
MEMORANDUM

January 31, 2008

TO: Mayor and Council

FROM: Michael Flanigan, Director of Real Estate Services

SUBJECT: Evaluation and analysis of developers' pro forma and methodology used for calculation of heritage compensation - CD-1 Rezoning, Designation and Heritage Revitalization Agreement - 3238 Granville Street and the westerly portion of 1402 McRae Avenue

This Council Memorandum summarizes the methodology and business practices undertaken by City Real Estate Services in reviewing the development proposal submitted by *Bell Holdings* (the "Developer") to ascertain the appropriate amount of financial compensation required for the heritage designation and retention of the development proposed for 1402 McRae Avenue.

City Policy

The methodologies used to ascertain the level of heritage compensation are set out in the City's Heritage Policies and Guidelines;
<http://internal.vancouver.ca/commsvcs/guidelines/H003.pdf>

In summary, two land valuations are required: the first to estimate the land value of the site unencumbered by the heritage component in its highest and best use (the "unencumbered land value"); and secondly, a land valuation of the site encumbered by the heritage retention (the "encumbered land value"). The difference between the two land values determines the required compensation.

The purpose of the methodology set out in the City's Heritage Policies and Guidelines is to provide a framework for which staff and the land Developer can reach agreement on an appropriate compensation package to secure heritage designation and preservation of this important historic asset. Council makes the ultimate decision as to whether or not the merits of the heritage project warrant the degree of financial compensation.

The Development Proposal for 1402 McRae Avenue

The Developer has made an application to the City to develop the subject property and preserve the heritage building and landscape by entering into a Heritage Revitalization Agreement and agreeing to legally designate the property to prevent future demolition. The Heritage Revitalization Agreement will obligate the developer to undertake heritage retention work with a premium heritage cost estimated at over \$1,400,000. Premium heritage costs are those hard and soft costs associated with keeping Nichol House in situ, and utilizing the 1402 McRae site in its highest and best use incorporating the required heritage features of the

existing improvements. These estimates have been scrutinized by the City's Quantity Surveyor and any escalations in costs in excess of this figure will be at the Developer's sole expense and risk. An alternative development option could see the Developer demolish the existing heritage improvements and under existing zoning, develop multiple new Shaughnessy estates on three lots. It is this alternative option that serves to set a development benchmark to ascertain the amount attributable to foregone development opportunity costs. These opportunity costs are further exacerbated by the premium heritage costs the City would require the Developer to expend.

Under the subject development proposal, the Developer is essentially neutering a large development parcel by retaining the heritage house (see Appendix A). The heritage land use is clearly not the highest and best use of this property and the Developer is entitled to heritage compensation when designating the property as a "Class A" protected heritage site. Although best heritage practices have the heritage home and landscaping remain in-situ, the western property line is proposed to be moved approximately 160 feet east along the McRae frontage (see Appendix B) in order to mitigate the size of the land parcel being encumbered.

In many cases involving heritage designation and preservation, the City's Heritage Policies and Guidelines permit for off-site transfer of density to mitigate the form and massing required on a heritage property. As there is to be no transfer of density off site in this case, the land value of the remainder of the site needs to be increased to generate a commensurate level of financial compensation to cover the heritage opportunity costs. It is the increased land value which is identified by reviewing various forms of development to interpolate the density and form of development to generate sufficient land value to provide compensation.

Land Valuation

Unencumbered Value - To identify the unencumbered land value of the subject property, staff have utilized the direct sales comparison method (the "Direct Comparison Approach"), a universally accepted appraisal methodology governed by the Canadian Uniform Standards of Professional Practice of the Appraisal Institute of Canada. *"The Direct Comparison Approach involves comparing the subject property to the sale, listing or offered prices of properties which are judged to be comparable to the subject. Adjustments are made to the prices of the comparable properties to reflect differences in market conditions, location, physical and economic characteristics, use, conditions of sale and other relevant factors. This approach is best suited to those types of property where there is a degree of uniformity in the above factors and where there is adequate sales data concerning recently sold or currently offered properties similar to the subject."*

