PRELUDE MIXED-USE DEVELOPMENT BUSINESS PLAN

by

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Abstract

The purpose of this paper is to assess the feasibility of Prelude, a land development project that proposes a mix of uses in City Centre, Surrey, BC.

Market research needed to focus on both hotel and condominium markets. Additional research was needed to confirm the cost projections of the pro forma.

Research was collected in several ways. Some data was mined from municipal websites, other data was gleaned from industry organizations and even further material was harvested from talks with industry experts.

Research results largely supported the projections of the pro forma. However, in some cases, the results prompted changes to the financial forecasts. Results also identified certain risks and caused mitigating solutions to be considered. The process resulted in the project being recommended for investment.

Executive Summary

This paper provides an analysis of the potential investment in a mixed-use development project called Prelude in Surrey BC. The Prelude project is a hotel/office/condo development in excess of 400,000 square feet. After a thorough due diligence process was undertaken the conclusion reached was that the project should be advanced to the next phase. The following steps were taken to arrive at this conclusion:

- Complete analysis of the hotel and condo market
- Financial pro forma was built and tested
- Schematic drawings were sufficiently detailed in order to confirm costs
- Thorough product costing was completed
- Key risks moving forward were flagged and mitigating solutions found

The proposed Prelude is a substantial project with commensurate risk. This is clearly recognized. However, the research shows that support for advancing the project is justified. The implementation plan identifies performance thresholds at several intervals, which must be met before subsequent investments can be made. Therefore it is recommended that the project proceed.

Dedication

This work is dedicated to Heather, Oliver, Georgia and Declan, who put up with an absentee husband and father for the nearly 2 years that it took to work on my degree. Your understanding attitude and patience on the many late nights and weekends did not go unnoticed. I write this as we enter the homeward stretch, and I look forward to making it up to you all.

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Thanks too go to Team Phoenix. The hours working together on projects, though daunting at the time, have produced many memories and a few good laughs.

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Glossary

Cap Rate	Or Capitalization Rate, is the ratio between the net operating income produced by an asset and its capital cost (the original price paid to buy the asset) or alternatively its current market value.
SF	Abbreviation for Square Feet. Land development industry still very much adheres to imperial units of measurement.
PSF	Abbreviation for Per Square Foot. See above.
FAR	Abbreviation for Floor Area Ratio. Measures the ratio of total building area in relation to site area.
MLS	Abbreviation for Multiple Listing Service. Is a cooperative system for the 98,000+ members of the Canadian Real Estate Association (CREA), working through Canada's 101 real estate boards and 11 provincial/territorial associations.

1: Introduction

1.1 The Surrey City Development Corporation (SCDC)

1.1.1 Background

Established in 2007, the Surrey City Development Corporation (SCDC), is a wholly owned subsidiary of the City of Surrey with a mandate to initiate, lead and facilitate real estate developments to create community, social, environmental, cultural, economic and financial benefits for the City of Surrey. SCDC was created in the belief that a city-owned corporation, with seasoned real estate expertise, taking a private sector approach, could help achieve strategic community objectives, optimize the use and value of city-owned lands, leverage civic facilities to encourage private sector projects and produce long term financial returns to the City.

1.1.2 Mandate

The corporation's mandate is threefold. Firstly, it is to develop city owned land or acquired land for a profit. Secondly, it is to build an income producing real estate portfolio through development or acquisition of an existing asset. Thirdly, it is to pursue the type development that is undersupplied by the private sector.

1.1.2.1 For-Profit Development

The city of Surrey currently owns hundreds of acres of development land throughout the city. Historically, it has divested itself of development parcels through it own realty department to private sector land developers. These developers have added value to the land through rezoning, servicing and construction and have made huge profits in the process. The city feels that it is able to participate in some of the additional profits by engaging in the development process itself. In this respect, SCDC is mandated to act like a private developer

1.1.2.2 Real Estate Portfolio

Other municipalities have in the past been in similar situations as that of Surrey in that they have been owners of large tracts of land that have been sold off over the years. In many cases the sale proceeds were added to annual operating budgets. While this helped to keep property taxes low in the short term, eventually the asset was gone and the municipality was left with no revenue producing real estate assets. With this in mind, Surrey has mandated that when a bare land asset is divested of, a portion of sale proceeds be invested into the building of an income producing real estate portfolio. The goal is to have a $500 million portfolio within 10 years of start up.

1.1.2.3 Non Financial Objectives

The third aspect to SCDC's mandate is to advance the development of projects not likely to be supplied by the private sector. The obvious projects in this category are those that address a social need such as low-income housing. However there are other objectives as well. SCDC can be the catalyst for further development by demonstrating to the private sector that previously neglected areas of the city can be profitable. The corporation can also act as an extension of the Economic Development Office in that it can develop pieces of infrastructure or amenities that may be preventing certain business from investing or relocating to Surrey.

1.1.2.4 Operations

The yardstick by which success is measured for SCDC is no different than that of any other private development company. The corporation must produce profits. No potential project will be given the green light without demonstrating that it has been conceived on the foundation of a sound financial pro forma.

While SCDC's mandate allows it to develop property on its own without financial partners, it also has the latitude to mitigate risk by entering partnerships with other financial or development entities. These partnership arrangements are not overly prescriptive and grant SCDC a wide range of options in terms of the final form of partnership. This paper will discuss in particular a development opportunity with a potential joint-venture (JV) partner in Surrey City Centre.

1.2 The Prelude

1.2.1 Site Context

The actual product/service, Prelude, is a mixed-use land development project of more than 40,000m^2, encompassing condominiums, office space and a hotel. Before the specifics of the project can be analyzed, the physical location of the site must be put into context so that its strategic importance can be appreciated.

1.2.1.1 Context: History

The City of Surrey was incorporated in 1879. For the better part of the next century it slowly emerged from its agricultural roots to become a bedroom community for Vancouver, offering starter-home possibilities for young people and new immigrants. Over the last quarter of a century however, the city has struggled to shake the “second-fiddle-like” role of the bedroom community and begin to find its own identity as the province’s next major metro centre.

During this period of time, Surrey’s administration had been housed in modest structures that reflected its self-proclaimed pragmatism and these structures were located in suburban, park-like settings that aligned with the City’s identity within the region. The early City Halls were in Cloverdale, but these had been abandoned by the middle of the 20th century as a new hall was built on a lush garden-like eight hectares near King George Boulevard and Highway 10. The last 50 years have seen additions and annexes built in an ad hoc fashion, resulting in a rather unwieldy labyrinth that bears the distinct resemblance of a rabbit warren. Talk of a new facility has surfaced and resurfaced for years but the extravagance of such a move did not seem to align with its prided pragmatic history.

1.2.1.2 Context: Economic Development

The current mayor, Diane Watts, first elected mayor in 2005, resurrected such talks with renewed purpose and fresh vision. It was a much bigger vision however than just a new City Hall to house the 750 head office workers. She saw the move as a tool to leverage more economic development in an area of Surrey that the city was working hard to revitalize and re-brand. The area of Whalley had been the punch line of jokes for the past half century. It was a hardscrabble area, high on crime and low on redeeming qualities. It is generally bounded by 100th Avenue on the south, 132nd Street on the west, 112th Avenue on the north and 140th Street on the east. The Mayor made it clear when elected that one of her top priorities was to clean up Whalley. She realized this could not be done on her own. She would need the private sector to invest in the area. Natural attrition was needed where good development displaced the less desirable. To this end she initiated an Economic Action Plan. This plan identified certain areas of the city where municipal fees where substantially reduced for new developments. In addition, property tax vacations were offered to new developments. The hope was that this would be enough to attract investment to the area. Though a response was prompted, it was not overwhelming. Mayor Watts believed that if Surrey expected a few bold corporations to make the pioneer-like move to locate head offices to the rebranded Whalley, it had better lead by example. It became a staple of her pitches to business leaders and investors. She peppered her speeches with bold promises of major infrastructure investments that would provide the needed signals to the business the business community that their investment in Surrey was a safe one. It was decided that part of this infrastructure investment would be the construction of a new City Hall. In the fall of 2009 the city identified two blocks in the heart of Whalley that would become the "ground zero" of their investment. The four-hectare site was bound by 102nd Avenue on the south, University Drive on the west, 104th Avenue on the north and 135th Avenue on the east. In Q1 of 2010, the city broke ground on an infrastructure investment that would eventually total over a quarter of a billion dollars. The first phase included the city's flagship 7,500m^2 library designed by world-renowned architect, Bing Thom, and scheduled for ribbon cutting in mid 2011. This would be followed by a new 20,000m^2 city hall and outdoor assembly space for 5,000 people in a 5,000m^2 civic plaza to be completed by Q3 2013. Eventually the site will accommodate space for a yet to be designed performing arts centre.

1.2.1.3 Context: Future Growth

Surrey has become the 12th largest city in Canada and the second largest in BC. With a current population of 480,000, and growing at a rate of 1000 people per month, it will overtake Vancouver as the province's largest city within the next decade. Surrey is home to shipping ports, two universities, two international border crossings (one of which is the second busiest in the nation), 140 public schools and 6000 acres of parks - 6 times the area of Vancouver's Stanley Park. (Source: http://www.surrey.ca/). As Surrey competes with other cities and municipalities for coveted development and its resultant tax base, several factors give Surrey a distinct natural advantage. In addition to its larger supply of developable land for industrial, commercial and residential development, it also offers lower property taxes and shorter commutes for the people living in the numerous bedroom communities to the east. Entering the next decade, Surrey feels it is poised to attract significant industrial development to its newly created industrial lands and commercial development to its recently rebranded "downtown".

