



MEMO TO COUNCIL

Date: Oct. 16th 2014 **From:** Sage J. Baker
Economic Development

Subject: Land / Intergovernmental Negotiations – 812 Wharf St.

Closed Meeting Rationale

This memo is recommended for consideration at a closed meeting as it pertains to negotiations regarding the proposed acquisition of land. Consideration of this memorandum in a closed meeting is authorized under Section 12(3)(e) of the Council Bylaw.

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Executive Summary

From the discussions Council defined 812 Wharf St as a key asset for the citizens of Victoria because of its historical significance, position in the harbor, linkages to public facilities (walkway, event space at 814 Wharf St, restroom facilities etc.) and also balanced with the financial potential for gain.

This report follows up on the motion passed on September 11 (motion attached as Appendix 1) directing staff to move forward with the potential acquisition of this property. S.17

The building at 812 Wharf St. is a strategic long-term asset for the City to own as the development of the waterfront continues and this potential purchase is supported by the fact that the financial returns for the building are able to cover all costs of ownership ensuring that the City and its taxpayers are not out of pocket on this purchase.

Recommendation

That Council:

1. Direct staff to move forward with the purchase of 812 Wharf St and authorize the Mayor and Corporate Administrator to execute a purchase and sale agreement and other necessary documents, in a form satisfactory to the City Solicitor, assuming a price not to exceed \$8.0 M.

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Additional Information

Since the last meeting staff has continued in conversations with the Province (as directed by the motion from Sept. 11, 2014 attached as Appendix 1) to understand their commitment to this potential sale as well as their needs/desires for this to be a successful transaction for them, which will help build the foundation for a positive negotiation.

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Over the next few weeks the core discussion focused on testing the Province's price floor to ensure realistic expectations between both parties related to a feasible purchase price for the City. After various meetings and discussions we were able to have agreement from them that we would not be paying full price given the desire for an 'as is' transaction. We further tested their tolerance of discounted pricing being quite aggressive on the desired price range in our Expression of Interest (attached Appendix 4), and after a number of additional strong conversations, was accepted by them and signed this week on Oct. 15th putting the City in a position of strength noting the range of price expected to be between \$7.5 M - \$8.0 M.

Financial Business Case – Appendix 3

From a financial perspective the potential purchase of this building would be funded from our buildings and infrastructure reserve fund (approximately \$31M balance), which is earning interest in the range of 2%. The costs of using this capital would be the opportunity cost of lost interest on reserve balance at current GIC interest rate. With this we have modeled the time to pay back assuming an internal borrowing rate of 2% interest.

Debt Assumptions for property purchase considerations:

Reserve balances are insufficient to purchase property outright, therefore all scenarios are based on the payback of the full balance.

Internal borrowing rate: 2% = opportunity cost of lost interest on reserve balance at current GIC interest rate

BC Assessed Values for the building are just over \$8.7 M and the Province's appraisals range between \$8.4 - \$8.7 M. During the due diligence phase we will be testing the appraisal assumptions to come back with a proposed value to the Province which is less than the current values. We have modeled various purchase prices from a low \$8 M up to a max of \$8.4.

Working with the current revenue and expenses numbers from the Province the building provides estimated annual income of approximately \$470,000. Assuming interest rate stability, and the financials as defined by the Province, the City would have full ownership of the building and the loan from the buildings and infrastructure reserve paid back in approximately 21 years leaving the City with an asset generating approximately \$470,000 annual income moving forward. During the due diligence process we will of course be validating the leases, their

terms and any risks associated with the revenue associated with these leases.

	Option #1	Option #2	Option #3
Repayment of internal borrowing using estimated net surplus			
Purchase Price = Total borrowing amount	8,400,000	8,200,000	8,000,000
Rate of Interest = 2%			
- annual P&I payment	475,703.76	482,035.11	489,253.75
- payback period	22 yrs	21 yrs	20 yrs

Thus, given our current approved allocations of this fund, our costs of borrowing and the projected returns from the building, the Director of Finance feels there are sufficient funds to cover the purchase of this building and are comfortable recommending the purchase to Council.

Property Management

The CWPC appraisal prepared for the Province has Op Costs for the year to April 2014 of approximately \$200,000, comprising security (\$15,150), roads and grounds (\$28,058), maintenance and repairs (\$35,245), life and safety (\$1,139), utilities (\$36,579) and operations center which covers the restroom facilities (\$82,975).

Although the subject leases note the total percentage share of op costs for which the tenants are responsible is 92.03%, however, it appears that the amount actually recovered was less than this and it is our understanding that this is related to the costs for the restrooms not currently being passed down to the tenants. This will be clarified during due diligence.

There are a number of items not included in the above costs such as structural elements, capital costs etc which will also be assessed during due diligence. Given the Province's requirement for this potential purchase to be 'as is, where is' we want to ensure that we have a clear understanding of the additional costs that may be incurred (which will also help us reduce the purchase price during negotiations).

