, lot preparation and landscaping at \$10.1 M to be expended in phases in response to market demand. The Head Lease also provides a funding mechanism to fully recover the capital investments made by the City on a priority basis. The financial model suggests, based on projected ground lease rates, that the infrastructure costs attributed to each tenant will be recovered. Depending on how quickly development occurs in the 46.25 developable acres of the research park, the City's \$10.1 million plus carrying costs could be recovered between 45 and 50 years.

The businesses in the research park will also pay municipal taxes which will offset the City's ongoing responsibility to maintain the public infrastructure within Cleantech Commons. Although very preliminary, assuming a similar build-out of 46 acres in one of the City's other business parks, staff estimate that the annual municipal taxes could be approximately \$0.6 million.

Background

2017 was a milestone year for the Trent Research and Innovation Park. The 2017 Capital Budget established the Reconstruction of Pioneer Road, including the extension of municipal services, as a corporate capital priority. The project was commenced early in the 2017 construction season and will conclude in the summer of 2018.

Figure 1: Pioneer Road Reconstruction, September 2017

The 2017 and 2018 Capital Budgets established a pool of funds to complete the first and second phase of the Research Park Subdivision. Detailed design on these components is nearly completed and is scheduled for tender this Spring. Construction is expected to commence by summer with the objective of having the development serviced and available for investors in 2018.

On July 31, 2017 City Council adopted the Trent Research and Innovation Park Master Plan as the framework for the physical development of the Research Park (PLPD17-032). In adopting the Master Plan Council recognized that the plan was a dynamic document where adjustments would be made to account for changing market conditions, investment requirements, and the introduction of new information that promotes a more responsive development, including the conclusions of the Indigenous Consultation program.

Since July the Master Plan has been updated to reflect the implications of new information on the significance of the adjacent wetland community. The redesign removes a portion of internal roadway on the southwestern corner of the subdivision adjacent the wetland. This is both a cost-savings and a benefit to the environmental conditions of the subdivision. Additionally comments from the Ministry of Transportation with respect to the long-standing Peterborough By-Pass have resulted in a portion of the subdivision being held in reserve until the By-pass plans have been confirmed.

On July 31, 2017 City Council also granted Draft Plan Approval to a plan of subdivision for all 85 acres comprising the Research Park. The first phase engineering design and subsequent phases of development will implement the conditions of draft plan approval over time.

Lastly, in December of 2017, following a period of evaluation, Trent and the City elected to formally launch the marketing of the Research Park under a new name and brand to distinguish it from the competition and more accurately describe the research and innovation entity that we aspire to be.

Cleantech Commons at Trent University positions the Peterborough/Trent research park as Canada's premier cleantech destination. Now, with a product "on the ground" and a clear marketing direction PKED, Trent and the City are well-positioned to secure a tenant base that will give life to the vision.

Figure 2:
Master Plan Cover and Brand



In November of 2015 the City and Trent University (Trent) entered into a Memorandum of Understanding to acknowledge the shared objective to build a Research Park on lands owned by Trent University. Pursuant to the intent of the MOU, Trent and the City have now developed a Head Lease to describe in detail the business relationship between both parties. Terms of Reference for a Management Committee have been developed to ensure good communication between the City and Trent on tenant, development and governance issues. Now that the Master Plan has been completed more accurate development costs are available to better understand the financial obligations of the City. A financial model has been developed to ensure that the ground lease rates will be competitive and allow the City to recover its capital costs. The purpose of this report is three-fold:

1. To seek Council's endorsement of the key principles of the Head Lease.
2. To seek Council's endorsement of the management structure.
3. To seek Council's endorsement of the financial model for Cleantech Commons.

1. Key Principles of the Head Lease:

a) Trent University is the Landlord and the City is the Tenant:

Trent has agreed to contribute the land – 85 acres of its Endowment Lands fronting on Pioneer Road for the creation of Cleantech Commons.

**Figure 3:
The 85 Acre Site**

Trent will retain ownership of the land but the 85 acres will be leased to the City based on a 110-year term. This will allow the City to offer 99-year ground leases to tenants for the first 11 years.