1.2.2 Expressions of Interest

SCDC feels that this development of infrastructure by the city has enhanced the value and potential of sites in close proximity to "investment ground zero". Throughout the site planning processes for these projects, potential non-public development land parcels were created. SCDC felt that these sites should be carefully managed so as to produce maximum value to the city. In August 2010, SCDC issued a call to land developers for Expressions of Interest in one of these sites. SCDC felt that the site would be a coveted development parcel given its location of immediate adjacency to the new Civic Plaza.

The call for the Expressions of Interest asked the responding firms to not only to indicate interest, but also to outline their development ideas and propose the financial arrangement they envisioned would unfold between themselves and SCDC. The call was not prescriptive as to the arrangement. SCDC was open to considering an outright sale of the property as well as various forms partnership. Four submissions were received from Century Group, Bosa Properties, Great West Life and PCI Group, all prominent lower mainland developers and/or real estate investment companies.

The Century Group Expression of Interest was judged to be the best proposal.

1.2.3 Prelude

1.2.3.1 Prelude: The Project

Century Group's proposal was a 40,000m^2 mixed-use development project called Prelude @ City Centre (Prelude). Prelude is comprised of 24,000m^2 of residential condominium space, 5,000m^2 of commercial office/retail and a 160-room hotel. Prelude is proposed to have 52 floors, which would make it the 2nd tallest building in British Columbia. Only the Shangri La in Vancouver would be taller.

At grade, Prelude will feature an inviting double-height lobby directly off the civic plaza complete with restaurant, coffee shop and other commercial retail units that will further animate the space. Directly above this level will be the hotel meeting space, which overlooks the lobby. The subsequent 9 floors house the 160 hotel rooms complete with required amenity space. Floor levels 12 through 15 are occupied by the office space. The 16th floor will feature an ample amenity floor with access to outdoor space over the podium below. The building is topped with 36 floors of market condominiums.

1.2.3.2 Prelude: The Pitch

Century Group's proposal outlined the following financial arrangement. SCDC and Century Group would form a joint venture partnership to develop, build, market and operate Prelude. Details of this arrangement follow later in the Financial Plan. Generally however SCDC would contribute the land (which has no debt) plus cash to secure a 30% ownership in the venture. The balance of equity would be contributed by Century, securing a 70% stake.

The idea was that the condominiums would be sold. The joint venture partners would keep the office space to rent and/or occupy and the hotel would be retained and operated until operating incomes could be established to enable a sale to an investor at a decent cap rate.

1.2.3.3 Prelude: The Problem

Details of Century's proposal were presented at SCDC's board meeting in November 2010. The directors were generally in favour but expressed some concerns as to the validity of some the numbers in the preliminary pro forma. Management was asked to carry out a thorough due diligence process and report back at the next board meeting in May 2011. The project has several components which need to be verified through the due diligence process.

Project Costs

A large part of the project costs surround construction. Conceptual plans will need to be developed to schematic drawings in order to verify that the numbers are reliable.

Condo Market

Expected sales values of condominiums will have to be verified. To do this an industry analysis will be undertaken to gauge the validity of sales projections. Specifically the high-rise concrete market in Surrey City Centre will be the main area of focus.

Hotel

Because this project is producing something from two distinct industries, a separate analysis will need to examine the hotel industry. In addition to verifying the operating revenues for the hotel, research will need to be done to provide the basis for a decision as to branding and/or licensing.

2: Industry Analysis

2.1 Condo Market

2.1.1 New Home Market Overview

2.1.1.1 2010 New Residential Market Synopsis

The new home marketplace of greater Vancouver continues to evolve and adapt. The unprecedented run up from 2003 to the middle of 2008, the subsequent halt in activity after the global economic crisis and then the unexpected rebound that took place in 2009 and into 2010, has demonstrated the resilience of the new development market in greater Vancouver.

With a limited supply of developable land, a reputation as being one of the most liveable amenity rich places in the world, strong immigration forecasts, stable government and a Pacific Rim port location, demand for new multi-family in greater Vancouver is expected to remain favourable over the long-term.

The following points need to be considered when forming an opinion on the future of the greater Vancouver market:

- There was a dramatic decrease in housing starts in 2008/2009 reflecting the uncertainty of the economic conditions at the time;
- According to Canada Mortgage and Housing Corporation (CMHC), 2009 saw approximately 8,000 new home starts (one of the lowest on record) while 2010 rebounded and saw an estimated 15,000 starts, indicating increased confidence from suppliers and greater demand; (Source: http://www.cmhc-schl.gc.ca/).
- Most of the Fraser Valley still has not recovered to 2008 peak pricing, with CMHC estimating that the Surrey market is still about 10% below the "high water mark" for the region;
- Moving into the spring and summer months of 2010, sales stalled due to tighter lending requirements, the introduction of the HST and a general lack of affordability throughout the region;

- New home product introduced at comparably low price points experienced the bulk of demand (example projects include; 2300 Kingsway in East Vancouver, Park Place in Guildford, Wall False Creek in Vancouver, Quintet in Central Richmond);
- The new condominium market is largely driven by Chinese buyers. Both local and off shore Chinese investors account for the vast majority (estimated to be as high as 80%) of the pre-sale absorptions recorded in greater Vancouver year to date. Remaining demand is typically made up of first time buyers, move ups and downsizers;
- Projects unable to capture this very active Chinese demographic segment are absorbing at much slower rates, often only through incentives and price reductions;
- Longer absorption times and more flexible pricing and contract negotiating is now commonplace in the greater Vancouver market;

2.1.1.2 External Market Factors

External factors supporting the market

- Interest rates remain well below the 20 year average and are only expected to increase slightly over the next 12 months;
- In 2007 and 2008 the Fraser Valley Regional District had the highest level of intra-provincial migration; (Source: http://www.bcstats.gov.bc.ca/);
- Construction costs continue to decrease and skilled labour capacity is expected to increase over the short term as government stimulus projects wind down;
- Chinese government policy remains favourable to wealthy Chinese moving capital offshore;
- Global economic conditions have seemingly stabilized and are beginning to trend upwards;
- Consumer confidence is expected to strengthen over the next two years as employment numbers are forecast to remain stable;

External factors undermining the market

- Federal Government is considering reducing the maximum amortization period to 25 years with many commercial banks seeming receptive to this initiative;
- Uncertainty surrounding the HST has caused many buyers to hold off on purchase decisions. If the HST remains in effect, it is expected to hamper achievable new home construction values;
- The tighter lending requirements implemented in the spring of 2010 have subdued local demand, especially from first time and price constrained buyer segments. This could be exacerbated by shorter amortization periods;
- Interest rates are expected to begin to increase over the next 24 months;
- Chinese government policy could change and the flow of buyers from this region could taper off;

2.1.1.3 Multi-Family Product in the Fraser Valley

The Fraser Valley has traditionally attracted lower density residential development. In recent years there has been an increase in vertical development, with all multi-family product forms now represented throughout much of Fraser Valley. Neighbourhood and Community plans have been adapted and designed to centralize growth and provide compact, mixed-use "villages" within different municipalities and cities of the Fraser Valley. Increasing allowable density around transit infrastructure is now commonplace and some developers have been able to financially rationalize high-rise construction within these nodes.

The market too has come to accept this housing form. Affordability limitations and the lifestyle attributes associated with strata housing have increased its popularity in the Fraser Valley. No longer do young families and first time buyers expect to purchase a single family home. Most are now resigned to the fact that condominium or town-home ownership will be the logical first step in climbing the housing ladder.

With a shrinking developable land base, an increasing cost of living, expanding rapid transit infrastructure, strong population forecasts and a growing immigrant population already used to multi-family housing, condominium and townhome product in the Fraser Valley will continue to become the dominant housing form moving into the next decade.

Townhome

Town home product is a popular multi-family form in the Fraser Valley. A number of active buyer segments are drawn to the Fraser Valley in search of affordably priced, ground oriented homes, including young families and downsizers. Townhome and duplex forms provide many similar attributes to single family product but usually at a more attractive price point. This type of offering is especially popular around existing single family neighbourhoods.

Woodframe Condominium

Woodframe condominium product has been well represented in the Fraser Valley for many years. This type of construction offers relative affordability, typically larger unit plans and often locations concentrated near services and amenities. Traditionally this type of product has been consumed by first time home buyers and older, more price sensitive downsizers or singles. Woodframe product is still the most common condominium form in the Fraser Valley and will continue to be the most affordable option for buyers in most markets.

Concrete Condominium

Proposals for concrete condo product saw a dramatic increased in the Guildford/Whalley/City Centre area of Surrey, as well as in the more exclusive village of White Rock, during the 2002 to 2008 run up in the greater Vancouver market. Surrey was not the only region that developers thought could support concrete forms. Both Abbotsford and Pitt Meadows saw high-rise projects during this heady time in the market, a first for both areas. The Pitt Meadows project is under construction and struggling for sales, while the Abbotsford high-rise was cancelled, although a new high-rise project is expected to come to the Abbotsford market in 2011.

Concrete product, inherently more expensive than woodframe product due to the cost of construction and the increased value the market tends to put on high-rise inventory, sold exceptionally well in the City Centre (Surrey) node during the 2002 to 2008 time period. Large contingents of investor buyer segments bought into the vision proposed for City Centre and quickly consumed the majority of product launched at the time.

