

File No. 04-1000-20-2016-383

November 9, 2016

s.22(1)

Dear s.22(1)

Re: **Request for Access to Records under the Freedom of Information and Protection of Privacy Act (the "Act")**

I am responding to your request of October 20, 2016 for:

Heritage Density Report, by Coriolis Consulting, 2015.

All responsive records are attached.

Under section 52 of the Act you may ask the Information & Privacy Commissioner to review any matter related to the City's response to your request. The Act allows you 30 business days from the date you receive this notice to request a review by writing to: Office of the Information & Privacy Commissioner, info@oipc.bc.ca or by phoning 250-387-5629.

If you request a review, please provide the Commissioner's office with: 1) the request number assigned to your request (#04-1000-20-2016-383); 2) a copy of this letter; 3) a copy of your original request for information sent to the City of Vancouver; and 4) detailed reasons or grounds on which you are seeking the review.

Please do not hesitate to contact the Freedom of Information Office at foi@vancouver.ca if you have any questions.

Yours truly,



Barbara J. Van Fraassen, BA
Director, Access to Information
City Clerk's Department, City of Vancouver

Encl.

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VIA EMAIL

25 April 2016

Mr. Michael Chin
Supervisor Property Development, Real Estate Services, Real Estate and Facilities Management
City of Vancouver
4th Floor – 507 West Broadway
Vancouver, BC
V5Z 0B4

Dear Mr. Chin:

Re: Setting the Value of Heritage Bonus Density in Vancouver

As you requested, I have provided a letter of opinion regarding the process of setting the appropriate value of heritage bonus density.

You asked me to address four specific questions:

1. Is there a difference in the value of heritage density used on the heritage site versus transferrable heritage density?
2. When should the City change the value that it applies to the creation of new heritage bonus density?
3. As of March 2016, what is the appropriate value for new bonus density?
4. If the suggested March 2016 rate is different than the rate the City has recently been using in actual projects, what impacts would this have on the City of Vancouver, developers, and the heritage bonus system?

Description of the City's Heritage Density Bonus System

As background to my answers to your questions, I think it is important to describe in detail how the City's density bonus system works.

The City of Vancouver has the authority to designate buildings as heritage assets that cannot be demolished or significantly altered. However, unless such a designation is voluntary on the part of the property owner,

Section 595 of the Vancouver Charter states that if heritage designation will cause “a reduction in the market value of the designated property, the Council must compensate” the owner.

Such compensation could be in the form of a direct cash payment to the owner, but the City typically prefers to use incentives that do not require the out-of-pocket payment of cash.

Property tax exemption is one of these forms of compensation, but it often does not produce enough benefit on its own to persuade owners to retain and refurbish heritage buildings, particularly in cases where the existing heritage building is at a much lower density on the site than existing zoning or potential rezoning would allow. Usually, compensation much greater than property tax reduction is needed to make up for the redevelopment opportunity that is lost and the extra costs incurred by retaining an existing building.

One way to provide compensation to heritage property owners is to provide development entitlements (i.e. density). Extra density has financial value and can be “created” by the City without having to pay compensation in the form of cash. There are two different ways the City can use development entitlements as compensation for heritage retention:

- Rezoning.
- Heritage density transfer.

Rezoning

The City can rezone sites to increase the allowable development density. Typically, when the City rezones sites it obtains Community Amenity Contributions that are public benefits that help address the impacts of densification on the community. However, when a site with a heritage building is rezoned, the extra density can be used to compensate the owner for the cost of heritage retention rather than used to achieve CACs. A recent example of this approach is the Old Stock Exchange Building in downtown. The developer agreed to retain and fully refurbish the heritage building and, via rezoning, was granted a substantial increase in density to cover the costs of the heritage preservation. This approach could be characterized as a “heritage bonus”, but it is no different in principle than any rezoning: in exchange for increased density, the City receives a public benefit. On heritage sites, the public benefit is the protection of an important part of the City’s history, whereas on other rezonings the public benefit might be daycare, community space, or affordable housing. This approach to heritage compensation obviously only works in cases where the heritage site can accommodate additional density while retaining the existing building.