The City will be the ground tenant and it will further sublease portions of the acreage to subtenants on the basis of a land lease. As long-term land leases are entered into with private investors who will pay an annual “rent” for the land exclusively occupied and the rent payment will be shared between Trent and the City. This model is conceptually similar to the way private investors develop property at the Peterborough Airport. Under the Head Lease Trent has the ability to transfer the 85 acres to a corporation owned or associated with Trent. Of the total 85 acres, it is estimated that 46.25 acres is developable.



b) City is the Developer with Shared Term Lease Arrangement with Trent University:

As Tenant, the City assumes the role of Developer, fulfilling our traditional function in the Peterborough marketplace as the primary provider of serviced employment lands. The City can phase the development to match market demand to minimize the cost exposure to the City. Trent has agreed that the first priority in the sharing of the land lease revenue

is for the City to recover its capital investment. Net revenues will be allocated between the Landlord and the Tenant on the following basis:

	Year 1 to 9 of the term of each Sublease	Year 10 to 19 of the term of each Sublease	Year 20 to 29 of the term of each Sublease	Year 30 to 39 of the term of each Sublease	Year 40 and onward of the term of each Sublease
Tenant	80%	60%	50%	40%	20%
Landlord	20%	40%	50%	60%	80%

This framework is designed for the City to recover all servicing and development costs. Within this term once the City is paid back its servicing costs it will no longer receive any portion of the lease revenue.

c) The Head Lease conveys lands to the City:

Although the Head Lease envisions that all 85 acres will be leased by the City, the Head Lease also acknowledges that the lands devoted to municipal infrastructure will be conveyed to the City.

**Figure 4:
Road Network to be Conveyed**

As a general rule land within Cleantech Commons devoted to roadways and improved parkland/open space will be conveyed to and owned by the City. Utility corridors not in road allowances will be protected by easements in favour of the City in perpetuity. Informal trail corridors and other amenity areas within the Research Park will be common elements for the term of the Head Lease after which they become the responsibility of Trent. Once conveyed to the City the effected lands are no longer subject to the Head Lease.



d) Limiting the City's Risk and Responsibility to reflect a Partnership Relationship:

In a traditional commercial lease the landlord typically transfers all risk and responsibility to the tenant. If the tenant then subleases property to subtenants, the tenant usually transfers risk and responsibilities to the subtenants; however, in the eyes of the landlord the tenant is still responsible. The Head Lease reflects that the partnership between the City and Trent is **not** a traditional commercial lease relationship. While the City will be required to actively manage the subtenants, the City is only responsible to remedy defaults of subtenants that would mirror our traditional responsibilities as a municipal authority.

For example, when a subtenant's building becomes unsafe, or the lands no longer comply with the Minimum Property Standards By-law, the City can remedy the default and add the costs to the tax obligations of the subtenant. However, if the subtenant's premises simply look shabby there is no obligation of the City to make cosmetic improvements. Each subtenant will be obligated in their subleases to maintain their properties to a standard befitting a high quality research park. If they fail to do so the subtenant would be in breach of their lease obligations and the City could then terminate the subtenant's lease.

In short, the Head Lease anticipates a partnership relationship between Trent and the City rather than a traditional landlord/tenant relationship. The City will "ensure" subtenants perform their lease obligations but the City's risk is limited to our traditional risk as a municipal authority. The Head Lease anticipates that the City and Trent will complete our due diligence prior to offering a parcel of land to a subtenant, thereby minimizing risk to either party. The Head Lease assumes that the potential for difficult subtenants is low and that the parties, acting reasonably, will find a way to overcome any challenges that may emerge.

e) Ground Leases Recover Capital Costs; Taxes Recover Operating Costs:

The Head Lease recognizes that Trent, as landlord, will not be responsible for the payment of Development Charges or municipal taxes or utility costs arising from private investment on land that it owns in Cleantech Commons. Rather, the City will ultimately secure those funds, where applicable, directly from the subtenant. The Head Lease recognizes that ground lease payments will recover the City's capital costs for internal services only, and provide an ongoing revenue stream to Trent University.

Various assumptions can be made as to how quickly the industrial park will develop and how quickly the City will recoup its capital investment. Based on the chart outlined in section b) above and assuming development of 12 acres the first year and approximately 3-5 acres each year thereafter, it is estimated that the City will be reimbursed for its capital and carrying costs in 45-50 years.

Municipal taxes paid by subtenants will be used to directly offset the costs incurred by the City to maintain the common areas and municipal infrastructure within Cleantech Commons, in the same manner as municipal taxes pay for the annual operating costs in other areas of the City. Under the Head Lease the City agrees that the “tax sale” remedy is not available and therefore it will be in the City’s interest to ensure that a subtenant’s default is addressed expeditiously.

f) Evaluating the Landlord/Tenant Relationship over Time:

Given that the City’s primary role under the Head Lease is to build and manage the Research Park, the parties may come to an agreement that, once the Cleantech Commons is built and the City’s capital costs are recovered, there is more value in Trent assuming a direct landlord/tenant relationship with businesses in the research park. The Head Lease therefore acknowledges that the parties will agree to review this matter from time to time with a potential outcome being that the City and Trent mutually agree to shorten the 110 year term of the Head Lease, while maintaining the security of the long-term leases with sub-tenants.