Unfortunately, inexperienced offshore groups were developing much of this successfully marketed and presold concrete product. These groups had little practical knowledge of the Fraser Valley development process and were unable to deliver the projects as many were stalled and/or cancelled. This caused a ripple of uncertainty throughout the Fraser Valley concrete marketplace and slowed the evolution of the City Centre node.

After the market correction in 2008/2009 the concrete market in the Fraser Valley was relatively quiet. Those developers left standing focused on completing construction and closing presale buyers. At this point in the market, new concrete product was typically in the $420 to $460 per square foot range. This changed when Concord Pacific bought the two remaining Infinity sites originally being developed by Jung Ventures. They re-branded and re-launched the remaining towers to original purchasers at original prices in January of 2009 and then released the remaining inventory in the two buildings in July of 2010. The available units were priced approximately $380 per square foot, significantly less than any other concrete project in the competitive market area. This reset the presale high-rise market and attracted a number of investor buyer segments, including the seemingly insatiable Chinese investor.

2.1.2 Site specific overview

2.1.2.1 Surrey City Centre Location Analysis

The Surrey City Centre node is in transition. This once dilapidated and undesirable area has begun to transform under the City of Surrey's Secondary Land Use Plan for Whalley/City Centre. This area is well serviced by rapid transit and has been up-zoned in order to attract high density mixed-use development, essentially creating a Surrey "downtown" node that the City of Surrey estimates to ultimately grow to accommodate over 160,000 people (Whalley and City Centre combined). (Source: http://www.surrey.ca/). Some important facts about the Surrey City Centre node include:

- The current population of the Whalley/City Centre area is approximately 97,000;
- There are currently 17 developers actively selling new home developments in Whalley/City Centre and Guildford. Of these, three are townhome, nine are low-rise and five are concrete in form;
- The City Centre/Whalley market is serviced by four SkyTrain stations;
- The City of Surrey's tax incentive policy should continue to encourage development and business creation in the Whalley/City Centre area;
- Surrey City Centre is in relative close proximity to the U.S. border, the Vancouver International Airport, and the second busiest port in North America, Fraser Surrey Docks;
- Surrey City Centre has experienced two major periods of growth, the first in the mid 1990's (corresponding with the expansion of rapid transit to the area) and the second from 2002 to 2008. At present, the area is seeing an uptick in non-residential development with the City Centre Library, Chuck Bailey Recreation Centre and Covered Youth Park increasing the civic presence in the area, as well as the expected construction of the new City Hall building beginning in 2011;
- Currently an estimated 15,000 people are employed in the City Centre node. This number is expected to grow to 36,000 by 2031 (Source: http://www.bcstats.gov.bc.ca/). This would make the Whalley/City Centre market one of the fastest growing employment nodes in the province.

2.1.2.2 OCP and Neighbourhood Plan Analysis

The following section highlights the vision, goals and objectives outlined in the City of Surrey Official Community Plan (OCP) and the Surrey Centre Neighbourhood Plan. These planning principles directly relate to the viability of high-density condominium product in this submarket.

The major goals and objectives for the City of Surrey as defined by the most recent Official Community Plan update include:

- *Manage Growth for Compact Communities*
- *Build a Sustainable Local Economy*
- *Build Complete Communities*
- *Enhance City Image and Character*
- *Increase Transportation choice*
- *Protect Agricultural Areas*
- *Protect Natural Areas*
- *Provide Parks and Recreational Facilities*
- *Improve the Quality of Community*
- *Enhance Citizens Safety and Well Being Though Crime Prevention*

The OCP describes the intention to strengthen the City's nodal development pattern, with specific reference to the City Centre market.

> *"The City supports the formation of a regional downtown in Surrey City Centre and a nodal community development pattern made up of mixed-use urban centres and business communities serving the needs of people living and working in towns and neighbourhoods."*

The vision, goals and objectives for Surrey City Centre as defined by the most recent Surrey City Centre Neighbourhood Plan Update include:

"*To create an identifiable, energetic downtown for Surrey, comprised of distinct neighbourhoods, focused on a dense urban core and an enhanced civic centre, linked by a green public network.*

- *The massing of significant and iconic buildings around all three Skytrain stations, but around the Surrey Central Skytrain station in particular, will create and reinforce image for Surrey.*
- *Develop attractive, compact high-quality, mixed-use spaces for a local and regional audience to work, live, play and learn in Surrey City Centre;*
- *Create a hierarchy and network of great streets, local streets and paths to provide access, disperse traffic and encourage walking and cycling;*
- *Strive to create and promote an urban fabric within the City Centre and establish a built legacy for future generations;*
- *Exemplify design excellence by incorporating compact urbanism, density and sustainability to the greatest extent possible, consistent with best practices;*
- *Establish a sense of place through the development of distinct neighbourhoods, celebrating the diversity and history of the area;*
- *Concentrate new high-density mixed-use development around City Centre's three Skytrain stations, using the highest standards of Transit-Oriented Development;*
- *Create public amenities appropriate for a major downtown centre that are designed and programmed for multiple users;*
- *Celebrate and showcase enhanced City parks and a greenway network through partnerships between private, public and non-profit stakeholders;*
- *Create, promote and sustain a human scale and context to development;*
- *Balance liveability with sustainability and affordability; and*
- *Build upon existing assets, such as SFU Surrey and the Surrey Memorial Hospital, to build a new diverse and robust economy for the City Centre."*

(2031 Surrey City Centre Plan Update – Stage 1 Report, 2008)

These broad planning objectives provide direction and substance for new development activities within the City of Surrey. For the proposed project to move more smoothly and swiftly through the approvals process, the development plan will need to adhere to and be sensitive to these defined goals.

2.1.2.3 Site S.W.O.T. Analysis

Strengths

- Arguably the best high-rise location in the area
- Walk-able proximity to a large employment base (New City Hall, Simon Fraser University, etc.)
- Mixed-use design with high quality retail tenants proposed
- Rapid transit oriented development
- Iconic, 52 storey tower design proposed
- Larger proposed unit mix will differentiate the offering from both the new and used condo markets
- Adjacent to public open spaces designated for community events
- The high level of amenities incorporated for the hotel component can be leveraged be the residential units (fitness facility, spa/pool, lounge, etc.)
- Strong development team assembled with a successful track record for delivering quality concrete product in this submarket

Weaknesses

- The site is located within the transitioning Whalley area; the reputation of this neighbourhood may be a limiting factor for new residential product
- The site's close proximity to the Surrey Central Skytrain Station – while proximity to transit is typically considered an asset, the poor reputation of this particular station could potentially deter some buyer segments

Opportunities

- To capitalize on the wave of expected population growth forecasted for the City Centre submarket
- Up-zoning and higher density development is encouraged by Surrey in City Centre node
- To build a unique high-rise offering that incorporates uses not currently available in the City Centre marketplace

- Contribute to the ongoing revitalization process occurring in the City Centre area
- To capture increasing Chinese buyer demand currently driving the presale condo market in Metro Vancouver
- To build product that targets under serviced "niche" markets

Threats

- The large amount of concrete condo supply scheduled for the immediate area is a real threat to any new product
- The dependence of past concrete projects in the area to attract speculative investor buyers in order to realize sales
- Less participation from Chinese buyers in this marketplace to date when compared with other suburban high-rise markets

2.1.3 Supply

2.1.3.1 Current Concrete Presale/New Supply in Whalley/City Centre

At the time of writing, there are five concrete condo developments with active new home inventory. The following table summarizes new concrete condo metrics in the market:

Whalley/City Centre Product Details	Metrics
Number of new concrete projects actively selling (Feb/2011)	5
Total number of units (actively selling)	1,764
Estimated number of units sold	1,286
Estimated number of units remaining	478
Current average price per square foot (actively absorbing)	$390
Unit range size	357 – 1,493 S.F.
Estimated concrete units under application	6,205

New Concrete Condo Metrics

The majority of the new concrete inventory remaining for sale in the City Centre market is contained in two projects, both of which launched in 2010. This product is yet to complete and one of the developments has not yet started construction. In terms of completed product, there are an estimated 118 units of standing concrete inventory in the market. The majority of this product is not actively being sold, as the developers work through closings and prepare strategies to re-launch remaining inventory to reflect the current market conditions, as much of this unsold completed supply is contained within buildings that at the height of the market sold for well over $400 per square foot. The majority of new concrete condo inventory in the market is designed and sized in order to create the most affordable offerings possible.

The high-rise projects that have launched in this market in the last few years have all heavily targeted investors, first time buyers and other price sensitive market segments. Basic finishing specifications, small floor plans and high unit counts have all been common trends in high-rise projects in the area. It should be noted that there are nine actively selling wood frame projects in the market. This inventory is averaging about $340 per square foot and accounts for about 316 available units.

2.1.3.2 Current Concrete Pricing Summary and Thresholds

The concrete pre-sale market in City Centre is currently averaging between $380 and $400 per square foot. The majority of one-bedroom units are priced under the $250,000 threshold; two bedroom units are typically priced under the $375,000 mark.

