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CITY OF **VANCOUVER**

ADMINISTRATIVE REPORT

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TO: Standing Committee on City Services & Budgets

FROM: Director of Financial Planning & Treasury in consultation with the Project Manager, Southeast False Creek and Olympic Village

SUBJECT: Southeast False Creek Redevelopment: Property Endowment Fund *Pro Forma* Update

INFORMATION

This report is submitted for Council information.

CITY MANAGER'S COMMENTS

The City Manager notes that the updated *pro forma* for the redevelopment of the Property Endowment Fund land in Southeast False Creek should be considered with caution. Although the redevelopment of site is underway and the first of the development sites have been sold, 2006 is just the second year in the 18 to 20 year build-out of the site.

This report indicates that the financial position of the PEF is about 30% better than the $50 million that Council has established as a long term objective. However, the City Manager cautions that there are considerable uncertainties about future revenues and expenditures that may not have been captured in the *pro forma* and that will likely erode this position as we move forward. In addition, Council did not remove the 1/3 modest market housing requirement in sub-area 1A and 3A which leaves a significant unfunded liability in future phases.

Council is advised to acknowledge the current financial position as a step toward achieving its long term financial objective in Southeast False Creek but to accept this report for information. Staff will provide periodic updates of this *pro forma* to keep Council informed as the project progresses.

COUNCIL POLICY
The applicable Council policy is embedded in the Background section of this report.

PURPOSE

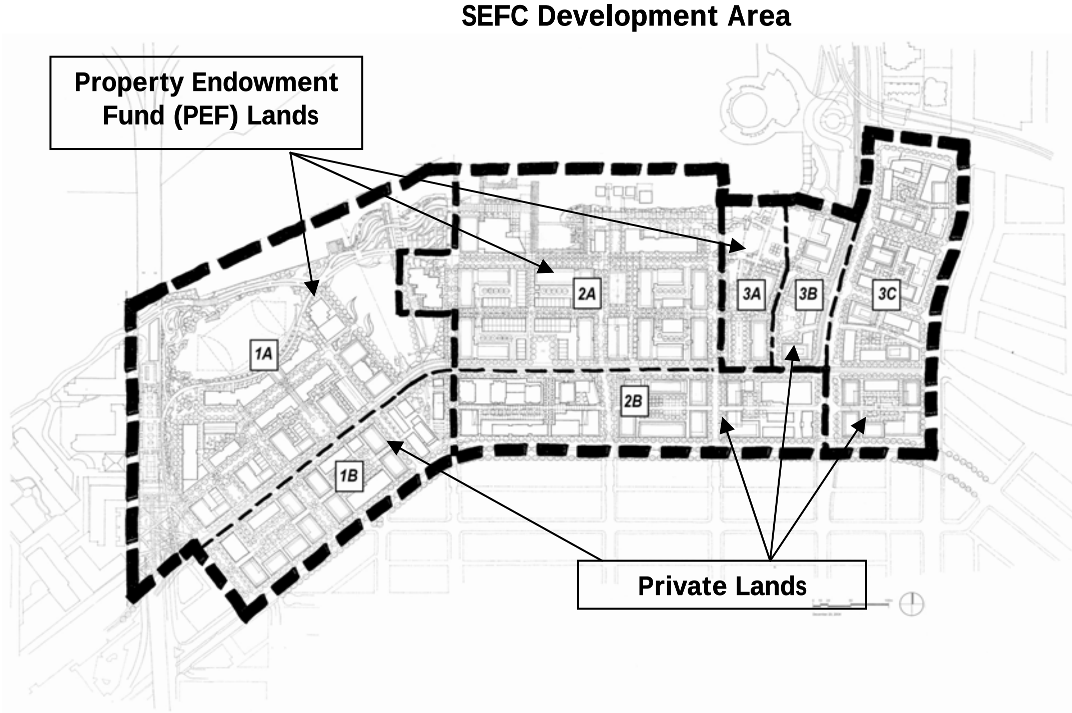
The City is involved in the redevelopment of the Southeast False Creek ODP area in two capacities. As regulator, Council has established land use, urban design and development zoning for the ODP area and has defined the level of public amenities to be provided and extent to which properties in the area will contribute to their achievement. As owner of approximately 60% of the land in the ODP area and 1/3 of the development density, Council also serves as developer with the objective of ensuring that development of its lands meets its financial objectives.