In the subject analysis, the site was valued in its highest and best use. Accordingly, the site would be marketed for sale, at a minimum, as three individual lots for the development of three single family dwellings at 0.45 Floor Space Ratio ("FSR"). The existing improvements including the house would be demolished. By using the sales comparison method the overall unencumbered land value of the site was ascertained. The pro forma analysis that informed this transaction was backstopped by an arms length, third party appraisal prepared by Burgess Cawley Sullivan and Associates. Although the Developer's pro forma relies on specific details of this appraisal to calculate the unencumbered land value, provisions of confidentiality preclude the public release of this document. Accordingly, for explanatory purposes the Director of Real Estate Services advises that publicly available "2008 Assessed Values" follow closely, and each of the subject lots has been valued by British Columbia Assessment Authority as follows:

Lot 1 - 3238 Granville St(1452 McRae Ave): Lot size: 40,043 sq.ft.
Land: \$2,026,000 (\$ 51per sq.ft. of site)

Lot 2 and 2A - 1402 McRae Ave: Lot size: 63,862 sq.ft.
Improvements: \$ 367,000
Land: \$8,587,000 (\$134 per sq.ft of site)

The assessed values indicate the significant difference in land value across the site, to the extent that over 80% of total site value is contained in Lots 2 and 2A. This is a material fact that weighs heavily in the pro forma analysis. The primary reason for this assessed value disparity between Lots 1, 2 & 2A is Lot 1's proximity to the busy intersection at 16th Avenue & Granville Street and the significant decrease in land value associated with a Granville Street frontage vis-à-vis a quieter internal Shaughnessy street address.

Encumbered Land Value - In order to identify the encumbered land value of the site, it is assumed the site would be utilized in its highest and best use, subject to incorporating the required heritage upgrades, preserved heritage landscaping, and retention of key existing heritage improvements. The value of the land is estimated by using a land residual method of land valuation (the "Land Residual Approach"): *"The land is assumed to be improved to its highest and best use and all expenses of operation and return attributable to the other agents of production are deducted and the net income imputed to the land is capitalized to derive an estimate of land value. An alternative land residual technique is applied by valuing the land and improvements and deducting the cost of the improvements and any entrepreneurial profit. The remainder is the residual land value"*.

Accordingly, the land residual for the encumbered site is calculated as follows:

Market Value of the Heritage House remaining in situ encumbering Lots 2 and 2A

Less: Construction (Hard) Costs related to heritage retention

Less: Indirect (Soft) Costs - all indirect costs such as professional fees (for architect, lawyer, consultants, development manager), holding costs, contingencies etc.

Less: Developers Profit (15% of costs)

Equals: Residual Value of the Land

The land residual method identifies the amount that a developer would pay for the land and therefore represents the encumbered land value of Lots 2 and 2A. Lot 1 is not encumbered by any heritage designation and the sales comparison method can be used to estimate land value. The total land value of Lots 1, 2 & 2A represents the encumbered land value.

The difference between the unencumbered land value and the encumbered land value is the amount for which a developer is to be compensated in consideration of the heritage designation and associated obligations.

Real Estate Evaluation & Analysis

The heritage house encumbers Lots 2 & 2A, which with reference to the above BC Assessment Authority assessed values, contains over 80% of the overall combined sites' land value. Accordingly, it is evident that heritage retention results in a significant shortfall cost to the Developer between the unencumbered and encumbered land values of the site. This shortfall, given the disparity of appraised (and assessed) values between the sites is significant. In

short, the Developer would be way better off financially by demolishing the heritage home, and constructing three (or more) new Shaughnessy estates on the unencumbered properties. Council policy directs that efforts be made to avoid the demolition of valuable heritage resources such as this.

To mitigate this economic shortfall, and to generate sufficient land value on the encumbered site to compensate for the further heritage retention and landscape costs, several development options were explored. The option, as proposed, retains the heritage house in situ, but reduces the size of Lot 2 and 2A, and does not relocate the house to an individual lot within the site (see Appendix B). This necessitates a form of development on the west portion of the site (i.e. the proposed CD-1 zoning) that generates sufficient additional land value from a higher density form of development to compensate for the heritage encumbrance.