The following table outlines available concrete unit type pricing in the Whalley/City Centre market:

Current Pricing for Available Condo Product in City Centre				
Product	**Unit Type**	**Size Range SF**	**Price Range**	**Avg PPSF**
Concrete	Studio	385	$157K	$410
	1 Bed	553 – 602	$217K – $308K	$394 - $513
	1 Bed & Den	661 – 902	$357K - $307K	$284 - $410
	2 Bed	776 – 889	$264K - $374K	$344 - $416
	2 Bed & Den	1103	$315 - $330K	$285 - $299
	3 Bed	-	-	-

Current Pricing Concrete Condos City Centre

2.1.3.3 Current Concrete Product Mixes

The following table outlines active high-rise product mixes in the City Centre Market:

Project	Studio	One Bed	Two Bed	Three Bed	Total Units
City Point	4	362	86	0	**452**
D'Corize	30	96	54	0	**180**
Park Central	0	24	44	4	**72**
Park Place	0	276	422	0	**698**
Ultra	96	226	40	0	**362**
Total	**130**	**984**	**646**	**4**	**1,764**
Percentage	**7%**	**56%**	**37%**	**0%**	**100%**

Product Mix

- One bedroom unit types (including one bedroom and den plans) make up the bulk of new concrete inventory in the market. These units are typically sized between 475 SF and 575 SF.
- Small, compact two bedroom plans make up a large portion of the Park Place development mix. This unit types, typically between 775 SF and 875 SF in size, appeal to investor buyers looking to maximize rental income. These smaller two bedroom plans have seen strong demand from Chinese investor buyers.

2.1.3.4 Current Resale Supply by Product Type

Inventory Analysis

An analysis of MLS sales data for high-rise product in the City Centre area of North Surrey shows that since the beginning of 2008, monthly sales have averaged close to 10 units per month. In comparison to other MLS high-rise markets in Greater Vancouver, North Surrey is one of the smallest markets in terms of sales volume.

Sales of newer high-rise condos, in buildings less than five years old, make up approximately 40% of total MLS high-rise sales in the market. This equates to an average of about four re-sales per month transacting on MLS.

Over most of 2010, it's taken between two to three months to sell a high-rise condo in the City Centre market on MLS. Average-days-on-the-market is similar for newer high-rise product. Over the past few months, the number of new listing has declined resulting in a reduction of estimated weeks of supply.

At the end of November 2010, total MLS listings of high-rise units in City Centre represented an estimated 49 weeks' worth of sales.

Through September, October and November 2010, MLS high-rise sales in City Centre have been close to $242,000 or $260 PSF. This represents a slight improvement from $240 PSF recorded in the first quarter of 2010. Average list prices in November 2010 were $265,000 of $341 PSF.

As expected, newer built high-rise condos are more expensive than older product. Although the data is quite limited, it does indicate that the average high-rise condo in buildings less than five years old, sells for around $256,000 or $316PSF. MLS listings of newer high-rise product in November were more expensive. The average list price for newer concrete condos was $284,000 or $448PSF. This larger discrepancy in sale and list values can be attributed to investor buyers stubbornly attempting to recover after the market correction of 2008.

An analysis of project amenities and unit features that could affect selling price indicates that new high-rise units are priced over $500PSF but unit sizes are less than 500SF in size. Most likely these units are targeting the investor market, which has been far less active in North Surrey since 2008.

Other value influencers (with estimated value premiums) are included below:

- View – add $30 to $50 PSF
- Central location, close to shopping – add $10 to $15 PSF
- West or south exposure – add $30 to $40 PSF
- Gas or electric fireplace – deduct $6 to $50 PSF
- Exercise/fitness facilities – add $30 to $60 PSF

Over the past six months, there has been a mismatch between MLS high-rise sales and listings in City Centre. Units under 600 SF in size made up about 35%of all high-rise listings and 60% of newer high-rise listings. However, these smaller units make up only 14% of all MLS high-rise sales and about 30% of newer high-rise sales. Product in the 800 to 1,000 SF range accounts for most of the MLS high-rise sales. The analysis suggests that, if supply were not a constraint, about half of all high-rise sales would be in the 800 to 1,000 SF range.

Pricing Summary and Thresholds

The analysis of MLS high-rise sales in City Centre, indicates that these could be an opportunity for new product in the 800 to 1000 SF range. Although demand for new high-rise product in North Surrey is limited, targeting the market for larger product makes more sense than going after investors or young singles with 600 SF one-bedroom units. Price will be a limiting factor. The resale price point for product in the 800 to 1000 SF range appears to be around $300,000. This would mean an average selling price of $375 to $400 PSF.

2.1.3.5 Potential Upcoming Supply (Under Application or Soon to Launch)

Projects Ranked in Terms of Competitiveness and Likelihood

The following table outlines condo projects, both woodframe and concrete, under application or branded and soon to be launched in the Central City market (Gary Gahr, Senior Planner, City of Surrey, personal communication, February 21, 2011). These projects are ranked from one to five in terms of potential competitiveness and likelihood of actually coming to market (with one being directly competitive and five being not competitive at all).

Site Address	Developer	Building Type	Status	# Units	Competitive Ranking
13906 Fraser Hwy.	n/a	Low-rise, Woodframe	Under application – no activity in 2 years	40	4
13773 101 Ave.	n/a	Low-rise Woodframe	Under application	50	4
11079 Ravine Rd.	n/a	Low-rise Woodframe	Under application	54	4
14008 108 Ave.	n/a	Low-rise Woodframe	Under application	60	4
13782 108 Ave.	Tien Sher Group	Low-rise Woodframe	Under application – no activity in 2 years	64	3
10575 139 St.	S&S Titan Developments	Low-rise Woodframe	Third reading	68	4
10154 139 St.	n/a	Low-rise Woodframe	Under application	83	4
10672 140 St.	n/a	Low-rise Woodframe	Under application	83	4
13806 108 Ave.	Avila Development	Low-rise Woodframe	Under application – site currently for sale	86	5
10156 132 St.	Tara Development	Low-rise Woodframe	Under application	90	4
10316 132 St.	Prosper Development	Low-rise Woodframe	Under application	91	4
10438 University Dr.	Newgen	Low-rise Woodframe	Under application – presale website shut down	105	4
13242 104 Ave.	n/a	Low-rise Woodframe	Under application – site subsequently listed for sale	112	4
11037 Ravine Rd.	n/a	Low-rise Woodframe	Under application	131	4
13674 Grosvenor Rd.	Tien Sher Group	Low-rise/Mid-rise Woodframe	Under application	155	3
Quattro Ph. 4	Tien Sher Group	Low-rise Woodframe	Under application – active pre-sales	160	3
14723 104 Ave.	n/a	Low-rise Woodframe	Under application	212	4
10577 140 St.	n/a	Mid-rise Woodframe	Under application	221	4
Estimated Woodframe Units Under Application – 1,865					
14653 104 Ave.	n/a	High-rise Concrete	Under application – no activity in 3 years	121	4
13852 101Ave.	Odyssey Tower Properties	High-rise Concrete	Under application – site currently listed for sale	167	4

10925 University Dr.	n/a	High-rise Concrete	Under application	186	3
13586 98 Ave.	Kenstone Properties	High-rise Concrete	Under application	206	2
10342 136A St.	Janda Tower Corporation	High-rise Concrete	Under application	234	3
13433 Gateway Dr.	G5 Properties/H4 Development	High-rise Concrete	Under application	252	3
13111 King George Hwy.	n/a	High-rise Concrete	Under application – no activity in 2 years	277	4
13479 108 Ave.	n/a	High-rise Concrete	Under application	450	4
13748 104 Ave.	n/a	High-rise Concrete	Under application	504	4
13778 100 Ave.	King George Developments	High-rise Concrete	Third reading	555	3
13424 King George Hwy.	Seagate Properties	High-rise Concrete	Under application	565	3
14970 101A Ave.	n/a	High-rise Concrete	Under application	637	3
9900 King George Hwy.	Berezan Management	High-rise Concrete	Under application	1000	4
9905 King George Hwy.	Century Group	High-rise Concrete	Under application	1050	3
Estimated Concrete Units Under Application – 6,205					

Condos Under Application

The City Centre market is fragmented with a large number of smaller, relatively inexperienced developers proposing complex multi-phased projects. This market has a track record of cancelled projects and expired applications. This is why the majority of the proposed developments are ranked not overly competitive to the Prelude. The probability of even a third of the proposed number of concrete units coming to the market in the next 24 months is quite low.

2.1.3.6 Historical Condo Starts

From 2002 to 2010 there were on average 973 new condominium starts in Surrey. The drastic decrease in the number of new condo starts in 2009 can be attributed to the poor market conditions that prevailed at the end of 2008. The quick reaction from the development community to reduce oncoming supply helped to stabilize the market moving into 2010.

Surrey Housing Starts by Year (CMHC)												
Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 (F)	2012 (F)	2013 (F)
Condos Only	192	261	186	721	1,391	2,766	2,346	371	526	1,226	1,830	2,040
Total Starts	2,532	3,758	2,985	4,460	6,023	6,758	5,140	2,439	3,058	4,119	5,283	5,853

Surrey Housing Starts

According to CMHC, over the past ten years Surrey had averaged approximately 3,734 total housing starts per annum. According to the Metro Vancouver Regional Growth Strategy; housing demand for Surrey is expected to be as follows:

- Annual estimated ownership demand for Surrey over the next 10 years – 3,330 Market Units
- Annual estimated rental demand for Surrey over the next 10 years – 1,790 Rental Units
- Total new housing demand is estimated to be 5,120 units per annum in Surrey

Using the Metro Vancouver Regional Growth Strategy as a gauge, the Surrey market was slightly overbuilt (on a whole) in the years 2006, 2007, 2008. (Source: http://www.metrovancouver.org/). As expected, 2009 and 2010 saw a significant reduction in the number of condo starts and an undersupply situation for appropriately designed and priced condo product, especially concrete construction. This has led to a more balanced supply of high-rise product in Surrey.