The purpose of this memo is to address the second of these roles – the City as developer – by updating the *pro forma* for the lands held by the Property Endowment Fund in SEFC. The *pro forma* indicates the extent to which Council's financial objectives for the development project may be achieved.

BACKGROUND

The Property Endowment Fund owns approximately 50 acres in the SEFC ODP area. This area is illustrated as Sub-areas 1A, 2A and 3A on Figure 1.

Figure 1
SEFC Development Area



The balance of the ODP area is in private hands and will be redeveloped within timeframes established by property owners/developers (market timing) and the City (land use rezoning).

In March 2005, Council approved the ODP for SEFC, outlining the development and public amenity objectives. The Financial Plan and Strategy accompanying the ODP defined the role of the Property Endowment Fund and the private land owners in achieving these public objectives and established the principle that the costs of the public amenity package would be shared by all development in the area.

Over the 18 – 20 year development period, the PEF is to be fully responsible for the costs of installing the public works infrastructure on its lands and for creating development sites. The ODP defined approximately 2.3 million square feet of development density for market and affordable residential, commercial, institutional and public uses within the PEF owned lands. In addition, the PEF lands are to accommodate 25.8 acres of park space, a 30,000 square foot community centre and at least three childcare facilities, the costs of which were to be shared with the adjacent private lands or be provided from the City's traditional sources of capital funding. The PEF will also provide a free site to house a community school to be built by the Vancouver School Board. All of the costs related to the PEF involvement in the redevelopment are to be recovered from the sale of development sites.

Council had initially agreed to re-invest the developer's "risk return" in SEFC in the public amenity package but to seek a return on the value of the land based on an industrial zoning. This was established at $50 million (2001). This amount was close to the actual costs the PEF had incurred in purchasing, holding, remediating and planning for the redevelopment. However, with the 2005 ODP, Council instructed that this return on the land also be reinvested in the enhanced public amenity package. The financial objective for the Property Endowment Fund was that all of the net income from the redevelopment would be re-invested in the enhanced public amenity package with the fund neither earning a return in its investment nor incurring a loss.

On January 19, 2006, Council reviewed the financial plan for SEFC and amended its overall expectation for the financial involvement of the Property Endowment Fund in the SEFC redevelopment in the following motion:

A. *THAT Council approve an amendment to the Southeast False Creek Financial Plan and Strategy establishing the long term objective of having the Property Endowment Fund ("PEF") recover the value of the City Lands in Southeast False Creek ("SEFC") (estimated at $50 million based on industrial zoning) over the 15 to 20 year development horizon for the neighbourhood;*

and

B. *THAT staff report back to City Council with an update on the financial status of the Southeast False Creek development prior to the rezoning Public Hearing for sub-area 2A.*

In order to achieve the desired financial outcome, Council, at public hearing, amended the SEFC ODP to adjust the housing mix and requirements for childcare facilities on the PEF lands. These changes had an anticipated value of approximately $28 million. The City Manager noted that there would be opportunities over the expected 20 year development period that could ultimately enable Council to reach the goal of recovering the land value in SEFC.

On April 5, 2005, Council approved Millennium SEFC Properties Ltd as the successful proponent for the development of the buildings in sub area 2A (the Olympic Village).

On June 06, 2006 Council approved the recommendation of the Directors of Current Planning, Director of Financial Planning and Treasury and Director of the Housing Centre related to a revised public benefits strategy and a compatible housing strategy for the SEFC ODP area. This strategy updated the costs associated with the public amenity package envisioned in the amended ODP and proposed a mechanism for sharing the costs of this amenity package between the PEF and the adjacent private property owners within the ODP area. In this strategy:

- all DCL eligible costs were proposed to be recovered through an area specific DCL of $14.50 per square foot in addition to the City-wide DCL of $6.00 per square foot (bringing the total DCL to $20.50 in the ODP area).
- in order to ensure a compatible housing strategy could be achieved on the private lands, a target community amenity contribution of $11.50 per square foot was established for discussion with the private land owners. The public lands are exempted from this latter charge because the PEF was already committed to providing sufficient free land to ensure that 20% of the residential units on its site were affordable, representing forgone revenues of up to $65 million based on current market values.