It is recommended by staff that the near term approach for Property Management on this building follows the same approach as our other real estate assets (such as VCC). Richmond Property Group charges 4% of the gross revenue billed through them at VCC (rent + op costs) – this is a fairly standard percentage and is what is used in the financial modeling (as it is the same as the Province was paying). Leasing costs – DTZ Victoria charges 5% of the base rent for each year of the first five years of a lease at VCC. On an annual rent roll of \$554,000, this would equate to \$27,700 per year, which is also within the range of expenses modeled.

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Next Steps

Task	Timeline
City executes the EOI and enters into discussions with the Province	Complete
Council consideration to move forward or not	In process – Oct. 23
If decision supported to move forward, City & Province work through core terms. City work to finalize offer, in the form of the purchase agreement based precedent provided by the Province and in accordance with Council instructions	Oct. 24 – Nov. 3
Province accepts the offer, becomes a binding agreement (subject only to any terms and conditions in the agreement) and the City pays agreed deposit to the Province	Week of Nov. 3
Province provides relevant materials for City's due diligence (leases etc) and the City conducts inspections as necessary (understanding Province's desire for the purchase to be 'as is where is' with as minimal impacts to the tenants as possible)	Oct. 24 – Nov. 10
Assuming the City is satisfied with due diligence and inspection results, City removes the "subject to" conditions and the transaction can proceed, if City is not satisfied with something it may require either another report to Council in order to seek new instructions or refuse to remove conditions and transaction fails (deposit returned)	Week of Nov. 10
Upon removal of the "subjects" and conditions, joint deal announcement made	Week of Nov. 10
City and Province work together to finalize all the necessary documents to complete the transaction	December
Complete the transaction, transfer funds, transfer title, etc... aligned with close dates as determined by both parties	TBD based on desired closing dates

Summary

Example risks for consideration – currently estimated to be medium level risk – some market risks and the rest will be addressed during due diligence

1. The Province has under estimated capital requirements for the building thus increasing the operating costs - these capital costs could be significant, in addition an annual contribution toward future capital replacement costs (depreciation) should be added
2. Over time the City's property management costs run higher than the Province's which have been used for modeling
3. The tenants evolve due to market constraints

Example rewards for consideration – currently estimated to be high level rewards – positive acquisition aligned strategically with other properties such as 814 Wharf St.

1. Restrooms remain as public use and the City could pursue a new cost sharing agreement with other relevant parties such as the GVHA,
2. Building could be managed more efficiently increasing annual income,
3. Leases evolve towards market rates increasing annual income – e.g. seeing Tourism Victoria increase their lease rates towards market could bring an extra \$30,000 annual income decreasing the pay back period to be less than 20 years.

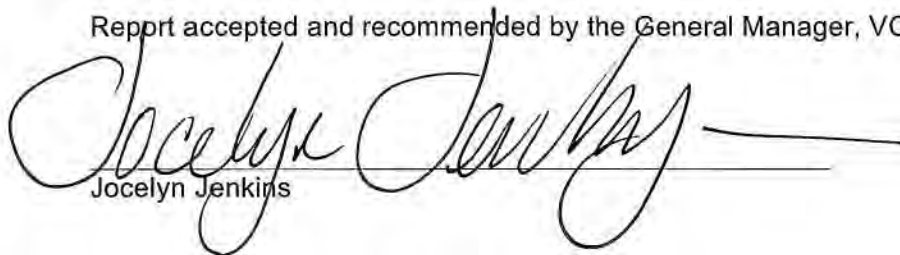
Given the strategic value of the building and location, the income generated combined with the low interest lending rates to offer a strong opportunity for the City of Vitoria. Staff recommend moving forward towards a purchase agreement with the Province for 812 Wharf St assuming that the agreed purchase price is below assessed values (not to exceed \$8.0 M) to compensate for any additional risks (that will be more deeply understood through due diligence) in the 'as is, where is' purchase scenario.

Respectfully submitted



Sage J. Baker
Executive Director Economic Development

Report accepted and recommended by the General Manager, VCC:



Jocelyn Jenkins

Appendix 1

Council motion from Sept. 11

1. That Council formally express interest to the Province in moving forward with the potential purchase of 812 Wharf Street.
2. That Council authorize the Mayor to send a Letter of Intent, in the form acceptable to the City Solicitor, to the Province of British Columbia to express the City's interest in continuing discussions regarding the possible purchase of 812 Wharf Street generally set out in the memorandum dated August 28, 2014.
3. That Council authorize City staff to continue the discussions with the Province of British Columbia regarding the possible purchase of 812 Wharf Street generally as set out in the report dated August 28, 2014 and return to Council with a proposed purchase plan.
4. That Council direct staff to develop a property management plan for 812 Wharf Street as a part of the business case.

