

March 14th, 2013

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Re: Fairwinds Amenity Contribution Analysis

The Regional District of Nanaimo (RDN) has retained G.P. Rollo & Associates (GPRA) to conduct an amenity contribution analysis for the rezoning of two sites that form a part of the Fairwinds development: The Lakes District and Schooner Cove. This analysis is based on the premise that there is typically an increase in land value (land lift) created from a change in use and/or density granted through a rezoning. The land lift identified is increasingly shared between the government (on behalf of the local community) and the developer through amenity contributions.

GPRA has received and reviewed all background materials, met with the proponent and the RDN to establish methodology and has prepared an analysis using both discounted cash flows and static proforma analyses for the components of the Sites. All analyses referred to herein are contained in a supplementary Excel workbook entitled ***GPRA Lakes District and Schooner Cove Analysis*** that has been included with the submission of this memo.

ASSUMPTIONS & METHODOLOGY

The Lakes District comprises roughly 280.2 Hectares and under the proposed rezoning would be developed over the next 25 years with a mix of estate, large, and compact single family lots, as well as lots for duplex, townhouse, and apartments for a total of 1,592 dwelling units. Schooner Cove has a gross land area of roughly 5.93 hectares and would encompass 360 multiple family units and 22,520 square feet of commercial space.

GPRA began by coming to a determination of the value of the Sites under current zoning. Based on the 2012 BC Assessment of the Sites the Lakes District has a value of approximately \$9.6 million and Schooner Cove a value of \$4 million for a total of \$13.6 million. GPRA has also looked at comparable sales and completed a high level residual for both Sites and arrived at a value of \$5.6 to \$6 million for the Lakes District and \$3.8 to \$4 million for Schooner Cove under current zoning for a total of \$9.4 to \$10 million for both Sites.

GPRA has reviewed all materials made available from both the proponent and the RDN to better understand how this proposed development will take shape. GPRA has reviewed Fairwinds assumptions on revenues, costs, timing, phasing, and absorption and have undertaken a review of current market real estate trends in the RDN and Nanaimo.

Construction costs in the market have also been reviewed, including estimates provided by Fairwinds. Hard construction costs used in the analyses range from \$140 to \$175 per square foot of buildable area, plus ~\$25,000 per underground parking stall. Soft development costs have been derived from sources deemed reliable, including the RDN.

Servicing and infrastructure costs are based on estimates prepared for the Fairwinds for both the Lakes District and Schooner Cove. No attempt has been made to verify these estimates beyond reviewing the estimates and noting that they have been prepared by professional engineers with experience in the market.

It must be noted that there may be costs included in this analysis which the RDN may construe to be for public amenities (such as a waterfront walkway, public art, or a fitness centre). Typically these sorts of items are isolated and removed from the analysis and are considered as credits toward the total amenity contribution from the development, but by including them within the cost of development they are considered to have already been credited to the developer above the line. The only remaining issue would be whether the RDN considers these items to be public or private amenities that are acceptable to the RDN. If any of these costs are deemed by the RDN to be extraordinary they could drag down the lift potential from the rezoning.

REAL ESTATE MARKET

The local real estate market has languished since the beginning of the global economic downturn of 2007/2008. The impact of this has been felt in sluggish sales and absorption for projects such as Fairwinds, and in a general decline in pricing for real estate over the last four years.

Single Family

A review of the market indicates that current absorption rates for single family lots in the RDN average less than 10 units per annum per project. Pricing can be quite variable depending on site influences and local amenities, but undeveloped single family lots cluster around \$14 per square foot of land for lots between ¼ and ½ acre (roughly \$200,000 to \$250,000 per lot). Larger parcels command significantly less per square foot, with sites 10+ acres in size selling for \$1 to \$2 per square foot, although examples of significantly higher prices can be found for both larger and smaller parcels.

