Subject: [Fwd: FW: Lynn Valley Project - a bit of history and some questions]
From: Brian Platts <bplatts@shaw.ca>
Date: Mon, 20 Mar 2006 11:50:23 -0800
To: Corrie Kost <kost@triumf.ca>, Corrie@kost.ca

Subject: FW: Lynn Valley Project - a bit of history and some questions
From: John Hunter <hunterjohn@telus.net>
Date: Mon, 20 Mar 2006 10:41:38 -0800
To: fonvca@fonvca.org

For posting if you wish

Subject: Lynn Valley Project - a bit of history and some questions

Dear Council

Introduction

Our Lynn Valley project, approved as a $6 MM library **only** in a 1996 referendum, has now potentially sprouted to nearly $40 MM given new staff recommendations going to council March 20. The project, even before this recent spurt in costs, had a totally different scope than in that decade old referendum, and with no elector assent to the massive change in scope and increased cost by a factor of five or six.. A NEW FEATURE OF THE Community Charter was used to dodge the need for elector assent. Please don't be offended by the work "dodge", because it is the truth, as several councilors said – publicly – we can't have a referendum, we'd lose - and others, like C. Nixon said publicly - we don't need a referendum because it will pass. Only C. Walton and Muri pushed for a referendum as I recall; some councilors broke their election promises re referenda.

A Sad History

This project was probably the worst run economic and political exercise in my time in the district since 1994. Most of the development work was before James Ridge (unfortunately). There was never a proper written business case or a risk analysis ('there are no risks so we don't need one", said a former DNV director publicly). Too much was done under a secrecy agreement and in camera. Council sought the last serious public input months ***after*** they had decided to proceed. The Community Charter "dodge" was sprung on citizens shortly before the final meeting, although the legislation came out quite some time before.

If you like a sad history tale, see the PowerPoint presentation attached.

Unfortunately, Council, you are now nicely positioned to be squeezed to death, bit by bit, precisely as predicted in 2003 when we said IN WRITING that unrealistic restrictions (type, density, height) made the commercial section uneconomic (see my January 2003 doc attached, yellow part). It's the old story I'm afraid – "to feed a very large apple to a horse, do it a bite at a time so he won't choke at any one feeding". You are now into what is famously know amongst us engineers as "scope creep". It can be a fatal disease. Nobody wins except contractors. You have allowed yourselves (the councilors who did this) to be jammed into a corner, and you were warned it would happen.

For the information of new council members, I attach a report of the Citizen's Budget and Finance Advisory Committee from 2003. Please note the yellow highlighted areas. You will see that a lot of what is happening should be no surprise. I believe the council of the day voted to largely ignore this report, after which the chair and vice-chair of the CBFAC resigned. A few questions/points:

- Did the legal opinion regarding the legality of the diversion of the $6MM to a different project ever get done?
- The $56-62 per taxpayer annual cost was when capital costs were in the order of $30-32 MM. Watch that cost now, especially if operating costs are increasing!
- The project has a history of underestimating capital and operating costs – are all covered now in these yet higher estimates?

The March 8 2006 Staff Report

The new Staff report dated March 8 does not contain information to determine if a second floor is economic, because it contains neither the discount rate for the NPV (net present value) calculation, nor the rationale for whatever discount rate is used. This is roughly equivalent to telling you I am investing your money at a good interest rate, but I don't tell you what the rate is. Technically a positive net present value is good news, but by changing the discount rate, I can make it negative, zero, or positive, with exactly the same financial input data. This is a time honored game. So the presentation of the positive NPV, absent the assumptions and the discount rate, is not informative.

The fact that the revenues from the extra floor exceed the costs (positive cash flow) is not a useful test. Would you be happy with an investment that gave you $100 a year positive cash flow? Perhaps - until I tell you that is from a $10,000 investment. A rationale human will want to know the return on capital invested, and compare it with other opportunities. It is NOT enough to say the cash flow is positive, or that it is a better rate of return than Heritage Fund interest. Council is investing taxpayer money by taking more taxes from our pockets, involuntarily. Unless they get a really good return, I want that money left in my pocket because I can sure invest it at a better rate than 3 or 4 % from the HF. In fact, nobody in their right mind invests in commercial real estate below, I'd guess, below 10-15% after tax to compensate for risk. And surely by now we accept that there is risk in this project.