With much of the new concrete condo inventory being purchased by investor buyers and little purpose built rental being constructed, the majority of new rental product is expected to come in the form of individual units rented by owners in strata-titled buildings.

There are currently over 6,000 units of concrete multi-family supply officially proposed with the City of Surrey for North Surrey. Most of this supply is concentrated in the City Centre node.

- The vast majority of these ambitious proposals are from inexperienced multi-family developers and it is expected that a large number of these proposals will not move to the marketing and construction stage.
- It should be noted that a number of the larger, master-planned and multi-tower developments scheduled for the area, if built, will most likely be strategically phased, reducing the number of units that will be introduced to the market at one time.

Even so, this is still a considerable amount of scheduled product for the market and a possible oversupply situation needs to be considered. The timing of the Prelude project will be key to mitigating this risk of oversupply.

2.1.3.7 Identifying Concrete Mixed-Use Projects with Hotel Components

Metro Vancouver has seen a number of concrete condo projects incorporate hotel amenities in recent years. The most of these developments have aligned with hotels that have a good brand awareness in an attempt to increase the prestige of the development, differentiate themselves from other competitors and maximize market value by leveraging off of luxury hotel amenities. Using a basic comparison at the time of sales launch to other non-hotel product targeting similar buyer groups, it is estimated that hotel/condo product lists, on average, at a 5% to 30% premium over competitors.

Project	Developer	Hotel Brand	Sales Launch	# Units	Average PPSF	Estimated premium over non-hotel competitors
Shangri-La	Westbank	Shangri-La	Oct 2004	300	$677	20%
Residences Hotel Georgia	Delta Group	Rosewood Hotels	Sep 2007	156	$1,450	29%
Fairmont Estates	Westbank	Fairmont	Mar 2006	173	$1,445	31%
L'Hermitage	Millennium	L'Hermitage	Apr 2005	204	$621	7%
Pinnacle Residences	Pinnacle	Pinnacle International	Nov 2007	79	$990	30%
Richmond Wall Centre	Wall Financial	Westin	Jun 2007	231	$504	5%

Mixed-Use Projects with Hotels

Market Positioning of Hotel/Condo Projects

The majority of the hotel/condo product that has been released in Metro Vancouver has been positioned as premium in relation to similar non-hotel condominium offerings in their respective competitive market areas. These developments have typically targeted wealthy; downsizers, single professionals and international buyers. These developments have leveraged locations close to the airport and the Central Business District in order to provide the viability necessary to maintain an operating hotel. Hotels with good brand perception have been critical to their perceived value and have allowed for significant premiums to be achieved in four of the six examples. Exclusive amenities and services, international branding and "premier" locations have all been used to leverage these developments into the marketplace.

It should be noted that the price insensitive buyer segments that this type of product was designed to attract is currently less prevalent than in past years.

2.1.4 Demand

2.1.4.1 Whalley/City Centre Absorption Trends (Pre-sale, re-sale and historical)

Pre-sale

The following trends have been observed in the Whalley/City Centre pre-sale market:

- Developers are using much longer registration periods in order to solicit qualified prospects. Increased lead up times and more prospecting is now a requirement in today's marketplace.
- Typically, developments sell silently to their most qualified purchasers first, before launching to the general public.
- Many new projects are seeing the relatively quick uptake of the first 20% to 30% of the development and then a marked decrease in absorption of the remaining product
- Absorption is predominantly coming from Asian investor segments, with diminished participation from Indo Canadian buyer segments and fewer first time home buyers.
- Participation from the local realtor community is a key to success
- Overall absorption timelines for new multi-family product are increasing
- Projects with finished product or visibly under construction and that are priced the most competitively and are transit-oriented, tend to attract a larger share of the active market.

Re-sale

The following trends have been observed in the Whalley/City Centre re-sale market:

- The average days on the market for newer concrete condo sales on MLS in North Surrey in 2010 was 65 days, with sales occurring later in the year having longer absorption timelines
- On average, newer concrete condo re-sales in 2010 were discounted by about 4% from original list price. As expected, discounting and price reductions have become more commonplace on MLS over the last 24 months

- Concrete re-sales average about 10 a month in the City Centre market and the number of active listings increased throughout 2010.

Historical

The following general trends with respect to absorption in the Whalley/City Centre market have been observed:

- In 2005, 2006 and 2007 there were a high number of Indo-Canadian and Korean investor buyers active in the new condo market
- In the past, the first time buyer was also attracted to condo product in this market
- Some concrete projects that launched during the peak of the market in 2005, 2006 and 2007 saw over 90% of the available inventory sold in the first month of sales
- Discounted woodframe product located in more niche neighbourhoods saw strong absorption in 2009

2.1.4.2 Active Buyer Groups in the Market

Indo-Canadian Investors

Indo-Canadian investor buyers were especially prolific in the City Centre market from 2005 to 2008. These buyers were often buying with short-term equity gains as the primary investment goal and had no real intention of closing on the purchase and holding the asset. They were attracted to condo inventory with small deposit structures (or bonded deposits), no restrictions on assignments, small unit mixes and low relative price points. These buyers usually worked with local Indo-Canadian realtors and it was not uncommon for families to pool resources and purchase multiple units in a project.

While small numbers of this segment are still present in the new home market, since the correction at the end of 2008, the Indo-Canadian investor buyer has been markedly absent. Many of these buyers purchased the product at peak prices and have been unable to sell their investments in order to realize a profit or even recoup their original investment.

Chinese Investors

The Chinese investor has been present in small numbers throughout the Whalley/City Centre market for the past five years. This group has been interested primarily in concrete product in central locations, close to rapid transit and employment centres. Typically the Chinese investor has a longer investment horizon and looks for rentable product in an emerging area. Currently the Chinese investor buyer makes up the vast majority of the Metro Vancouver new home marketplace with some estimates as high as 80%. This is no different in the Whalley/City Centre market. Chinese buyers are now the largest single active segment in this market.

First Time Home Buyers (Mixed Ethnicity)

While this segment of the market has been quiet in recent months, it is still an important buyer group in the price sensitive City Centre market. First time home buyers have been squeezed by tighter lending restrictions implemented in the spring of 2010 and higher deposit requirements by most developers.

This group was most active in the spring of 2009 as market conditions were bottoming out and prices came off significantly. Hefty buyer incentives, record low interest rates and the fact that this demographic segment was less affected by the economic collapse (with fewer assets and stock holdings), allowed large market participation by this group.

This segment is thought to continue to be active in lower price point oriented markets. However, they may be more attracted to low-rise developments or more affordable re-sale condos as they look for well priced inventory where they will be comfortable for a few years.

Price Sensitive Downsizers (Mixed Ethnicity)

There is a small buyer segment in the City Centre market that is currently not being served by the new home market. This segment is the local, North Surrey downsizer looking to sell an older single family home and purchase a slightly larger than average concrete condo in a walkable, amenity rich community. A limited number off these buyers have been seen in a select few woodframe condo offerings, as these projects typically are the only opportunities that provide the units sizes large enough to accommodate the downsizing buyer.

Most of the concrete product in this market over the last 5 years has been targeted towards the investor and first time buyer segments. These offerings do not appeal to the downsizer as the unit mixes are typically too small and the large number of renters, create a less than ideal environment for end users.

While the depth of this market is thought to be limited, these buyers are not currently being targeted in the market and may provide a limited opportunity for developers.

2.1.4.3 Future Demand Opportunities

There is no question that ongoing demand for new housing in Surrey will be strong over the next decade. The city is expected to attract a high percentage of the future growth expected for Metro Vancouver. The availability of developable land for residential, industrial and commercial use, rapid transit service, new highway infrastructure, affordable housing, high concentrations of services and amenities as well as a central location with proximity to ports, borders and the City of Vancouver will all drive growth into this region. The ability of developers to deliver appropriately designed and priced residential product to this market will determine success.

Future high-rise demand opportunities:

- Targeting and catering to the Chinese investor buyer
    - Attractive price point
    - Transit oriented concrete product
    - Proximity to employment centres
    - Attracted to pre-sale offerings where equity gains may be made during the course of construction
- Reaching out to the local Fraser Valley realtor community
    - Providing incentives to local realtors may help drive demand
    - Local realtors may provide the only conduit to the buyers that prefers buyer representation from their own community (Indo-Canadian, Korean, Persian etc).

2.1.5 Value

2.1.5.1 Current New Concrete Condo Values

The following table outlines the estimated achievable value of concrete high-rise product in a number of the major markets in Metro Vancouver.

Submarket	# Concrete Projects Actively Selling	Estimated # Units Available	Estimated Average Value in $PSF
Vancouver Downtown	26	763	695
Vancouver Westside	22	1,060	635
Vancouver Eastside	6	113	505
North Vancouver	8	362	625
New Westminster	5	169	395
Burnaby North	5	231	495
Burnaby Metrotown	2	47	545
Burnaby South	1	120	475
Westwood (Coquitlam)	7	388	435
Port Coquitlam	1	117	395
Port Moody	1	129	435
Richmond Central	10	1,146	525
North Surrey	5	474	385
South Surrey/White Rock	2	83	575
Pitt Meadows	1	134	425

Condo Values

The estimated current market price per square foot for North Surrey is based entirely on the absorption being experienced in Concord Pacific's Park Place development. This project has considerably undercut competitive projects in the area due to its competitive cost structure. The original Korean developers financed the project through Lehman Brothers. In September of 2008 the financing dried up and the project went into receivership. The partly finished asset was purchased by Concord at approximately $0.50 on the $1.00. Once remaining inventory in this project is absorbed and supply tightens, it is estimated that average values will move back up to the $400 to $405 PSF range later in 2011.