2. Management Structure:

In the early months of the City/Trent partnership a Canadian consulting team (*think/Stiletto*) with specific expertise in research park management was retained to prepare a Strategic Plan for Cleantech Commons. The purpose of the Strategic Plan was to give the City, Trent and Peterborough and the Kawartha Economic Development (PKED) a blueprint for the respective roles of each organization.

In order to provide a coordinated response to the roles, for the past year the City and Trent have met on a regular basis to guide the planning, development and marketing initiatives for Cleantech Commons. On an as needed basis PKED attends or is invited to participate directly in marketing activities, such as the recent branding and web-site development project.

In the formative years of Cleantech Commons it is important that decision-making processes be flexible and nimble. For this reason the Strategic Plan supports the notion of a simple operationally-focused Management Committee. The role of the Management Committee is largely operational involving subtenant approvals, the communication of development and lease management issues, and marketing. At some point in time, by mutual consent, the City and Trent may wish to change the governance structure, but for the foreseeable future the Management Committee is the preferred management model.

Currently the membership of the Management Committee includes:

- The Chief Administrative Officer, City of Peterborough

- Director of Planning and Development Services, City of Peterborough (or designate)
- Vice President, Research and Innovation, Trent University
- Vice President, Finance and Administration, Trent University

The Management Committee's primary roles are to:

- Provide a coordinating and governance advisory function for the marketing and tenanting of Cleantech Commons;
- Provide an ongoing forum to communicate management and development issues between the City and Trent concerning the challenges and opportunities influencing the success of Cleantech Commons;
- Advance the business relationship between the City and Trent regarding Cleantech Commons.

The Head Lease acknowledges the role of the Management Committee. Furthermore, the Head Lease identifies the City/Trent Liaison Committee, with City Council and Board of Governors representation, as a body that the Management Committee can refer matters to that are beyond its scope or cannot be resolved by the Management Committee.

The 2018 Capital Budget includes an allocation for the City's share of the funding obligations to hire an Executive Director for Cleantech Commons. Once Trent has secured its funding share, a recruitment process will be conducted to provide day to day leadership and support the corporate responsibilities of the City, Trent and PKED to ensure the success of Cleantech Commons.

3. The Financial Model for Ground Lease Rates:

The development of Cleantech Commons is a partnership arrangement that leverages the resources of the City and Trent. The completion of the Strategic Plan has finalized the Cleantech Commons Master Plan and through that process commitments have been made to advance a development with enhanced development standards and a high regard for the natural amenities of the site.

The Strategic Plan evaluated the financial model contemplated by the City and Trent given that the land will not be sold to investors but rather subject to long-term land leases. The task therefore was to establish a land lease rental rate as an alternative to the traditional "sale" model used in typically planned industrial parks.

The financial model is based on the recovery of the City's upfront \$10.1M capital investment with a higher recovery rate occurring in the early years. The model includes cost of borrowing and provisions for increases in today's estimated construction costs to accommodate the phasing of the build-out over time.

Based on a range of considerations, a land lease rate in the order of \$0.28 - \$0.30 per square foot of leased land (\$12,200 to \$13,000 per acre/year) represents a rate the market will bear. This rental rate compares favourably to a 2018 ground lease rate of \$0.2958 per sq ft at the Peterborough Airport which also has unique development standards. The proposed ground lease rate has also been reviewed by a major investor in Research Park real estate at the David Johnston Research Park at the University of Waterloo who validated that the rate was reasonable.

The posted lease rate does not preclude rate increases beyond 2019 to address inflation, nor the City and Trent from offering rental rate incentives for the inaugural sub-tenant in the Research Park. The model thus provides flexibility which will impact the period of cost recovery but will ensure the City recoups its investment. It is noted that the City will also collect taxes from the sub-tenant developments which will address the operational sustainability and eventual infrastructure replacement costs for roadways within the Park. This is typical of other subdivisions developed throughout the City.

Summary

Trent University and the City have worked diligently over the past 3 years to put in place the key elements of a unique partnership leading to the creation of Cleantech Commons. The finalization of a Head Lease allows the ongoing investment of the City to proceed confidently and is a necessary first step to recruiting business and investment prospects. The proposed management structure has been recommended in order to give Cleantech Commons the best chance to 'get out of the gate' as quickly as possible. The financial model demonstrates a prudent business basis for moving forward with enduring economic benefits for the Region.

Submitted by,

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