DISCUSSION

The PEF *Pro forma*

The PEF development *pro forma* is a summary of the anticipated revenues and expenditures related to the redevelopment of the public lands and indicates the net income that the fund can anticipate once the project is complete. As the development will take place over a 20 year period, the *pro forma* is based on a number of assumptions about the timing of revenues and expenditures and about revenue and cost inflation during the period. Risk factors related to future property values, construction costs, environmental issues, timing and other risks are reflected in appropriate contingency provisions in the *pro forma*. The intent is to provide as realistic a picture of the net position as possible. As we move through the development period, the inflation and contingency provisions will take a less prominent position in the *pro forma*. In order to make the result understandable in today's dollars, the *pro forma* brings these estimates to current values using a net present value approach. In measuring the success in achieving Council's financial objectives outlined above, this net present value result is the appropriate benchmark.

Since the ODP and the financial plan were amended, the SEFC project has proceeded through design to construction. Staff have updated the *pro forma* to reflect current revenue and cost information. Two significant changes have driven this update of the last *pro forma* developed in 2004:

- approximately 50% of the development density (sub area 2A) has been sold and the gross income is known. The experience from this sale has been used in part to update the revenue expectations for the balance of the site;

- a number of major construction contracts have been awarded for the public infrastructure work in sub area 2A and work is in progress. Along with more detailed design work, these estimates provide a more accurate reflection of the site servicing costs for work to be completed in the future. At the same time, the timing of development work has been clarified for *pro forma* purposes.

The following table summarizes the net present value of revenues and expenditures anticipated for the Property Endowment Fund over the 18 – 20 year development horizon for SEFC. A more detailed description of the major revenue and expenditure components in the *pro forma*, the assumptions that drive them, their timing over the development period and the changes since the *pro forma* was developed in 2004, follows.

	Net Present Value
Development Revenues	$ 217.9 million
Site Serving and Amenity Costs	(153.4) million
Net Income	**$64.5 million**
Compared to Target Return of	**$ 50.0 million**

1. Revenues

The primary source of revenue for the Property Endowment Fund will be from the sale/lease of development parcels across its site totalling perhaps 16 acres of the 50 acre site. The following table summarizes the assumptions used to forecast sales revenues:

Sub Area	**Timing**	**Density**	**Price (2006)**
Sub Area 2A	2006 / 2010	1.10 million sq. ft	$205 per sq. ft.
Sub Area 3A	2012	0.18 million sq. ft.	$140 per sq. ft.
Sub Area 1A	2014 - 2016	0.90 million sq. ft.	

The sale of development sites in Sub area 2A (the Olympic Village) will close following the 2010 games. Millennium SEFC Properties purchased all of the development parcels in sub area 2A, paying approximately $205 per square foot, with 15% of the proceeds payable in 2006 ($28.9 million) and the balance following the 2010 Games ($164.2 million). This delay in making the final payment translates to a current value to the City of approximately $165 per square foot.

The following assumptions drive revenue estimates for the two other sub-areas:

- Sub-area 3A, comprising approximately 150,000 square feet of market development space, will be made available in 2012.
- Sub area 1A, with approximately 760,000 square feet of market development space is anticipated to proceed following site servicing after 2012 with parcel sales closing during the three year period from 2014 to 2016
- An adjustment was made to the anticipated revenues from these sub-areas reducing the anticipated purchase price by the amount of the Area Specific DCL approved for

the ODP area after the Sub-area 2A bids were received. If this charge of $14.50 per square foot had been in place at the time of the bid, it would likely have reduced the bid amount of all proponents by a similar amount.

With these adjustments it has been assumed that the 2006 value of future development sites is in the order of $140 per square foot buildable for residential and 50% of that, or $70 per square foot buildable, for commercial density identified in the ODP.

Current land values have been inflated in the *pro forma* at 2% per year to reflect the potential impact of increasing market values over the development horizon. In addition, a revenue contingency has been included on revenues to be earned on site sales in sub-area 1A and 3A to reflect a number of risks. These include risks associated with future land tenure decisions (lease versus sale), achievement of market densities, marketing costs and market timing risks. As development timing and market conditions become more certain, these contingencies will be reviewed.

While not included in the *pro forma*, the PEF will be providing approximately 390,000 square feet of development density to meet the affordable housing objectives of the SEFC ODP. Based on the land values indicated above, this represents foregone revenue of approximately $65 million compared to selling the land for market housing. The ODP also requires that one-third of the residential units in sub-areas 3A and 1A be "modest market", however, there is no expectation that the PEF will provide subsidies for this objective and no costs are reflected in the *pro forma*. If funding is required, sources will have to be identified at the time the parcels are developed.