2.1.5.2 Value Forecast

Predicting pre-sale values 12 to 24 months out is highly inaccurate. Too many variables can affect achievable values. Most industry experts including CMHC, Real Estate Board of Greater Vancouver (REBGV) and Central 1 Credit Union agree that values across Metro Vancouver will remain relatively flat through 2011, with the most aggressive prediction being an increase of 2%. Most industry experts agree that 2012 will also be fairly flat with only a 2% to 5% increase expected.

Even so, applying these conservative percentage increases to the current concrete market in City Centre, it could be expected that values will rise to the $410 to $430 PSF range. Considering that the Prelude has a hotel component and arguably the best City Centre location, it can be expected that the Prelude will achieve a premium over these average market values.

2.1.5.3 Prelude Condo Value

It is estimated that the Prelude condo project could achieve from $420 to $450 PSF if launched later in 2012. This "best guess" is based on a number of factors, namely:

- The project's location – proximity to the new City Hall, Library and Civic Plaza
- The delivery of a quality product with a higher level of amenities due to the inclusion of the hotel component
- The project's ability to attract reputable retail tenants
- Ongoing demand from the offshore Chinese buyer and the ability of a reputable sales and marketing group to engage this market
- The continued growth and investment in the City Centre node from both the business community and the City of Surrey
- Interest rates remaining stable, below historic norms
- The continued improvement of overall global economic conditions

2.1.6 Summary of Findings

A point form summary of the major findings of this analysis:

- Overall the new home market in Metro Vancouver has stabilized and is poised for steady growth over the next 24 months
- The Surrey City Centre market is expected to continue to grow as local government policy is encouraging business development through tax incentives and increased amenity infrastructure
- Local government encourages the suggested development form in City centre
- The subject site is considered one of the most viable mixed-use, high-rise locations in the immediate competitive area
- Over 6,000 concrete units are under application in the City Centre market. A large amount of this scheduled new supply in unlikely to ever come to market as it is proposed by inexperienced developers with no track record and will not likely get financed
- From a macro perspective, the historically low number of housing starts in 2008 and 2009 has created a more balanced market in City Centre
- Available new concrete condo inventory in City Centre has been consumed relatively quickly in the recent months – particularly by Chinese investor buyers
- There is a limited amount of new concrete construction underway in City Centre (Park Place by Concord Pacific is the only high-rise actively under construction and is expected to complete in late summer 2011
- The majority of re-sale and pre-sale supply is designed to target investor buyer groups with small floorplans and basic spec levels
- The current concrete market in City Centre is trading in the $380 to $400 PSF range
- Hotel/Condo projects in Metro Vancouver have typically commanded a premium in the market between 5% and 30%
- 2010 saw an estimated 637 new concrete condos absorbed in the market. At this pace the estimated 474 units of supply of available inventory represents about 9 months of supply

- Strong population growth forecasts for Surrey and the City Centre in particular will bolster the demand for multi-family product offerings
- A recent increase in Chinese investor buyers active in pre-selling concrete projects could drastically increase demand for transit oriented, mixed use product
- On a whole the City Centre concrete market in one of the most affordable in Metro Vancouver

2.2 Hotel Market

2.2.1 Hotel Market Overview and Supply and Demand Analysis

2.2.1.1 Primary Competitive Supply

Due to the central location of Surrey relative to other Lower Mainland communities, many hotels that are located in the City compete with hotels located in neighbouring communities. As of January 2011, 23 hotels have been identified as competitive properties with a total of 2,422 guest rooms (Source: http://www.expedia.ca/). The competitive properties are located within a wide geographic region that includes Coquitlam, New Westminster, Langley, White Rock and Surrey. The properties were identified based on location, quality of product, facilities and services, rate structure and competitiveness in terms of attracting particular sources of demand.

Competitive Accommodation to Prelude			
Property	**# of Rooms**	**Posted Rates in $ (Jan 2011)**	**Facilities**
Sheraton Guildford	279	119 - 179	Pool, fitness, restaurant, room service
Holiday Inn Express Surrey	85	99 – 149	Fitness, business centre
Coast Surrey	77	119 – 149	Pool, fitness, free wireless
Sandman Suites Guildford	85	145 – 219	Fitness
Best Western Surrey	72	89 – 159	Pool, fitness, free parking, free breakfast
Best Western Peace Arch	42	89 – 179	Pool, fitness, free wireless
Pacific Inn Resort	150	109 – 249	Pool, fitness
Comfort Inn Surrey	82	89 – 149	Business centre, fitness, free wireless
Quality Inn Surrey	57	84 – 159	Free wireless
Compass Point Inn Surrey	81	95 – 129	Pool, fitness
Gateway Hotel Surrey	52	74 – 179	Free wireless
Ocean Promenade White Rock	51	139 – 469	Fitness, laundry, free wireless
Holiday Inn Surrey	76	99 - 149	Pool, fitness, business centre
Coast Hotel Langley	77	140 – 180	Fitness, business centre
Hampton Inn Langley/Surrey	96	139 – 179	Pool, fitness, business centre
Holiday Inn Express Langley	85	129 – 269	Pool, fitness
Sandman Inn Walnut Grove	146	115 – 200	Fitness, free wireless
Executive Plaza North Road	140	119 – 289	Pool, fitness, tennis, business centre
Best Western Coquitlam	106	149 - 299	Pool, fitness, business centre

Delta Hotel Burnaby	200	119 – 2,219	Pool, fitness, business centre
Hilton Metrotown	283	139 – 239	Pool, fitness, business centre
Holiday Inn Metrotown	100	119 – 300	Pool, fitness, business centre
Inn at Westminster Quay	126	149 - 169	Fitness, business centre, free wireless

Competitive Hotels to Prelude

2.2.1.2 Projected Additions to Competitive Supply

As of February 2011, three properties have been identified that have potential to add to the supply of rooms available in the competitive market.

Bosa Development

Bosa Properties has indicated that they will be constructing a 169 room, extended stay, branded hotel property on a site at the northeast corner of Willingdon Avenue and Kingsway, in Burnaby. The site is across the street from the Hilton Metrotown Hotel. The hotel will be part of a mixed use, high-rise project also featuring condos, office space and street level retail. Bosa has indicated that the project is scheduled to open in January 2014. Based on discussion directly with Bosa, it is estimated that this project has a 100% probability of completing.

Sandman Signature

Northland Properties is constructing a Sandman Signature Hotel located at 200th Street and Highway 1 in Langley. This is in addition to their existing Sandman Hotel located near this major highway interchange. The project is a 200-room hotel scheduled to open in the summer of 2011. Based on the fact that this project is well underway, there is a 100% probability that it will complete.

South Surrey Casino Hotel

A local developer has received zoning approval to develop a 200-room hotel and convention centre with an adjoining casino at 8th Avenue and Highway 99 in South Surrey. It is not believed that this developer has even applied for a gaming license yet. Given the significant hurdles to clear on this project, it is extremely unlikely that it will come to fruition. It is felt that it is safe to assign a 0% probability of completion.

Additional Room Assumptions

Based on the forgoing information, it is estimated that 529 rooms will be added to the competitive area inclusive of Prelude, by 2014. (169 Bosa, 200 Sandman, 160 Prelude)

2.2.1.3 Greater Vancouver Hotel Market/Demand Projections

According to PKF Consulting, Greater Vancouver area hotels have had a blended average occupancy between 57% and 64% for the 5 years period ending in 2009. (Source: http://www.pkfcanada.com/). No numbers existed specifically for Prelude's identified competitive market, however, for the purposes of the financial projections in this paper, an occupancy rate of 60% will be assumed. PKF also contends that demand growth (Greater Vancouver) has remained fairly constant at a rate of 2.5% during the same period. The same growth projections will be used for Prelude's target area.

Based on this information, the demand (in total occupied rooms per year) for Prelude's market in 2009 was:

2,422 Rooms X 365 Nights X 60% Occupancy = 530,418

Based on growth assumptions, it can be established that demand (in total occupied rooms per year) for Prelude's market in 2014 will be:

530,418 X 1.025^4 (for 4 years 2010 to 2013) = 585,482

During this same period, supply of total available rooms per year will have grown from:

2422 Rooms X 365 Nights = 884,030

To:

(2422 Existing Rooms + 529 New Rooms) 365 Nights = 1,077,115

Therefore, it is expected that the overall competitive market occupancy will fall from **60%**, to:

585,482 Projected Demand/1,077,115 Projected Supply = 54%

Furthermore, PKF states that the breakdown of demand for Greater Vancouver hotels can be shown as illustrated in the following table:

Greater Vancouver Hotel Market Segmentation - 2009	
Market Segment	**Percentage Share**
Corporate/Commercial	55%
Meetings and Conferences	6%
Leisure/Sport	33%
Government/Other	6%

Hotel Market Segmentation

Based on this information, the following projections can be made:

Prelude's Demand (in Occupied Rooms per Year by Market Segment) 2014					
Market Segment	Share	Total Occupied Rooms	Rooms by Segment	Prelude's % Supply	Prelude's Fair Share Rooms*
Corporate/Commercial	55%	585,482	322,014	5.4%	17,389
Meetings/Conferences	6%	585,482	35,129	5.4%	1,897
Leisure/Sport	33%	585,482	193,210	5.4%	10,433
Government/Other	6%	585,482	35,129	5.4%	1,897

Prelude's Demand

*Performing at Industry Average

The following section analyzes each market segment to gauge the probability of the Prelude penetrating that market segment. This will then result in an overall annual occupancy that is hoped to be greater than 54% (projected industry average for 2014).