I find this staff report confusing and not to open with information – perhaps they are trying to keeps secrets from contractors or potential buyers?

- No assumptions are given. Have operating costs been updated? Were the additions CBFAC recommended made? What costs are "in" and "out"? (This project has a bad history of costs being left out by treating them wrongly as sunk costs).

- Are we still stating the capital costs without adding what we paid for the land ($5.2 MM)? Is the old site still $4 MM? Is the federal grant still good? (This affects only financing, not economics).

- Was a second story commercial an option previously? If so, why was it bad then and good now?

- The current total cost estimate is conspicuously absent, and the progressing history of estimates. Why – are we afraid of the truth?

- What was the number when council approved the project in about June 2004, what is it with fully inflation to completion? It was $31.3 MM in the July 16, 2003 Report to Council. At May, 2004, Irwin Torry gave CBFAC $33.7 MM including land, perhaps the number that Council approved. Now it appears to be $36-39.3 MM, depending on which option you pick, IF that includes the land costs. This would seem to suggest we are about 17% over before the contracts are all let, if you accept Staff's option.

- What percentage of the total dollars has been received as commitments that are not subject to price changes? The Report does not say. Does the "90% certainty" apply to 100% of the costs, or only to the tenders/commitments received, and for what percentage of total costs are those? What does "90% certainty" mean? Are these BINDING tenders and irrevocable commitments? Note that 10% uncertainty on the total package ex land is roughly ANOTHER $3 MM plus. Is this what they mean?

- How will you handle another potential $3 MM? Another bite of the apple?

I see Staff again talk of potentially repaying the HF. Please ask them how many years the cash flow analysis shows it would take. Remember what happened with the Golf Course where we said we would repay the HF, and then had to cancel repayments of principal and interest.

In my view, Council had no moral right to do the project at all without a referendum on THIS project. That is history. In a similar vein, I don't think you have the right to spend yet millions more, even if the second floor is economic, which the Staff report does not show.

But at least put the economics to public scrutiny. That can be done in less than a week – just give a few of us a call.

regards

John Hunter, P. Eng.

Office Phone: 604-929-3415
Office Fax: 604-929-7168
Home Phone: 604-929-4436
Web: www.jhunterandassociates.ca

FW: Lynn Valley Project - a bit of history and some questions	**Content-Type:** message/rfc822 **Content-Encoding:** 7bit

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385132V1 FINAL LVP REPORT TO COUNCIL DEC 2003.DOC	**Content-Type:** application/msword **Content-Encoding:** base64

JCH COMMENTS ON LVP FOR COUNCIL JAN 2003.DOC	**Content-Type:** application/msword **Content-Encoding:** base64

JCH PRESENTATION LYNN VALLEY TOWN CENTER PRESENTATION.PPT	**Content-Type:** application/vnd.ms-powerpoint **Content-Encoding:** base64

COUNCIL AGENDA/INFORMATION		
❐ In-Camera	Date: ____________	Item # ____________
❐ Regular	Date: ____________	Item # ____________
❐ Info Package	Date: ____________	Item # ____________
❐ Agenda Addendum	Date: ____________	Item # ____________

Dept. Manager	Director	CAO

The District of North Vancouver
REPORT TO COUNCIL

December 5, 2003
File: 0360-20/62
Tracking Number: RCA -

AUTHOR: Citizens' Finance & Budget Advisory Committee

SUBJECT: **LYNN VALLEY LIBRARY PROJECT**

RECOMMENDATIONS:

1. THAT Council give re-consideration to the scale of the proposed Lynn Valley Library, and to other development options, recognizing that the cost of the current proposal will generate a probable property tax increase of roughly 4% (or $62 per annum for the average residence for twenty years), including funds already borrowed for this purpose.

2. THAT staff be requested to clarify the economics for the commercial component of the proposed development, in order that Council can fully understand if it subsidizes the library component.