Therefore using the methodology outlined above the residual land values were estimated for the reduced-in-size Lots 2, and 2A, with heritage house remaining in situ. To provide sufficient compensation as indicated in the Heritage Policies and Guidelines, a land value for the remainder of the site i.e. the west portion of the site (the proposed CD-1 zoning), would need to be in the region of \$6.16 million (\$172 per buildable sq.ft.). This amount represented the intrinsic underlying land value unencumbered plus the bonus land value required, and therefore indicated the target land value to be achieved on the CD-1 site. The difference between the target land value and the underlying intrinsic unencumbered land value represents the bonus buildable land value required to compensate the Developer. The total buildable area proposed of 35,828 sq.ft. will result in a bonus density of 10,456 buildable sq.ft (\$1,798,432 in bonus land value) representing a 0.18 FSR increase on the CD-1 site. However, the overall site area does not exceed the existing permitted 0.45 FSR which means there is no bonus density granted on the 1402 McRae site as a whole.

Once the target land value had been identified the Land Residual Approach was used, with the goal of achieving a residual land value on the east and west portion of the site which in total equated to the unencumbered land value of the total site. Using an iterative approach, various densities of development were analysed to arrive at a residual land value sufficient to equate to the target land value.

Although not relevant to this specific application, it is important to note that the other development options referred to above, only generated sufficient compensatory land value when the heritage house was moved to a further easterly location (Lot 2A). Resultantly, these options included various forms of lower density single family and townhouse development on the west portion (Lots 1 & 2), but obviously at the expense of proper heritage retention in-situ. It is also worthy of note that all the various options are significantly impacted by the land value disparity across the site referred to earlier. Such that, townhouse forms of development were necessary for part or all of the west portion of the site, with the exception of one of the options reviewed in which the heritage house is moved to a much smaller lot fronting "The Crescent", with little or no heritage landscape preservation. In this case the remainder of the site could be consolidated and subdivided into individual single family lots.

The above pro forma review and analyses were completed in July, 2006 using a "snapshot in time" approach which evaluates the proposal as at that date, and is a standard procedure with all pro forma reviews undertaken by City staff whether it be heritage compensation, amenity bonusing or rezonings. The analysis is concluded early in the process so that the necessary further steps such as permit application processing, design reviews, public consultation and hearings, Development Permit Board and Council approval etc. can proceed.

A recent staff review of the pro forma using assumptions updated to January, 2008 has been completed. The review concluded that the proposed form of development generated adequate compensation for heritage preservation costs and provided no undue profit to the Developer, and re-affirms the conclusions of staff's original pro forma analysis as set out in this memorandum.

Summary

City staff have followed proper urban land economic principles, the City's Heritage Policies and Guidelines, and a bona fide third party appraisal, all in accordance with established City policies. The land residual approach has been utilized to ascertain that the proposed townhouse form of development generates a supportable density (or buildable floor area) to create the required target land value estimated at \$6.1 million for the west portion of the site. The bonus land value required equated to a bonus density of 10,456 sq.ft of buildable area (0.18 FSR) on the CD-1 site, with a value of \$172 per buildable sq.ft. (\$1,798,432). Whilst this represents a 63% uplift in residual land value for Lot 1 and portion of Lot 2 being the CD-1 portion of the site, as the total encumbered site value (west and east portions of site) equates to the unencumbered land value, there is no overall uplift in land value. Furthermore the overall site density remains as existing at 0.45 FSR.

Staff therefore concluded that the density and form of development proposed, provided no undue profit whilst generating adequate compensation for heritage preservation costs. It's also of note that the Developer has the obligation to undertake heritage restoration work with a premium heritage costs estimated at \$1.4 million.

The Developer's pro forma has been scrutinized to ensure that the assumptions on selling values per sq.ft., hard and soft construction costs, holding costs, premium heritage costs, contingencies, and profit, were consistent with the proposed form of development, and reflected reasonable and accurate sales and cost estimates at the time of pro forma review.

In summary, while respecting the detailed confidential nature of the Developer's pro forma analysis, this Memorandum serves to provide a detailed overview of the methodology and policy and further highlights the challenges of this site in creating additional land value to generate sufficient compensation to the developer for the heritage designation and retention. In conclusion, City Staff are satisfied that the Developer's pro forma accurately reflected the sales and cost assumptions for this form of development and will be available to address any questions from Council at the Public Hearing. Staff will also be available to answer any questions Councillors may have at anytime prior to the date of Public Hearing.