2.2.2 Market Penetration

2.2.2.1 Introduction

The following analysis shows the basis for future occupancy and market penetration levels at the Prelude. As a baseline, it is assumed that Prelude should compete at the industry average as a minimum. That is, all things being equal, a property will attract room demand in the same proportion as its share of room supply. It is recognized however all things are rarely equal and that properties will penetrate the market at varying levels. This section will examine the Prelude in the context of these market segments.

Market segment penetrations in excess of industry average indicate that the Prelude has been judged to possess competitive advantages relative to the market segment as a whole, while competitive disadvantages will be reflected in penetration levels lower than industry average.

2.2.2.2 Corporate/Commercial

Prelude's location, guestrooms and suites, with well-appointed modern amenities, along with a fitness room, a restaurant, pool and business centre, should appeal to corporate travellers. Surrounding business and industrial parks, further offices being constructed at City Centre and Surrey's incentive to grow business within the City are all positives for Prelude's penetration in this market segment. Prelude is judged to penetrate this segment at 110%.

That is:

Prelude's Fair Share of annual rooms	17,389
Market penetration	<u>110%</u>
Rooms captured	19,128

2.2.2.3 Meetings/Conferences

The City of Surrey has no municipal convention facilities. The private sector has not stepped up in a significant way to address this either. The Prelude, as a new property at City

Centre with approximately 5,000 SF of meeting space, is projected to significantly penetrate this segment. The bulk of this demand will likely be weekday demand with little or no weekend/wedding type of demand assumed. Prelude is judged to penetrate this segment at 150%.

That is:

Prelude's Fair Share of annual rooms	1,897
Market penetration	150%
Rooms captured	2,846

2.2.2.4 Leisure/Sport

The sport traveller is usually travelling in groups with teams of youth and usually looking for locations near freeways and is price-point driven. This may not be ideal for Prelude. Alternatively, the visitor to the lower mainland to take in a Canucks game, or go shopping downtown will appreciate its great access to SkyTrain etc. Prelude is judged to penetrate this segment at 90%.

That is:

Prelude's Fair Share of annual rooms	10,433
Market penetration	90%
Rooms captured	9,390

2.2.2.5 Government/Other

There are several government and institutional organizations that are either already located in/or relocating to City Centre. Some of these are expanding existing facilities in the area too. Among these are: the new City Hall, the new RCMP E Division Headquarters (relocating from Vancouver), Simon Fraser University, Surrey Memorial Hospital (under two expansions), Passport Canada and the Revenue Canada Tax Centre. Presently, there are no hotels located in the immediate area that serve this market. Prelude is expected to penetrate this market significantly, well above industry average. Prelude is judged to penetrate this market at 200%.

That is:

Prelude's Fair Share of annual rooms	1,897

Market penetration	200%
Rooms captured	3,794

2.2.2.6 Summary

The following summarizes demand capture projections:

Corporate/Commercial	19,128
Meetings/Conferences	2,846
Leisure/Sport	9,390
Government/Other	3,794
Total	**35,158**

This projection of total rooms captured results in an annual occupancy rate of:

$$\frac{\text{35,158 Total room nights captured}}{\text{58,400 (160 rooms X 365 nights)}} = 60\%$$

These projections will be the basis of revenue projections later.

2.2.3 Revenues and Expenses

Much of the revenue section of what follows is based on occupancy rates and room rates developed in the preceding section. The expense section was developed after consultation with Sean Hodgins, President, Century Group (personal communication, January 14, 2011). The Century Group (SCDCs potential joint venture partner) currently operates a several hotels in the Greater Vancouver area.

Rooms

Total nights of 35,158 and an average room rate of $149 have been used. $149 is slightly higher than the posted average rates of identified competition, but the market segments where Prelude will be seeking higher penetration are typically less sensitive to price (corporate, conference, government). The one segment (leisure) where a lower penetration rate has been used the segment most sensitive to price.

Operating costs include wages and salaries, laundry, guest supplies, travel agent commissions, contract cleaning, cleaning supplies and reservation expenses. This expense is projected to be $34.00 per occupied room night (S. Hodgins, personal communication, January 14, 2011).

Food and Beverage

The Prelude includes a 150 seat restaurant, 50 seat lounge and a 40 seat seasonal patio, room service and 5,000 SF of meeting/conference space. Revenue projections from Century were in the range of $75 per occupied room based on experience, but this is felt to be conservative. The restaurant/lounge is expected to capture considerable demand from the area in addition to hotel guests. This is due to the lack of area amenities compared to other suburban hotels and the fact that the lunchtime business is expected to be significant given its location. In addition to the $75 per occupied room, $20 per .5 of restaurant seats and $10 per .5 of lounge seats per weekday have been added.

Food and beverage expenses are projected to be 75% of this department's revenue (S. Hodgins, personal communication, January 14, 2011).

Other

Parking will be procured from a third party provider and will not be a revenue generator. Historically, telecommunications have provided a lucrative source of revenue but given the high mobile phone user rate especially among targeted market segment, no revenue is expected. Movie rentals on average net about $3 per occupied room (S. Hodgins, personal communication, January 14, 2011).

Expenses

Historically allocated at per available room (160) basis:

Administration	$3,500
Marketing	$3,000
Maintenance	$1,500
Energy	$1,500
Property Tax	$1,200
Insurance	$300

Franchise Fee

Franchise Fees typically include an annual royalty, a marketing fee and reservation fee that are calculated as a flat percentage of gross room revenue. Scott Richer, Director, Development, Delta Hotels and Resorts, who has expressed interest in the branding possibilities, has indicated that this fee to be in the 5% gross room revenue range (S. Richer, personal communication, February 18, 2011).

Management Fee

Typically this is in the 3% to 5% of total revenue range. Have used 3% for projections.

Prelude Projected Operating Results	
Rooms Available Rooms Occupied Rooms Occupancy Rate Average Daily Rate	160 58,400 35,158 60% $149.00
Revenues	
Rooms	$5,238,542.00
Food and Beverage	$3,091,850.00
Other	$105,474.00
Total Revenues	**$8,435,866.00**
Variable Costs	
Rooms	$1,195,372.00
Food and Beverage	$2,318,887.50
Total Variable Costs	**$3,514,259.50**
Gross Profit	**$4,921,606.50**
Fixed Costs	
Administration	$560,000.00
Marketing	$480,000.00
Maintenance	$240,000.00
Energy	$240,000.00
Property Tax	$192,000.00
Insurance	$48,000.00
Total Fixed Costs	**$1,760,000.00**

Other Costs	
Franchise Fee	$261,927.10
Management Fee	$253,075.98
Total Other Costs	**$515,003.08**
Total Fixed and Other Costs	**$2,275,003.08**
Net Operating Income	**$2,646,603.42**

Projected Income

2.2.4 Value

Because SCDC is not necessarily interested in a long-term hold of the hotel portion, the forgoing section was an exercise to primarily determine the value of the hotel if it were to be sold to a real estate holding company or pension fund. Typically these entities are not willing to purchase a property until a steady income stream has been established. This means that SCDC and Century may have to stay invested in the hotel for a few years until such a stream is verified. At that point the hotel could be sold.

The values at which these types of properties are sold are usually based on income and capitalization rates (cap rate). Income producing properties historically have traded with cap rates as high 10% (resulting in low values) and as low as 5% (resulting in high values). The last few years have seen income properties trading in the 7%-8% range in the Fraser Valley. For the purposes here, 7% will be used.

$$\frac{\text{\$2,646,603.42 Net Operating Income}}{\text{7\% Capitalization Rate}} = \text{\$37,808,614}$$

Because the income has been calculated based on today's figures and not adjusted for inflation, neither has it been discounted backward.

3: Supply Chain

3.1 Overview

3.1.1 Land Acquisition

Acquiring land remains to be one of the most difficult and crucial segments of the supply chain. Typically, developers will have an acquisition department for their operations made up of real estate professionals. Actual execution of deals is sometimes carried out through brokers but where they can they will try to control this “in house”. Land is often acquired through a competitive bidding process, especially government owned land. Because of the usually high number of bidders for a piece of property, the successful bidder is usually left to deal with the effects of the “winner’s curse”. This is the part of the supply chain where the most money can be made and lost. If property is acquired properly – huge value has been created. It is also the area of the supply chain where most money has been lost. Countless developers have overpaid for property thinking that it will be made up somewhere along the line – only to find out that this is extremely difficult to do except in a rapidly rising real estate market. Land acquisition was kept in-house for the Prelude.

3.1.2 Rezoning/Permitting

This is an area of the chain that is usually tightly controlled by the developer. Direct employees of the company are typically the ones who undertake this work. Rezoning land can be risky – especially in a municipal election year (elections held every 3rd November). However if the land can be up-zoned through the rezoning process – huge value can be created. Permitting is less risky and usually involves acquiring the necessary approvals in accordance with the existing zoning. SCDC will keep this in-house for the Prelude.

3.1.3 Product Design

Regulatory approvals make it difficult for developers to employ designers directly as employees. Therefore the development industry is very different from the automobile industry for example where designers are part of an "in-house" team. Design is always contracted out. One particular architect may have a contract with 3 or 4 different land developers in the same city for a condominium design. For this reason it is not easy to differentiate the product and similarly it is not easy to create tons of value in this area. SCDC has retained Patrick Cotter Architects (PCA) for a limited scope of work as of March 2011.