3. THAT Council appoint a Development Project Manager for the project, who will be responsible for all aspects of the project (commercial, library and public spaces) and for ensuring that capital and operating costs are constrained to estimates approved by Council.

4. THAT Council obtain a legal opinion to ensure that the $6 million of the 1996 plebiscite funding is being spent in accordance with the plebiscite approval and that there are no other limiting factors associated with the plebiscite which might constrain this project.

SUMMARY

On July 22, 2003, Council requested the Citizens' Finance and Budgets Advisory Committee to review the financial projections associated with the proposed Lynn Valley Library/Town Centre development. The Committee has met with staff, conducted some independent research and has formulated some observations regarding the projections as well as the risk factors.

In summary, we believe the most likely cost of this development to be in the range of $56 - $62 annually per residence, for a 20-year term (see Appendix). This estimate compares to staff estimates of $48, with the differences primarily related to inflation on construction costs

and increased operating costs for the library. This is a significant cost increase for taxpayers, at a time when Council is attempting to also deal with other cost pressures. Given possible misconceptions among Council members regarding the cost of this project, the Committee felt that Council might want to discern whether this level of expenditure is justified. Council might want to re-consider the project and consider both a reduced scale for the size of the library plus the exploration of other development alternatives which might lessen the financial impact. **NOTE: T HIS WAS WHEN COSTS WERE ABOUT $30-32 MM JCH**

With respect to the business process used to formulate the project, the Committee observed that there may have been a number of steps missed out, including the development of a comprehensive business case. This may have precluded Council from making a realistic assessment of the financial viability of the project. The Committee submits some recommendations which Council might pursue to better understand the economics and risks associated with this project and to ensure that the project might be completed within the projected capital and operating costs.

Approach to Research:
The Committee had a great deal of support from staff in its' work and staff shared a considerable amount of information which had already been presented to Council. Nevertheless, staff has relied on the work of consultants for developing estimates of costs and revenues, and this consultant input was regarded as confidential, due to a confidentiality agreement with Dominion Construction. Accordingly, staff advised that they were not able to share source documents with the Committee. The Committee did not understand why such an agreement would be in place.

Faced with this restriction, the Committee did explore with staff the various components included in their estimates to ensure that they were all included. The Committee also sought information from outside sources so as to be able to make judgments regarding the reasonableness of the estimates. The Committee has concluded that it has, at best, only a fair appreciation of the financial projections. The Committee has built some risk factors into its conclusions, and has identified additional risk factors which might impact on the actual results.

Committee Findings:

1. <u>Construction Costs</u>

The Committee has been advised by staff that all costs of construction have been included in the estimates, including:
- o Property acquisition
- o All construction work, including municipal facilities
- o Provision for tenant improvements

As the Committee did not have access to detailed cost estimates, we accepted this information at face value. The Committee did identify that the following were not provided for in the estimates:
- o Moving costs for library, including initial set-up

- o Interest costs during construction and regular staff time. The Committee understands that these costs are charged to the annual Operating Budget in accordance with normal municipal accounting
- o Inflation costs from the time of the initial estimates to the time of start of construction

The Committee felt that the most significant of these omissions is the inflation on construction costs which staff advise might total $1 million. For analytical purposes (see Appendix A), the Committee has increased the construction costs by $1.0 million to account for additional inflation.

2. <u>Operating Costs</u>

The Committee reviewed, with staff, the budgets and provision for operating costs related to the development. Staff identified that certain costs might have offsets, and which need not be specifically identified at this stage. The following two areas were identified by the Committee as being areas where operating cost projections have probably been understated.

a) Library Operating Costs

The Committee understands that the Library Board developed an estimate for the additional costs for the new library of $100,000. The Library staff have characterized this estimate as a "very preliminary estimate, recognizing that the plans for the building were unknown and operating impact could not yet be accurately determined". The Committee appreciates the very preliminary nature of the estimate. The Committee is concerned that Council be provided with a more realistic estimate. The Committee noted a variety of factors such as:

- o that the public area of the library is proposed to increase threefold,
- o a substantial increase in patronage,
- o more complex mechanical systems in the building
- o a more efficient building

The Committee felt that the additional costs for books and materials, staffing, janitorial and maintenance, security, etc. would probably be greater than the very preliminary Library estimates. For analytical purposes (see Appendix A), a nominal additional $100,000 per year was added to the Library estimate.

b) Library Common Area Costs

The Library would share the common area costs for the proposed development along with the commercial tenants. The Library's share costs have not been included in the estimates. Based on some information from staff, the Committee felt that provision of $7 per square foot might be a minimum estimate, amounting to $280,000 per annum.