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Appendix 3 – Financial Analysis

FINANCIAL REPORT Estimated Cash Flow Scenarios

Organization Name: City of Victoria
Project/Programing Name: 812 Warf St
Date: October 6, 2014

Based on 2014 - 2015 forecast per CWPC Report

<u>Commercial Revenues</u>		Area (sq ft)	S.17	S.17	S.17
	SALTS	114			
	Maple Leaf Gifts	1,905			
	Tourism Victoria	3,318			
	Prince of Whales (Causeway Level)	2,498			
	Prince of Whales (Middle Level)	1,742			
	Milestone's	11,537			
-	Base Rent				560,396.40
-	% of Gross Sales				-
-	Tenant recoveries (92.03% of Operating costs below)				430,669.11
-	Other - ATM lease				4,000.00
Subtotal Revenue					995,065.51
<u>Expenses</u>					
<u>Operating Costs</u>					
	O&M				200,000.00
	Property Insurance				27,500.00
	Property Taxes				200,000.00
	Property Management fees - 4% of revenues				40,466.00
	Total Operating Costs				467,966.00
<u>Stabilization</u>					
		% of rent payable			
-	vacancy allowance	2%			19,901.31
-	collection loss allowance	1%			9,950.66
-	structural repairs	2%			19,901.31
					49,753.28
Total outlay					517,719.28
Net surplus (deficit)					477,346.23

Purpose of the Cash Flow Statement

The estimated cash flow statement identifies all current and potential revenue and expenses for the addresses located at 812 Warf St.

Estimates are based on the Cash Flow Analysis provided in the CWPC report.

Rate/sq ft for Tourism Victoria has been adjusted to include an amount for 'in kind' services

Debt Assumptions for property purchase considerations:

Reserve balances are insufficient to purchase property outright, therefore all scenarios are based on the payback of the full balance.

Internal borrowing rate: 2% = opportunity cost of lost interest on reserve balance at current GIC interest rate

Estimated net surplus **477,346.23**

	Option #1	Option #2	Option #3
Repayment of internal borrowing using estimated net surplus			
Purchase Price = Total borrowing amount	8,400,000	8,200,000	8,000,000
Rate of interest = 2%			
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Appendix 4 – Fully Executed Expression of Interest



October 10, 2014

CONFIDENTIAL

Mr. David Greer – Executive Director
Real Estate Property Division
Ministry of Technology, Innovation and Citizens' Services
4000 Seymour Pl
PO Box 9412, Stn Prov Gov,
Victoria BC V8W 9V1

Dear Mr. Greer:

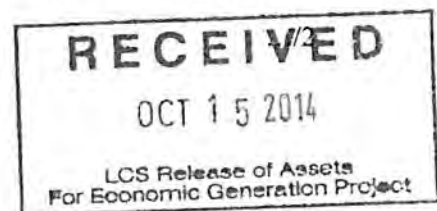
RE: Expression of interest to purchase 812 Wharf Street

The purpose of this letter is to notify the Province of British Columbia (the "Province") of the City of Victoria's (the "City") interest in purchasing 812 Wharf St. otherwise known as the Victoria Tourism Information Centre building.

If the Province would like to discuss the potential sale of this real estate on the general terms set forth in this letter, with a final price to be determined but estimated to be in the range of \$7.5m - \$8.0m, please sign and return a copy of this letter to the City at your earliest convenience.

Non Binding - The proposed purchase of real estate contemplated by this letter is subject to the negotiation and entering into of a definitive agreement (the "Purchase Agreement") between the City and the Province. This letter is an expression of intent only and it does not result in the formation of a binding agreement between the City and the Province other than in respect of terms under the headings "Confidentiality" and "Exclusive Negotiations" which will be binding obligations on the City and Province in accordance with their terms. This letter does not require either party to negotiate in good faith or to proceed to the completion of a binding Purchase Agreement.

Confidentiality – Until such time as the City and the Province agree otherwise, the City and the Province agree to maintain the confidentiality of this letter and the terms and conditions contained in this letter, except for disclosures that may be required by law.





Exclusive Negotiation - The Province will not participate in any negotiations regarding the disposition of, or dispose of, 812 Wharf Street, unless either (1) the City and the Province do not enter into a binding Purchase Agreement within three months from the time of acceptance of this letter by the Province, or (2) the City and the Province agree in writing to terminate this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Dean Fortin".

Dean Fortin
MAYOR

City of Victoria:

The above letter reflects our mutual understanding and sets forth the basis for discussing a Purchase Agreement as outlined above.

DATE OF ACCEPTANCE: OCTOBER 15, 2014.

Province of British Columbia:

Signature

A handwritten signature in black ink, appearing to read "David Green".

DAVID GREEN.

Print name

Cc. Jason Johnson, City Manager
Tom Zworski, Solicitor