The City’s approach to valuing the extra on-site density in a heritage project is the same as the approach the City uses in any rezoning, with the appropriate adjustment for the heritage element:

1. The City estimates the market value of the site under existing zoning as though vacant, using comparable site sales evidence and sometimes residual land value analysis.
2. The City and the developer come to agreement on the cost that is imposed by the retention of the heritage building on site. This might simply be the cost premium for renovation over new construction, or it might also include any extra costs on the non-heritage part of the project that result from working around the heritage building (e.g. unusual shoring and stabilization cost, the cost of extraordinarily deep underground parking).
3. The City and the developer come to agreement on the value of adding extra density to the project, based on the current market value of the extra density as it will be used at this location. So, if it is a residential project the extra density is valued at residential values and if it is an office project it is valued at office values, adjusted for the specific features of the site.
4. The aim is to balance the value of extra density against the cost of keeping the heritage building. If the value of the total proposed additional density is greater than the cost of the heritage retention, the developer might also provide a CAC.

The key point about valuing extra density used on site is that it is based on the market value of the proposed use at that location at the time of the application.

Heritage Density Transfer

To deal with cases when more density cannot be developed on the heritage site (usually because there is not physically room to accommodate the density without impairing the heritage building), the City can use Section 595A of the Vancouver Charter which gives the City the authority to use a “heritage density increase transfer system” as a means of compensating owners who retain and refurbish heritage buildings.

This density transfer system is described in detail in City documents including “Heritage Policies and Guidelines” and “Transfer of Density Policy and Procedure”, as well as City web site pages under the heading of Heritage Conservation. The transferrable bonus system works as follows:

1. The value of the subject heritage site is estimated based on its redevelopment potential under existing zoning, assuming demolition of the existing building. This is the market value of the property in the absence of an obligation to retain the heritage building.
2. The retention/refurbishment of the heritage building is analyzed in financial terms to calculate the value of the property if the existing improvements in their present condition must be retained.
3. For existing improvements that are under-developed relative to allowable density under existing zoning (or that are more costly to renovate than to build new), the market value in step 1 above is usually higher than the value in step 2 above. The difference between these numbers is the amount of compensation needed to make an owner whole in financial terms if the building must be retained.
4. To provide the necessary compensation, the City can provide density (i.e. development entitlements) to the heritage building owner. This density might be equal to the unused density under existing zoning (e.g. a site is zoned for FSR 5 but the existing improvements only use FSR 2, so there is FSR 3 of “unused” density on the site) or might be more than this if the unused density does not have enough value to fully compensate the property owner. In either case, to be useful to the owner as compensation this density must be transferrable off the heritage site. To create a market for the purchase of transferrable heritage density, the City has designated “receiver areas” to which the transferrable density can be exported. The density can be used on a site the heritage developer owns or sold to any party that owns a site in a receiver area. To facilitate the market take-up of transferrable density, in receiver areas development projects can achieve up to 10% more than the density allowed under existing zoning without having to go through the rezoning process. For example, a site in a receiver area that could be developed to FSR 5 under its existing zoning is allowed to achieve FSR 5.5 without going through a rezoning process if the extra 0.5 FSR is transferred heritage density. As another way to create a market for transferrable density, the City can require that a property being rezoned achieve some of the increased density by acquiring transferrable heritage density. For example, in the Cambie Corridor developers provide Community Amenity Contributions in exchange for increased density. Up to 10% of the CAC can be in the form of acquiring transferrable heritage density.
5. The City and the heritage developer negotiate to agree on the amount of transferrable density that is appropriate for a given project. That developer then completes the heritage renovation and owns the agreed-on transferrable density (i.e. square feet of development entitlements) that the developer can use on another property or can sell to others.

For this system of transferrable density to work and be sustainable over the long term, heritage property developers must want to use this approach to compensation. They must perceive that the City will provide sufficient transferrable density to make heritage retention worthwhile and they must have confidence that the transferrable density they accept as compensation will be saleable and will retain or increase its value. This means the City must be careful with regard to the pace at which it creates new transferrable density. If it creates new density faster than the market can take it up, then the price will fall.

