Mulholland Parker
Land Economists Ltd.

October 20, 2023

Miko Betanzo
City of Victoria
1 Centennial Square
Victoria, BC V8W 1P6

Re: Northern Junk Buildings Land Lift and Amenity Contribution Analysis Updates

Mulholland Parker Land Economists Ltd. (MPLE) was retained to update our land lift and amenity contribution analysis for Reliance Properties' (the proponent) proposed removal of the housing agreement on their property at 1314 Wharf Street, zoned Inner Harbour Heritage District. The goal is to determine whether the City of Victoria (the City) should seek additional amenity contributions. The analysis is to determine the difference between the supported land values of development of 3.39 FSR with residential uses above grade with one option being market rental and the other being market strata use. All other conditions in place are presumed to be present under both options (monetary contribution of $90,500, construction of a waterfront pathway, seismic upgrading of the existing heritage buildings).

The analysis consists of preparation of residual land value analyses which determine the maximum value that a developer could afford to pay for the Site under the conditions described. MPLE assumes development occurs under current market conditions and does not attempt to reflect potential changes in the market. MPLE used standard developer proformas for each case to model the economics of typical development as proposed.

The 'Lift' is then calculated as the difference between residual land values under the two proposed residential tenures.

METHODOLOGY & ASSUMPTIONS

The analyses are created using a standard developer proforma wherein estimates of revenues and costs are inputs and the remaining variable is the desired output. In typical proformas this output is usually profit, following a revenues minus costs equals profit formula. For a residual land valuation, however, an assumption on developer's profit needs to be included in order to leave the land value as the variable to solve for. For the strata option an allocation of 15% profit on project costs for the strata portion of the project is the target that lets us determine the supported land value. For projects with minimal strata a profit to project cost metric is not appropriate, as it would be difficult to support any land value and achieve a profit on cost with commercial and residential rents at market rates. Instead, developers would typically look at the yield of ongoing revenue measured as an internal rate of return (IRR). MPLE has determined the residual land value for the property in the base density scenario using a target IRR of 6.00%, which represents achieving 1.5% higher than the blended cap rates for commercial at 5.50% and 4.25% for residential rental (based on proportion of gross building area). The residual values are the maximum supported land value a developer could pay for the Site (under the densities tested) while achieving an acceptable return for their project.

The residual land values determined from these analyses are then compared to establish a 'lift' in value that arises from the change in tenure. This lift in value is the total potential monies that are available for amenities or other public works not considered as part of the analysis. Typically there is some sharing of the lift value between the Municipality/District and the developer, but the percentage shared varies by community and by project.

MPLE determined strata revenues used in the analyses from price estimates of newly developed apartments in the general vicinity of the Site from an independent survey of the market. Heritage building upgrades and other hard project costs were taken from estimates prepared for Reliance Properties and are deemed reliable. Other costs not provided and confirmation of costs provided were derived from market sources, including information readily available from quantity surveyors on average hard construction costs in the City. Development or soft costs have been drawn from industry standards, and from the City's sources.

Revenues and operating cost assumptions for the residential rental and commercial components of the project were determined from a review of current lease rates and terms for available space in the downtown of Victoria in proximity to the water.

All information provided by Reliance Properties has been checked and deemed reliable upon review by MPLE.

CONCLUSIONS & RECOMMENDATIONS

It is MPLE's conclusion that there is no lift in supported land value from change in tenure from removing the housing agreement from the Site based on the analyses. This lack of lift is due to a few factors, including the following:

1. The strata building is assumed to be entirely concrete construction whereas the rental option is only assumed to be concrete for the levels zero and one and wood frame above level one. There is roughly a 10% savings in hard costs from the use of wood frame versus concrete materials;
2. The change in materials is important as MPLE has found that there is greater propensity for the strata market to absorb higher prices required of concrete construction projects than there is in the rental market (i.e. the strata pricing has been raised to effectively offset the concrete costs whereas we would only be able to cover roughly 25% of the increased costs in market rental rates.
3. The biggest contributor to the lack of lift is the recent announcement from the Federal Government regarding 100% GST rebates for purpose built rental projects that saves the developer almost $1.4 million in costs on the rental option that were not available previously.

The City has also asked for commentary on significant changes to assumptions since prior analyses were undertaken, in particular changes to targeted IRRs. MPLE notes that target IRRs are derived from prevailing Capitalization Rates at the time of the analysis. We can say that Cap Rates in the Q2 2023 Cap Rate Report from Colliers Canada indicates that the rates for both commercial and for rental have both risen, which would in turn raise the target IRRs used in our analysis (rates noted in assumptions section above). In 2019 the residential rental Cap Rate used was 4.00% and commercial was 5.00%, so an increase of 0.25% to the rental and 0.50% to the commercial. It is important to keep in mind that there is an inverse relationship between Cap Rates and supported land value – the higher the Cap Rate the less land value that can be supported. In this case the changes were relatively small and were offset somewhat by other changes in assumptions including rental rates and the new GST rebates announced for rental projects.

Other changes that should be noted include increased interest rates and construction costs over the last 3-4 years that have risen at a higher rate than had been observed over the prior decade. Increases to revenues have remained relatively stable over the same period, although there is growing evidence of a slowdown in market demand for strata product due to tightened lending conditions and higher interest rates.

I trust that our work will be of use in the City's determination of the Amenity Contribution they will seek as part of redevelopment of the Northern Junk Buildings Site. I am available to discuss this further at your convenience.

Yours truly,

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