As part of the public amenity package, the PEF will allocate approximately 25.8 acres of its site for park. As the cost of the park space is being offset by the City-wide and Area Specific DCL to be paid by the PEF and private developers, the PEF will be partially compensated for the foregone revenue associated with this land. This recovery has been established at approximately $1.0 million per acre, equivalent to the pre-development industrial land value on the site.

In total, the *pro forma* anticipates that the PEF will receive approximately $217.9 million (net present value) for the sale of development sites and the allocation of parkland over the development period. This is just over double the revenue anticipated in the 2005 *pro forma* arising primarily because of a significant increase in the actual and anticipated prices for market development sites.

2. Expenditures

The Property Endowment Fund as property owner will:

- fully service its site (foreshore stabilization, utilities, roads and public realm improvements);
- provide free development sites for the affordable housing;
- provide free land for a community school;
- provide free land and pay for the construction of community facilities including a community centre and library (by way of contribution to the new Mt Pleasant Branch at 1 Kingsway);

- o participate in the funding of other community amenities including 25.8 acres of developed park land, three full size childcare facilities and a number of public realm improvements within the ODP area; and
- o provide funding toward retention of three heritage buildings on the site.

The costs that the PEF incurred in assembling the property, undertaking soil and water contamination studies and remediation and the initial design work prior to 2005 are not included in the *pro forma*. These costs are approximately $35 million.

There are four primary areas of expenditure reflected in the *pro forma*:

a) **Project Planning and Management** includes the costs of the Southeast False Creek Project Office, site planning, design and rezoning consultancies, development cost levies and soil remediation costs.

Council has approved the ongoing budget for the Project Office at approximately $750,000 annually ($2006) through the project. Although costs may be higher during the key pre-development years, these costs will likely continue through most of the development period.

The site planning and rezoning costs for sub area 2A are largely complete. Rezoning fees were prepaid by the PEF and are not included in this *pro forma*. It is anticipated that architectural design consultants will be engaged prior to rezoning of sub-areas 1A and 3A and the PEF will incur fees associated with these rezonings. The *pro forma* includes $3.0 million for these expenses.

In the case of all development on the PEF lands after sub area 2A, the developer(s) will pay the City-wide DCL and the Area Specific DCL. However, for sub area 2A, the developer will only be responsible for the City-wide DCL. As the area specific DCL was unknown at the time the RFP was issued and the proponent selected, the PEF will take responsibility for these costs, estimated at $13.6 million, payable at building permit stage in 2008.

Much of the soil on the development sites on the PEF lands will require remediation. As owner/vendor of the sites, the PEF will be responsible for remediation costs. In the 2004 *pro forma* (developed before excavation began) remediation costs were estimated at $18.6 million. However, based on experience to date, these costs could exceed $30 million when soils and contaminated water issues are included. The updated *pro forma* includes $28.5 million for these costs, however, the Project Office cautions that these costs will likely go higher as excavation proceeds in sub-areas 3A and 1A.

b) **Onsite Infrastructure** includes the costs associated with providing the public infrastructure on the PEF lands, including foreshore stabilization, utility installation and streets infrastructure construction, public realm improvements and park development.

Since the initial estimates were completed in 2004, more detailed design of an enhanced and active waterfront, including the enlarged inlet feature and structural stabilization to support buildings closer to the waterfront, have been completed.

Through this transition, foreshore stabilization cost estimates have increased by almost four times from $8 million to $32 million. The cost of some work abutting the major parks will be shared with the private land owners in the ODP area through allocation of their DCL contributions.

Development of streets rights of way, including installation of sewer, water and energy utility infrastructure in sub are 2A is underway with phased completion over the next three years to compliment the residential and commercial development. Only one right of way is necessary in sub area 3A (2011) and the balance of the work is scheduled to be undertaken in 2012 and 2013 to prepare sub area 1A for development. The *pro forma* includes $45 million for this work, up from $26 million in the 2005 plan.

The park space to be developed as part of sub-area 2A is approximately 11.5 acres of the total 25.8 acres to be provided on the PEF lands. Sub-area 2A park space includes the waterfront from Ontario Street to just west of Columbia Street, including the island, the hinge park west of Columbia Street, the village plaza and the pocket park on 1st Avenue. To date conceptual design has been completed for the only a portion of this park space with staff continuing to work within the $16.1 million ($625,000 per acre) included in the original *pro forma*. However because this work has not been tendered, the cost estimates include appropriate contingencies. This is an area where caution on the adequacy of the estimates must be used.

c) The Property Endowment Fund will cost-share in a number of **off-site public realm and traffic improvements**, including the reconstruction of First Avenue, upgrading of Second Avenue and traffic improvements on neighbouring streets. The current *pro forma* includes $17 million for these costs, up from $7.1 million in the 2004 *pro forma*. The primary driver follows from the redesign of First Avenue, which has increased from $7.3 million to $13.1 million.

d) **Community Facilities** include the 30,000 square foot community and non-motorized boating centre, childcare facilities, a contribution to the Mt Pleasant Library and the cost of holding three heritage buildings pending finalization of redevelopment plans.