In summary, the Committee believes that the operating cost estimates have probably been understated by, at least, $380,000 per annum.

3. <u>Revenue Estimates</u>

The Committee has reviewed market research information as well as vacancy rates in adjoining developments and concur with staff that, at the present time, there is a further demand for commercial/retail space in the Lynn Valley area. On the other hand, the Committee notes that:

- The new purchaser of the Lynn Valley Mall may undertake new developments on that site which might take up some of that unfilled demand for space.
- The nature of the proposed Town Centre site is such that it is somewhat isolated from both the Mall and the stores across the streets and does not provide any surface parking. These features do introduce an element of risk for marketing the site. Careful attention will have to be given to the choice of tenants, because any changeover of tenants will generate additional unbudgeted costs (loss of revenue and provision for tenant improvements).

The Committee did not have access to the detailed calculations of revenue estimates nor the consultant's recommended rental rates. However, from comparison to other comparable market rates in the area, the Committee is satisfied that the rental rates are reasonable.

The point of departure, which the Committee took from the position of staff, relates to the questions of:

- Quantifying risk
- The valuation of commercial assets.

Staff has assumed very low rates of vacancies for the commercial premises, which the Committee felt was unduly optimistic. Further, staff have not addressed or quantified other risk factors which are associated with such a business venture. The Committee did not agree with either of these positions nor the financial projections which flowed from the staff assumptions.

In an attempt to reasonably value the commercial assets with a greater recognition of risk, and to reflect the possibility that the municipality might sell these commercial assets, the Committee utilized private sector methods of valuation of commercial revenues. This approach, which is common in the industry, establishes the capitalized value of the commercial component based on the capitalized value of the rental income – as opposed to the cost of construction of the commercial component. This approach also reflects the market value of the commercial component, which would be particularly pertinent should the municipality seek to sell these assets.

The results of this approach estimates that the commercial assets would have a value of $12.4 million. This valuation is about $2 million below the cost of the commercial component, which the Committee understands totals $14.4 million. Implicit in this analysis is the Committee's preliminary conclusion that the commercial component does not pay its way, let alone subsidize the library component.

The Committee undertook the balance of its analysis (see Appendix A) based on the assumption that the commercial revenues would only support $12.4 million of total project costs and that taxpayers would be responsible for the balance of the costs.

4. <u>Financing Costs</u>

The majority of the financing for the project comes from borrowed funds – both from the issue of debentures through the MFA as well as borrowing from the Heritage Fund. The Committee gave attention to both the assumptions around interest rates as well as the repayment terms. The bulk of the financing for the library/plaza components is already in place, with the remaining financing related to the commercial component. With respect to the financing for the library/plaza, we concluded that the main risk was related to re-financing a portion of the debenture borrowing in ten years time, and this was not considered a material issue.

The financing risks associated with the commercial component has been noted and reflected in the Committee's approach to valuation of the commercial assets (see previous section).

The Committee agreed with staff analysis pointing to a twenty-year term to amortize the debt, noting the stretching out public debt too far into the future is not good debt management policy.

The one potentially contentious issue is whether the analysis (see Appendix A) should reflect the repayment of the Heritage Fund contribution, plus interest. The Committee feels strongly that the Heritage funds should not be considered "free money" and that, if not used for this project, might alternatively be used to reduce taxes in some other manner. Accordingly, the Committee's analysis reflects repayment of these funds, with interest and reflecting the District's cost of borrowing.

Summary of Financial Analysis

The Committee's financial analysis of the proposed project is summarized on the attached Appendix A. The Committee has summarized all relevant information, made adjustments where previous staff estimates might be understated, and translated all this information to reflect the impact on annual taxes for the average residence.