Multiple Family

The market for comparable apartment projects is thin, with no projects completed since 2010. GPRA expanded research to include resales from older projects in the greater Nanaimo area (Nanaimo, RDN, Parksville, & Qualicum) to determine market absorption

rates and pricing for multiple family units with water views.¹ Absorption rates are very low, with roughly 2 units per month being sold at this point in time. Sales of RDN and Nanaimo water view condos within the last 12 months average \$250 per square foot of saleable area (unit prices between \$250,000 and \$300,000). Listings for sale are priced slightly higher at \$275 per square foot. The majority of these units include underground parking.

Commercial Retail

The latent retail demand that could be captured based on work undertaken in 2009 could be for as much as 25,000 square feet at Schooner Cove. According to spending capture assumptions used by GPRAL in other work for the RDN, the Fairwinds population could today support about 30,000 square feet of space in Fairwinds. However, this raw conclusion must be tempered by the following: the capture rates we have set are based on the assumption that Schooner Cove and perhaps another retail node in Fairwinds offers a healthy mix of retail and amenity to draw residents from across Fairwinds and Nanoose Bay to the waterfront. If there were no plans for a comprehensive village at Schooner Cove, we would set the capture rates much lower, perhaps even to zero, and re-direct spending to Red Gap and Parksville.

Updated estimates of retail rents that could be commanded at Schooner Cove are approximately \$19 per square foot under triple net leasing terms. There would be significant inducements required to attract a suitable tenant mix and ensure tenants had time to firmly establish their businesses, likely as much as 2 to 5 years free rent for new tenants. Also worth noting, the lease rate of \$19 per square foot is substantially lower than rates that could be achieved in more urban areas and is lower than the required economic rent to support the commercial development at this site (i.e. this component is not feasible on a stand-alone basis).

ANALYSIS

Discounted Cash Flow

As indicated above GPRAL prepared a discounted cash flow (DCF) analysis looking at the two Sites developing over a 25 year timeline. GPRAL has prepared both a Constant Dollar Analysis (one wherein there is no inflation of revenue or costs over time) and a Current Dollar Analysis (wherein GPRAL has made modest allowances for inflation in both revenues and costs over time) to determine the performance of the project and the land value that it can support.

In a DCF revenues and costs are projected out over a timeline (25 years in this case) with the sum of all of these converted to a Net Present Value (NPV) through a discount rate (set at 15% based on observations of rates used by other large multi-phased projects). If the Net Present Value is equal to or greater than \$0 then the project is considered viable.

For this analysis the goal is to determine the land value that can be supported by the project. Therefore GPRAL adjusted the land value used in the DCF until the NPV was roughly \$0 (making the project viable from a market perspective). However, GPRAL found that in both

¹ Note GPRAL has excluded listings and sales from timeshare developments.

a Current Dollar and a Constant Dollar DCF analysis the project would not support sufficient land value to generate any lift. The combined value supported by the lands to be rezoned and developed as proposed is \$3.5 million using a Constant Dollar analysis and \$4.7 million using a Current Dollar analysis, well below the estimates of \$9.4 to \$10 million indicated by our analysis of the Sites under current zoning.

Upon sharing the preliminary findings with the District GPRA was instructed to analyze Schooner Cove independently to illustrate the potential for amenity contributions from solely the rezoning on this site. In contrast to the Lakes District, Schooner Cove is a much smaller site, with a significant increase in density that can be developed in a relatively short span of time, and should, therefore, generate some lift in residual land value from the rezoning.

Schooner Cove Static Analysis

The Schooner Cove site comprises roughly 5.93 hectares, approximately 4.67 of which can be considered developable. Under the current zoning of RS5J, CM5J, and WA2Z there would be potential for a total of 12 lots; 11 single family lots and the marina lot. Assuming some costs for servicing and roads these lands as they are now support a value of between \$3.8 and \$4 million (roughly \$260,000 per acre).