The inventory of approved transferrable density that has not yet been transferred to development sites is sometimes called the “density bank”, although this is a misnomer. The un-transferred density is not held by the City in a single “account” awaiting transfer. The inventory is simply the sum of individual approved density bonuses that are owned by various heritage project developers and that have not yet been transferred to and incorporated in a development project. As of October 2015, City records show that there is a total of about 760,000 square feet of bonus density (held by about 16 owners) that had not yet been used. The City estimates that about 336,000 square feet of this space has been earmarked for specific projects even though

the transactions have not been completed, so as of October 2015 there appears to be about 423,000 sq.ft. considered to be available on the open market. The available inventory is large relative to the rate of take-up, so the City currently is not creating much new transferrable density. There have been only two such projects approved since 2007. At present, the City prefers to grant heritage bonus density when it can be used on site, rather than having to be transferred.

There is at any given time a market price for the transferrable density available for purchase on the open market. One might think that the value of transferrable density (expressed in dollars per square foot of developable area) might be similar to market values for development sites and this would be the case if there was a relatively small supply of, and high demand for, transferrable density. However, the marketplace for transferrable density is very different than the general land market for development sites in several important ways:

- there is a limited number of sellers (at present only about 16 parties own density and not all of these are interested in selling),
- there is a limited number of potential buyers, consisting of developers who have properties in designated receiver areas and who want additional density,
- the value that a buyer is willing to pay depends heavily on how the density will be used (e.g. if it is used for residential development it would be more valuable than if used for office development), and
- the supply and demand relationship of transferrable density can be very different from the supply and demand relationship of development sites on the open market.

These particular market characteristics have three important consequences.

- there are relatively few transactions (8 purchases in 2013, 15 in 2014, 17 in 2015).
- the value of transactions can vary widely in any year, depending on the motivations of sellers and buyers and the nature of the individual transaction. For instance, in 2015 the price paid per square foot ranged from a low of \$25 per square foot to a high of \$65 per square foot. I understand that the low end of this range was a non arms length transaction (the owner of the heritage density transferred it at book value to another project by the same developer) and the high end represented open market transactions.
- the average transaction price (in dollars per square foot) tends to be much lower than prevailing land values as expressed in dollars per square foot buildable. As an illustration, transferrable density transactions to date in 2016 have been in the range of \$65 to \$75 per square foot of buildable space for projects in the core area of Vancouver, whereas land values in this area are about \$160 per square foot buildable for office sites and \$250+ per square foot buildable for residential development sites. This discount is due to the fact that for a time the City created new transferrable density faster than the market has taken it up (there is currently about 3 or 4 years of density available, but there have been times when there were more than 10 years worth of supply) and due to sellers being willing to sell at this price to ensure they receive their compensation and avoid the risk of future price decline.

The “going rate” for transferrable density on the open market is an important consideration in the negotiations between the City and the owner of a property being considered for heritage designation.

Suppose the City and a property owner agree that the market value of a subject site, without heritage retention, is \$5 million and that heritage retention/refurbishment supports a site value of only \$4 million. This means the property developer would want at least \$1 million in compensation to keep the heritage building. If the going market rate for transferrable density is \$40 per square foot, the owner would want 25,000 square feet of extra density (because 25,000 x \$40 is \$1 million). But if the going rate is \$50 per square foot, then the owner would only need 20,000 square feet of transferrable density.

The heritage property owner negotiating with the City has an obvious motivation to make sure the density bonus is not priced at more than market value. If the owner accepts an amount of density on the assumption it is worth \$50 per square foot, but it turns out that the achievable price is only \$40, the owner will not realize

the full amount of compensation needed. The City also has an important reason for getting the price right. If it tries to use a price that is too high, heritage property owners will not want to use the incentive system. If it uses a price that is too low, then it is creating more new transferrable density than necessary. If the City creates more transferrable density than the market can take up in a reasonable time, the price will fall, meaning even more density must be approved for the next heritage project.

The City needs to be careful with regard to the rate of density creation. It should not provide more than necessary in any single heritage project and it should be careful regarding the total density it approves in new heritage projects or else the “bank” will just keep getting bigger and price will collapse.

The City monitors all transactions of transferrable density and based on these transactions tends to set a rate that it uses in negotiating new heritage bonuses. For administrative ease, the City has tended to adopt a sort of posted rate, which it adjusts from time to time. I understand that the City used a rate of \$25 per square foot when the system was initiated in 2003, and changed the rate to \$50 in 2004 and \$65 in 2008.

The chart below summarizes transferrable density transaction data for several recent years.