Based on the assumptions made by the Committee, the end result would be a minimum 3.6% increase in annual property taxes, or approximately $56 per year for the average residence for twenty years. However, the Committee notes that there is a considerable amount of information that the Committee did not have access to, and is of the opinion that additional contingencies need to be built into the estimates. Accordingly, the Committee feels that it would be more realistic to anticipate a 4% tax increase, or $62 per year for the average residence.

The Subsidy Theory

The Committee has heard claims that the commercial component of the development "subsidizes" the library – that is, the commercial section makes a positive (revenues over costs) cash contribution to the library. The Committee was unable to substantiate this theory. Rather, as the foregoing analysis demonstrates, the investment in the commercial component would appear to generate a capital loss of $2 million. While other approaches to valuation might generate more optimistic estimates, the Committee felt that there was little chance that the commercial component would "subsidize" the library – in the traditional meaning of this term.

The Committee suggests that this issue might be re-visited by Council to ensure that they have a complete understanding of the relative contribution of the investment in the commercial component of the development.

Project Development Accountability

The Committee observed that some DNV staff were operating under certain constraints and were unable to impact or verify estimates generated elsewhere. As one example, DNV staff did not feel that they were able to impact decisions on the size and design of the library nor validate operating cost estimates. At other times, the input of consultants was relied on for estimates of costs and revenues. The Committee understands that this situation is in accordance with normal District practice to bring a project proposal to this state of development.

It appears that one individual has not been given the authority, or responsibility to manage this project. Also, a business case was not developed at the outset to guide project development and provide a mechanism for project accountability. **ALSO NO PROPER RISK ASSESSMENT JCH**

On a project of this size, it is good practice to appoint a Development Project Manager, who would be responsible for all facets of project approval through completion. It is the Committee's opinion that authority and accountability needs to rest with one individual, who is in a position to validate all cost and revenue estimates. This individual must be able to make changes to scope and design to ensure that the development stays within the financial, design and other parameters approved by Council. Other jurisdictions, including the Library Board, need to respect Council's position as funder of the project.

Usually the Development Project Manager's initial responsibility is to develop a business case which contains the following elements and provides a map for the approval, execution and completion of a project.

- Description of issue or opportunity
- The economics of the proposal, cost, rate of return, etc.
- Risk analysis
- Budget supported by cost estimates
- Schedule including start and projected completion dates
- Exit strategy

The Committee believes that the advanced stage of the project may preclude the value of prepare a proper business case, unless a different option is pursued. At this time, a Development Project Manager could assemble the various documents that are available to use as an ongoing guide. An initial requirement should be a presentation to Council of a high level project plan that would include a budget, schedule, risk assessment, and exit strategy, as a minimum.

Legality of Expenditure of the 1996 Referendum $ 6 Million

The Committee does not claim expertise in the issue of permitted uses of referendum-approved funds. However, the Committee notes that the proposed project is substantially different in nature, scope and cost from that which was advertised prior to the 1996 referendum. The Committee considers it to be prudent for Council to obtain a legal opinion regarding the use of the referendum funds to ensure that any future challenge might be addressed without derailing construction.

Conclusion

The Committee appreciates the opportunity to work with staff and Council to review and comment on this important initiative of Council. The Committee is available to provide further clarification to this report. Should Council pursue an alternative development strategy for replacement of the library and development of the town centre site, the Committee would request that its' involvement might be at an earlier stage, in order that it might be able to support the work of Council, rather than critiquing a finished proposal.

Hugh Creighton
Chair
Citizens' Finance & Budget Advisory Committee

REVIEWED WITH:	REVIEWED WITH:	REVIEWED WITH:	REVIEWED WITH:
❑ Community Planning	❑ Clerk's Office	External Agencies:	Advisory Committees:
❑ Regulatory Services	❑ Communications	❑ Library Board	❑ ________________
❑ Utilities	❑ Finance	❑ NS Health	❑ ________________
❑ Engineering Operations	❑ Fire Services	❑ RCMP	❑ ________________
❑ Parks & Environment	❑ Human Resources	❑ Recreation Commission	
❑ Golf Facilities	❑ ITS	❑ Solicitor	
		❑ Other: ______________	

SOME COMMENTS ON THE LYNN VALLEY TOWN CENTER PROJECT

These are a few comments made on my own behalf that may assist council as it continues deliberations on this project. There was not time to make all these observations in the CBFAC in camera presentation to council January 19, 2004.