The site as proposed in the Fairwinds rezoning would house 4 or more multiple family buildings, including a mixed use development at the marina, for a total of 360 residential units and 22,520 square feet of commercial GBA. GPRA prepared four static proforma analyses for each of the Village mixed use, Waterfront Ridge, Waterfront, and the Commons buildings to determine the supported land value for each. The analyses were prepared utilizing a standard developer proforma that typically follows a “REVENUE minus COSTS equals PROFIT,” format. For the purposes of this exercise GPRA has assumed that the developer’s profit is a fixed number, in this case set at 10% of project revenues (which is lower than the 15% that GPRA would typically allow for), and the money available for land (and any other costs not accounted for in the analysis) being the unknown value that the analysis solves for.

The results of the static analysis do not tell a significantly different story than the DCF analysis of both the Lakes District and Schooner Cove. Even using very ambitious pricing that is significantly higher than evidenced in the market (~\$450 per square foot for the Village and both waterfront buildings, and \$325 a foot for the Commons), **and** without allocation of the servicing and infrastructure costs that Fairwinds has indicated will need to be incurred to develop Schooner Cove **or** allowing for the time-value of money to recognize that the Commons project will not likely be constructed and sold for at least 10 years (i.e. the revenues and costs associated with this development would be lower in relation to the same dollar amounts today if there is even an allowance for CPI indexing over a ten year period), there is only a very small lift created from the rezoning of Schooner Cove.

Figure 1 Schooner Cove Static Analysis

	Village	Waterfront Ridge	Waterfront	Commons	Total
Net Revenue	\$25,402,950	\$19,672,749	\$23,948,725	\$78,074,878	\$147,099,302
Hard Costs	\$16,488,921	\$10,261,792	\$11,602,201	\$51,566,466	\$89,919,379
Soft Costs	\$5,475,866	\$4,436,218	\$5,405,789	\$23,006,072	\$38,323,945
<u>Profit (10%)</u>	<u>\$2,309,359</u>	<u>\$1,788,432</u>	<u>\$2,177,157</u>	<u>\$7,097,716</u>	<u>\$13,372,664</u>
Residual	\$1,128,804	\$3,186,308	\$4,763,579	-\$3,595,376	\$5,483,315
Infrastructure	\$6,137,689	\$1,396,652	\$2,126,681	\$7,277,441	\$16,938,463
Land Residual	-\$5,008,885	\$1,789,656	\$2,636,898	-\$10,872,817	-\$11,455,148

Given the conditions tested in the analysis, even if there were not significant infrastructure costs to be incurred to develop Schooner Cove the lift would be at most \$1.5 million. However, there will be at least some costs attributable to the development of Schooner Cove that will likely more than offset any lift indicated through the analysis that does not include any infrastructure costs.

CONDITIONS AFFECTING VALUE & LIFT

There are several market conditions which contribute to the poor project performance and subsequent low land value supported:

- The Island market felt the economic downturn of 2008 more so than the mainland leading to a deeper and more sustained reduction in demand and pricing in the residential market
- There is no evidence the market would support selling prices that are sufficiently high enough to incur the costs to develop waterfront apartments in this area at this time. Resales from the apartments located adjacent to the Site are around \$200 to \$250 per square foot at this time, not even enough to cover the cost of new construction, parking and soft costs. Even the prices indicated as ‘hoped for’ by Fairwinds and found in projects in Nanaimo in the mid \$400s are barely sufficient to warrant project approval based on GPRA’s proforma analysis.
- Absorption rates are low, which means longer periods that interest expenses must be carried.
- The commercial development at Schooner Cove will command, at \$19 per square foot, less than economic rents than would be required to make the commercial portion viable.
 - Furthermore, there will have to be significant inducements offered to attract the appropriate tenant mix to Schooner Cove, potentially as much as 2 to 5 years of free rent as well as interior improvements and signage allowances. Taking this into account the effective rent would likely be less than \$10/sq.ft. leasable over the initial term of the lease.
- High costs of underground parking and infrastructure will hamper the economics of any development here.