3.1.4 Construction

Construction of the final product varies greatly across the industry. Many developers feel that there are many good general building contractors in the industry to ensure competitive pricing and therefore out-source this area. Concord Pacific, Concert Properties, Wall Financial are a few examples of developers who out-source. Others keep this function in house (i.e. Polygon, Bosa, Mosaic). They are required to take on larger staffs, more equipment and increased risk in return for a tight control of this area of the chain. Two possible benefits are, firstly more control over schedule during peaks in the construction cycle; secondly it facilitates easier after sales service. It is difficult to see how great amounts of value can be created in this area. Pricing is competitive and whether a developer self-builds or not, they are still relying on all of the same sub-trades which end up doing 90% of the work. The Prelude is a large building with a complex core given the mix of uses. SCDC will definitely outsource this phase of the supply chain for the Prelude.

3.1.5 Sales/Marketing

Again, this is an area where developers seem split. Many will out source to large marketing and sales forces such as Bob Rennie & Associates among others. These companies will undertake the entire process for the developer and mitigates the need to manage this process. Others control integrated teams that directly sell the product to the end customer. A third option is to out-source the marketing experts who usually are more adept than in house teams, and maintain the selling "in house". While this may not help create value, it may prevent value erosion. Because of the inherent proneness to the agency problem, value is often lost through outside sales forces. It seems that industry has not been able to come up with a contract that adequately address this moral hazard. With respect to the Prelude, no decisions have been made yet as to whether this will be outsourced or not.

3.1.6 Value creation/capture/retention

The dynamics of the development supply chain in Surrey seem to support the idea that most value is created/captured/retained at the beginning and end of the chain. This would also seem to be borne out by the fact that these are the areas that are usually vertically integrated within the company.

3.2 Costs

3.2.1 Construction

Construction costs are thought to be the largest area of risk when it comes to production costs. SCDC however is not a "widget-producing" company where a prototype can be built and costed to accurately determine production costs. Therefore, PCA was commissioned to develop full schematic drawings to the point that a Class C budget can be procured.

ITC Construction Inc. was then approached to provide a Class C Budget. ITC is a large Vancouver based construction company with vast experience in the construction of high-rise product. Among many other examples, the recent Woodwards project in Gastown is a testament to their ability as builders.

The budget from ITC indicated that the construction costs of Prelude to be $89,257,877.00 or $203.95 PSF. Risk allowances have been built into this number already in the event of severe construction inflation occurring by the time Prelude breaks ground. This is the number that will be carried in the financial section that follows later.

3.2.2 Other Costs

Other costs that will be used in the overall pro forma of the financial section will be taken from historical costs on similar projects.

4: Financials

4.1 Deal Synopsis

Project Summary:

Project Costs				$133.5 million
Owner Equity				
	Century	$30.5 million	(66%)	
	SCDC	$13.5 million	(29%)[1]	
	Cotter	$ 2.0 million	(05%)	
		$46.0 million		$ 46.0 million
Financing Required				$ 87.5 million

Profit projections:

Revenue			
	Residential	$ 96 million	
	Office	$ 17 million	
	Hotel	$ 38 million[2]	
		$151 million	$151.0 million
Costs			$133.5 million
Profit			$ 17.5 million

SCDC Investment Summary:

Outflows		
	Land	$ 6.5 million[3]
	Cash	$ 7.0 million[4]
		$13.5 million
Inflows		
	24,000 SF office space	$ 8.5 million
	Hotel operating income (3 years)	$ 2.0 million
	Hotel sale proceeds (after year 3)	$10.5 million
		$21.0 million

[1]Ownership stake is based on equity share and not total project share including guaranteed debt. SCDC will not have to secure any financing, or be exposed to any risk beyond its equity contribution.

[2]Hotel sale proceeds after end of third year. Additionally hotel would produce an annual income of $2.6 million.

[3]It should be noted that the land is actually worth approximately $120 per actual square foot based on area transactions (or $4.0 million).

[4]The cash component of SCDC's equity would not begin to be paid in until the project had generated approximately $22 million in costs (Q3 2012), after which point SCDC would be responsible for $ 0.29 of every $1 of equity injected (roughly at a rate of $1 million per month) until total equity obligation is reached (Q2 of 2013).

4.2 Project Pro forma

Development Costs ($)		
Demolition and Clearing (Est.)	150,000	
Land	6,500,000	
Property Transfer Tax (2% land)	130,000	
Municipal Charges (DP/BP Fees)	5,250,000	
Offsite Servicing (Est.)	100,000	
Management/Development Fee (5% construction)	4,500,000	
Consultants (6% construction)	5,400,000	
Marketing ($6,000/res unit)	2,160,000	
Sales Commissions (4% condo rev/3% hotel sale)	4,980,000	
Finance (7% - 30 months)	8,500,000	
Construction	90,000,000	
Hotel FF&E ($10,000/room)	1,600,000	
New Home Warranty ($1,600/res unit)	576,000	
Contingency (4% construction)	3,600,000	
Total Costs	**133,446,000**	**$133,446,000**
Revenues ($)		
Residential Condos ($445PSF)	96,000,000	
Hotel Value (from previous discussion)	38,000,000	
Office Value ($25 Triple net lease/7% Cap)	17,000,000	
Total Revenues	**151,000,000**	**$151,000,000**
Projected Profit		**$17,554,000**

Pro forma

5: Implementation

5.1 Next Steps

The following represents a tentative schedule moving forward:

• Conclusion of joint venture agreement	Apr/May 2011
• Development Permit/Rezoning Application	Apr/May 2011
• Final Approval of Hotel Brand	Apr/May 2011
• Development Permit/Rezoning Approval	Dec 2011
• Filing of Disclosure	Jan 2012
• Pre-Sales Launch	Jan 2012
• Building Permit Submission	Mar 2012
• Construction Start	Apr/May 2012
• SCDC begins cash equity contribution	Fall 2012
• SCDC finishes cash equity contribution	Spring 2013
• Construction Completion	Fall 2014
• Pre-Sales Completions	Fall 2014

5.2 Key Risks

Moving forward we see five key areas of risk and have offered our opinion of how these can be mitigated:

	Risk	Mitigation
1	Can the condominium values forecasted be achieved?	We will pre-sell to an agreed-to threshold, both in price and percentage of units pre-sold, before a lot of costs are sunk. If the thresholds cannot be achieved we can re-jig the project. In any event, pre-sales would have to be sufficient to cover at least the debt. This would mean that if we were left with units at the end of the project, it would only represent equity and profit and not require slashing prices to meet debt obligations as is the case with the Olympic Village in Vancouver.
2	Will current construction pricing estimates hold until next year?	This is difficult to mitigate. However, any increase in construction pricing is likely reflective of an improving economy and therefore result in higher pre-sale pricing. Additionally, any disclosure statement and pre-sale agreement would be contingent upon acceptable construction pricing.
3	Construction Financing	In the event that we cannot achieve the projected debt ratio of 65% of costs, Century is reserving other resources in order to increase equity.
4	Interest Rate Risk	Interest rate swaps can be secured that can lock in the construction-financing rate over the 30-36 month build period. This will however, come at a premium over the floating rate.
5	Pre-sale non-performance	All pre-sales should be subjected to a minimum of 15% down payment. This should discourage the pre-buyer from defaulting on the deal. Many of the Olympic Village pre-sales were sold on the basis of 5% down, making the consequences of walking away from the deal less severe.

Risk and Mitigation Matrix

6: Conclusion

Going into this project, three items were identified as areas of concern to be addressed and/or resolved. These have been investigated and the results of said investigation have been presented. The three concerns were:

Construction Costs

In order to confirm costs, conceptual designs for the project had to be developed to the Schematic Design Drawings stage so that the biggest factors affecting cost could be confirmed. These include hotel program requirements and elevator core design development.

ITC Construction Inc. has extensive experience in building similar projects throughout Greater Vancouver and has just recently completed two residential towers for the Century Group. They have provided a detailed budget stating that the project could be built for $203/SF. This is just under the figure of $205/SF that we carried in the last pro forma. In addition to this we are carrying normal contingency amounts and feel the number to be safe.

Revenue Projections/Condo Sales

A thorough analysis of the condo market was undertaken in order to understand the risks of this component. Demographics, economics, absorption, location and price points were all looked at. The retail price of $445PSF seems to be a defendable number.

Hotel Viability

An analysis of the hotel market was conducted as well. While the long-term operation of a hotel is not the goal at this time, a sub pro forma was built in order establish cash flows. While the hotel does not indicate stellar results, they are not unreasonably low either. The main goal is to get the hotel up and running and then look for an investor. The cap rate that has been used to indicate value is a reasonable one that real estate assets trade for.

SCDC Mandate

When the Prelude is considered in the light of the City's objectives through SCDC, it appears to fit well within the threefold mandate of the corporation. Firstly, it addresses the aspect of profitability. This paper has sought to outline how a profit will be generated from the investment. Secondly, it speaks to the need to build an income-producing portfolio of long-term holds in real estate. There are at least two components to the project that can be held as long-term investment even after the condos are sold. Thirdly, it achieves the "city-building and economic development" part of the mandate whereby the corporation seeks the development of the type of projects under-supplied by the private sector.

Appendices

Appendix A – Schematic Design Drawings, Patrick Cotter Architect Inc.

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Appendix B – Construction Budget, ITC Construction Inc.

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