	Number of Purchases	Total floor space (sq.ft.)	Lowest Transaction Price (\$/sq. ft)	Highest Transaction Price (\$/ sq. ft)	Median Transaction Price (\$ per sq. ft)	Weighted Average Transaction Price (\$/ sq.ft).
2013	8	175,000	\$37	\$65	\$47	\$52
2014	15	114,000	\$40	\$68	\$60	\$51
2015	17	160,000	\$25	\$67	\$65	\$48
2016 (to end Feb)	2	66,000	\$65	\$75		\$72

The chart shows the wide range in individual transaction prices. The chart also shows that the upper end of transactions during 2013, 2014, and 2015 was consistently around \$65 in part because this is the rate the City tended to seek based on the transaction evidence available. In other words, the transaction evidence helped create the City position that the “right” rate was \$65, which in turn tended to influence the City’s negotiations to achieve this number. This is further evidenced by the median values, which in 2014 and 2015 are above \$60 (the median value means that half of all transactions are at or above this rate). Finally, it is also interesting to note that the weighted average transaction price was very consistent over 2013 to 2015, at around \$50, but that the weighted average price has jumped considerably in 2016 (albeit based on only three transactions in January and February).

This jump in price does not appear to be due to diminished inventory of available space, as there are over 400,000 square feet available for sale (i.e. about 3 to 4 years worth of transactions at the recent rate of absorption) as of March 2016. Nor does the price jump appear to be due to dramatically increased activity as 3 transactions in 2 months is equivalent to 18 per year, on par with recent activity (17 transactions in 2015).

In my view, the jump is likely due to the dramatic rise in downtown development site values in the recent past, associated with increased residential unit prices and office rents. While transferrable density clearly trades at a significant discount to market land values, it nonetheless responds to increased demand and rising prices for new residential and commercial floor space.

Response to Questions

I turn now to the four questions you asked me to address.

1. *Is there a difference in the value of heritage density used on site versus transferrable heritage density?*

The values of on-site bonus density and transferrable bonus density are determined by very different market factors. While it is theoretically possible under some market conditions that the numbers are very similar, it is far more likely that at any given time the numbers will be different.

Density used on site is valued based on the current market value of the proposed use (e.g. office, residential) in that specific location at the time of application.

Transferrable density is valued based on how much transferrable density is available on the market, how many developers are looking to buy such density, and the willingness of current owners to settle for a price in order to obtain the cash that is supposed to compensate them for a past heritage investment. Transferrable density is a small submarket of the overall development market, with a small group of sellers and potential buyers.

Transferrable density would have a similar value to on-site density only if there is a small supply of transferrable density relative to take-up. If there are more sellers than buyers (as at present) transferrable density will trade at a discount.

2. *When should the City change the value that it applies to the creation of new heritage bonus density?*

For bonus density used on site, the density should be valued based on current market conditions for the applicable use in the applicable location, just as in any rezoning. The City may have knowledge of prevailing values, which could make the analysis easier, but there is no “established rate” that is set for a specific length of time.

For new projects seeking transferrable density (assuming the City resumes using this vehicle to facilitate heritage preservation), the value of the density should be based on recent applicable comparable transactions. In practice this will be challenging, because there are few transactions and some of these will be outliers, either low or high, based on unique circumstances. So, the City needs to adopt a consistent approach to determining the density value it will use each time it enters into a negotiation with a developer interested in a heritage project. We suggest this approach:

- Continue to monitor and record all transactions.
- To the extent possible, flag any transactions that are non arms length or for which there is some indication that they are not true market indicators (e.g. a distress sale, an unusually motivated purchase, or an internal transfer between related entities).
- Calculate the weighted average of the recent “valid” transactions, either quarterly or on a semi-annual basis.
- Use that figure as the starting point of negotiations for each new project.
- Be open to market evidence presented by the developer, particularly if there is compelling evidence that the City number is too high. The developer has to be able to actually sell the density in order to realize the incentive.

This means the City may at any given time have an approximate price that it can communicate to interested parties in the early stage of considering a project, but the City should not describe this price in terms that suggest it is fixed for some calendar period. Choosing this value is not at all similar to (for example) the City setting the DCL rate for a fixed time with a periodic adjustment. The value of density is always changing based on market trends, so it should be adjusted in real time as appropriate.

3. *As of March 2016, what is the appropriate value for new bonus density?*

The appropriate value for new on-site density is the current market value of land (in dollars per square foot buildable) that applies to a subject project.