- Even if hard and soft costs were 10% lower than the assumptions used in the analysis there would still not be any lift generated after accounting for infrastructure costs.
- The Commons development has the poorest economic showing of all the developments and lowers the overall supported land value and lift potential. However, even if it were possible to remove the Commons from the equation there would still be no monies left over for Amenities after accounting for infrastructure costs.

CONCLUSIONS & RECOMMENDATIONS

Both the Discounted Cash Flow analysis and the Static Proforma analysis by G. P. Rollo & Associates indicates the supported land value for the Lakes District and Schooner Cove are at best roughly equivalent to the starting value for the Sites under current Zoning. Upon factoring in estimates of infrastructure costs there is actually less value to the land than under current Zoning, all of which indicates that there is no lift created from the rezoning these Sites. This in turn means that there is no possibility for the RDN to secure additional amenity contributions from the Fairwinds as part for the rezoning using these assumptions.

It is worth noting that the infrastructure standards proposed by the developer are higher than would typically be required by the RDN. These standards are driven in large part by site conditions and also by an ambitious vision to build a community like no other in the area. These higher standards are likely related to the high costs of infrastructure and contribute to the lack of a land lift from the rezoning of the Site.

Sensitivity analysis on infrastructure costs indicates that a 10% reduction in costs would yield a land value of \$9.4 million in a current dollar analysis, roughly equivalent to the low end estimate of current value, whereas a 20% reduction would yield a value of \$14 million, roughly the same as the 2012 BCAA assessed value of \$13.6 million. As such, to generate any lift from this rezoning there would need to be a minimum reduction by 10% of the infrastructure costs, and more likely in excess of 20% to have reasonable certainty of a land lift from which the RDN could seek amenity contributions.

There are, however, some amenities that are proposed to be developed as part of the project that the RDN may consider as in-kind contributions already credited due to the inclusion of their costs in the analysis, pending review by the RDN.

There are numerous reasons why the supported land value is lower, even in Schooner Cove that has a significant increase in density in the rezoning, including poor market conditions, low projected selling prices, long holding periods to sell through inventory once built, high costs for construction and underground parking, and high infrastructure costs associated with the development as planned.

However, it must be noted that even when GPRA removes the infrastructure costs entirely from the Schooner Cove analysis there is little lift created and it would be unreasonable to assume there would not be a significant portion of the costs estimated that would have to be borne by any development of this size on the Site.



Furthermore, GPRA has if anything been aggressive in both pricing and in the profit allowance for the projects. Utilizing prices evidenced from GPRA's research or if GPRA were to include standard profit allowances of 15% on project costs there would not be *any* supported land value from the Schooner Cove Site. The same would hold true for the Lakes District in the DCF analysis.

Ultimately, were GPRA preparing a market feasibility study for these Sites we would likely conclude that the highest and best use for the Sites would be to develop under current zoning to current RDN standards which would carry only a fraction of the infrastructure costs that have been proposed. Conversely, another option would be to hold the Sites for a period of time until the market for multiple family matures to support the high costs associated with development.

The high cost to build underground parking also plays a role in diminishing the land value of the Sites as proposed. If, in fact the parking requirements are reduced significantly at Schooner Cove for later stages of development, there could be additional land value supported from development of that Site.

GPRA feels that market conditions may change for the better once initial stages of development at Schooner Cove are completed and higher sales prices may be supported in the market at that time. As well, the aforementioned changes to parking requirements, if approved, would also have potential to contribute to additional land value, and thus lift.

I hope that this informs and assists the Regional District of Nanaimo in their review of the rezoning applications for the Lakes District and Schooner Cove. Please do not hesitate to contact us if you wish to discuss things further.

A handwritten signature in black ink, appearing to read "Gerry Mulholland", is located below the main text.

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