The Library Sector of the Project:

- CBFAC did not check the 1998 library sizing/design study done under the Library Board auspices to see if the assumptions and design basis still make sense, and we were under the impression that Staff did not either. That study is over a half decade old.
- However, Peter Thompson did, and his work raises serious issues. My understanding from his work is as follows:
- The library is probably significantly oversized, and hence overpriced, for two reasons. Firstly, the design basis was for year 2030. The population growth assumptions are twice actual recent DNV experience, forcing a larger library. Secondly, there is a perplexing assumption that library use will shift to this new library from other branches. The extra size due to these assumptions is 15%, or about $1.4MM.
- As noted in Staff's July 2003 report on the project, the library design includes pre-investment of 8300 square feet (20%) for future expansion, with interim commercial use. The cost of this pre-investment is approximately $1.9 MM.

- **In short, there appears to be a "double dip", resulting in a library oversized by about 35%, or $3.3 MM.**
- I am not suggesting that a library needs to make a financial return, but it should be minimum reasonable cost. I recommend that the key design assumptions (including the future impact of Internet use), be rechecked.

The Commercial Sector of the Project

- No private sector party would undertake such a "commercial" project ("CP"), which clearly has risks (despite Staff's public and private denials of risk) without a significant margin over their cost of capital. None of the private sector parties would undertake the CP under the conditions offered by DNV – unrealistic conditions in my view.
- CBFAC showed Council a calculation of the cost of the CP vs. its apparent value using a typical private sector method involving an 8.5% return, a *low* range number. It showed the CP as unattractive. One council member has argued this return is too high so that the CP is perhaps attractive.

- This belief is incorrect. At my request, Staff ran some rate of return numbers on the CP, using a set of assumptions that are deliberately unrealistic in the favorable direction. This method takes costs and revenues over the years, and calculates a percent return on capital invested, somewhat analogous to what you may do for your investments. **The deliberate unrealistic assumptions designed to make the CP look good were:**
    - **None of the several millions of dollars of common facilities (Ross Road re-alignment, plaza, underground parking, etc.) are apportioned to the CP.**
    - **Using Staff's operating and capital costs, which CBFAC found are too low.**
    - **Assuming no risks in the project other than ramped vacancy rates.**

- **The resulting returns were around 4% for a 20 year project life, even with unrealistic assumptions designed to make the CP look good.**
- **Translation: economic turkey.**

The CP does not subsidize the library. The argument that because the revenues from the CP exceed costs, the CP is subsidizing the library, is naïve. It ignores the fact that $14 MM has to be invested to achieve this. The return is even below projected cost of capital of 5.5%, and far below a realistic return for a commercial project that does entail risk. If we put in actual costs, and included a share of common facilities, the returns would be much worse.

What is the problem?

It is not that the CP is too large as Mayor Bell wondered aloud in our meeting. If anything, it is ***too small*** to be economic. In addition, the many limitations put on the CP over time (e.g. no residential component, no more than three stories) destroyed any possibility of the CP being economic.

Can it be Fixed?

Yes, if Council is prepared to look at changing limitations. However, based on past experience, I strongly suggest DNV not undertake the CP. It should formulate a realistic picture of risks and returns, and induce the private sector to undertake it.

Whatever is done, we should have business plan, including a risk assessment, an exit strategy, and commercial style economics with sensitivities for various cases. Also an absolute requirement is single point accountability for the project by a senior staffer, not from start of construction as staff misinterpreted the CBFAC recommendation, but including the entire business plan and construction, including due diligence on the input of others such as the Library Board.

I think Council needs to report to taxpayers that as is, the LVP project is too risky and too expensive, and redesign a package that works.

John Hunter
January 30, 2004
Belleville Ontario
613 398 7676