The appropriate value for new transferrable density appears to be about \$75 per square foot based on transactions in early 2016. This is significantly lower than prevailing land values.

4. *If the suggested March 2016 rate is different than the rate the City has recently been using in actual projects, what impacts will this have on the City of Vancouver, developers, and the heritage bonus system?*

For new heritage bonus density used on site, the City will always use current market value based on land values for the applicable use(s) and location. This number will change with market conditions for development properties. If the City has been using numbers less than market value, this will benefit land owners and developers, to the extent that they will capture the difference between real market value and the value the City has applied in a heritage negotiation. There is no market-wide negative impact.

For new transferrable density, we understand that the City has been tending to use \$65, which is lower than the current market value.

If the City uses \$75 as the target (until such time as the market price changes materially), there are various impacts on all stakeholders. To address these impacts, it is important to first explain what happens if the target is too low or too high.

If the City uses a price for newly created transferrable density that is materially below the actual market value, it means it is giving out more bonus density than is needed in financial compensation. Giving out too much density is good for the developer striking the deal at the time, who gets more density than is warranted, but it is bad for the overall system. Creating too much transferrable density will put downward pressure on the market price. This harms developers who already hold transferrable density from previous heritage projects, could inhibit other developers from doing heritage projects, and means that the City has to keep giving out more density than it otherwise would have for new heritage projects. In effect, creating too much new density in the “bank” is like printing currency to pay bills: it inevitably leads to devaluation, which requires printing ever more new currency.

If the City insists in negotiations on a density price that is materially above the actual market value, new heritage projects won’t happen. The incentive will not be sufficient to compensate developers for lost value due to heritage retention. This would be good for developers who already hold transferrable density from previous projects (because the supply of new density will be choked off) and will help shrink the total inventory of un-used density, but it will detract from the broader goal of heritage building protection.

It is likely that the optimal market price trajectory over the long term for transferrable density is that it is rising (meaning it proves to be a good investment for heritage developers) and it is trading at a small discount to prevailing land values so owners of potential receiver sites have an incentive to buy density.

So, the impacts of shifting from \$65 to \$75 will be as follows:

- Using the current market value will not have a negative impact on potential new heritage projects. It is possible there would be a negative impact on any project already being negotiated based on the amount of density that would be created using a \$65 price, so these may need to continue at the “old” rate.
- Using the current market value is good for developers who already hold transferrable density from previous heritage projects, as the pace of new supply creation will be slower than it would be if the City uses a rate that is too low.
- Using current market value is good for the City, as it helps avoid creating too much density, which would have the effect of devaluing it. Using current market value also helps maintain confidence in the system. Developers would be less willing to participate in the density bonus system if they perceive a high likelihood that the City will over-create density and drive down the value. Why would a developer agree to accept transferrable density in exchange for heritage protection if the developer believes the value of such density could fall because the City gives out too much to the next developers coming through the heritage bonus system?

Conclusions

I close with these observations:

1. It is important for the City to keep in mind that the values of on-site and transferrable heritage density are set in real time in the market. These values will always be in flux, so there is not a cost-based rate such as a DCL that can be “set” for some fixed time and adjusted on a pre-determined schedule. The City must constantly monitor transactions (land purchase transactions for on-site density and transferrable density transactions for transferrable density) to understand the current value of the density each time it negotiates a new heritage retention project.
2. Setting the value of transferrable density too low for any new project will be good for that developer (who obtains more density than is really needed as incentive) but it makes the system weaker. Setting the value too low results in over-creating new density, which puts downward pressure on price. This hurts

developers who already own transferrable density. Reduced price due to over-supply also leads to even more supply creation, to provide sufficient compensation to the next heritage developer seeking a deal. This downward price spiral will lead to a collapse of the system. The sustainability of the transferrable density system depends on the City using market price when creating new density.

3. The transferrable density system depends on trying to ensure that the pace of creating new density in heritage projects is broadly in step with the pace of absorption of the already-existing inventory of unused density. This limits the amount of heritage retention that can be funded using this approach, but it is essential for the sustainability of the system.

Yours truly,

CORIOLIS CONSULTING CORP.

A handwritten signature in black ink, appearing to read "Jay Wollenberg". The signature is stylized and cursive.

Jay Wollenberg