Respectfully submitted,



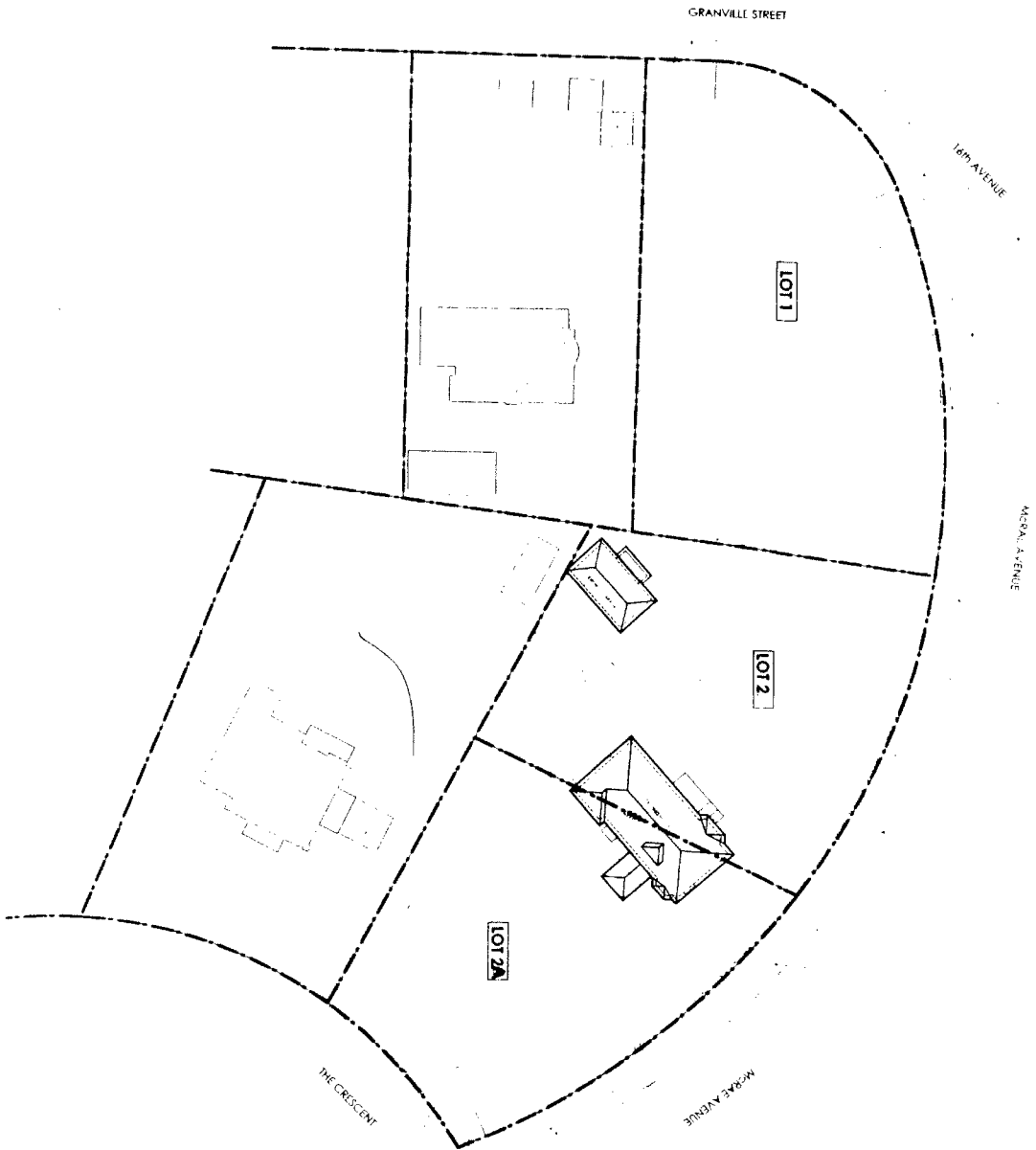
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APPENDIX A

**MCRAE AVENUE
EXISTING SITE**

3228 GRANVILLE STREET (LOT 1)
1402 MCRAE AVENUE (LOT 2A, 2B)
VANCOUVER, BC