In July 2004, Council approved the inclusion of a full service, 30,000 square foot community and non-motorized boating centre in sub area 2A (free land and building). At the time, the cost of this facility was estimated at $13.5 million with the PEF including this cost in its *pro forma*. Although design of the building is not completed, this facility is currently estimated to cost approximately $19.5 million including design and construction to a LEED Platinum standard and the provision of the required underground parking. An adjoining 8,000 square foot space, designated for retail lease, is the subject of a separate business case. This building will be completed for the 2010 Games.

The PEF will share in the cost of at least three childcare facilities within the ODP area. These costs were estimated in 2004 to be approximately $15.5 million. The first of these facilities will be designed and built by the PEF as part of the community centre project at an incremental cost of approximately $5.0 million, with the PEF recovering a share of the costs from the private land owners through their DCL payments.

There are three heritage buildings on the PEF lands – the Salt Building, Wilkinson Steel Building and Saw-Tooth Building. The ODP contemplates these buildings will be retained and functionally integrated into the development. The pro forma does not make any allowance for final retrofit costs for these building in the expectation that an income-earning use will be found that will help offset them. However, it is anticipated up to $4.2 million will have to be spent to stabilize the buildings until final uses are determined. The first of these buildings to be restored, the Salt Building, will be the subject of a future report to Council.

The net present value of the PEF expenditures in SEFC are currently $153.4 million - an increase of approximately 66% since the 2005 *pro forma*.

3. *Pro forma* Net Income

The net income in the PEF *pro forma* is currently $64.5 million (net present value) compared to the Council objective of returning the industrial land value of $50 million to the PEF over the development period. This compares to net income of approximately $4.0 million based on the *pro forma* reported when the 2005 Financial Plan and Strategy was adopted by Council.

There are two primary reasons for this increase in the net present value:

- The actual and anticipated revenues available from the sale of development sites have increased by some $200 million (nominal $) as a result of the actual revenue for the sub area 2A development sites and the subsequent adjustment to anticipated revenues for the two remaining sub-areas;
- Costs to service the site and to provide public amenities have increased from an estimated $143 million in 2005 to $240 million (nominal $). This reflects the impact of a greater level of detail in the design of these works, experience from construction contracts for site services already awarded and the resulting adjustment to the costs of future work.

It is worth noting that the changes that Council made to the financial plan and strategy in January 2006, extended out over the entire development period, have been key in achieving the current financial position. Without these changes, the net present value of the *pro forma* would be in the range of $23 million and additional steps to reduce costs or increase revenues would have been required to meet the financial objective for the PEF.

It is still early in the redevelopment of SEFC and much can happen to change the financial position reflected in the *pro forma*. As noted, soil and water contamination costs have risen significantly as excavation on the site has begun and will likely increase beyond the provision in the *pro forma*. There is no final design for the community centre and, with current estimates based on conceptual design work, there is considerable risk that costs will continue to rise for this signature building. As the PEF is providing this building, any costs beyond the current estimates will affect the financial position. In short, there are both opportunities and risks that in the current *pro forma*, however, as the development precedes the revenue and cost estimates will become more certain and the requirement for contingencies can be reassessed. Staff will provide Council an annual update of the pro forma.

FINANCIAL IMPLICATIONS

The financial implications of this report are included in discussion above.

CONCLUSION

The update of the Property Endowment Fund *pro forma* for SEFC indicates that Council's objective of earning a return equal to the land value of the site may be achieved over the 18 – 20 year development period. The net present value of the net income to the PEF has increased from approximately $4.0 million in the February 2005 version to $64.5 million in the current version. However, staff caution that it is still early in the development phasing for SEFC and, although contingencies have been provided for the risks and uncertainties for both revenues and expenditures, the margin over Council's $50 million objective is not significant. As a result, it is recommended that staff report to Council on an annual basis with updates of the *pro forma.*

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