

PRINT

How city hall messed up Millennium Water; By adding millions of dollars to the cost unnecessarily, Vancouver created the problem that it's trying to get everyone else to solve

Vancouver Sun
Sat Oct 16 2010
Section: Issues & Ideas
Column: Rob MacDonald
Source: Special to the Sun

The financial problems with the Olympic village project have not all been caused by the developers, Peter and Shahram Malek, who seem to be taking all the heat from both the media and current Vancouver councillors.

These criticisms are being levelled by people who are either unfamiliar with, or wish to ignore, all the facts surrounding the development on False Creek.

When Mayor Gregor Robertson asked me and several others to review the affairs of the Olympic village last year, I took my investigations seriously and a number of things came to light that are important to put on the table to provide some measure of historical context and balance to the discussion.

1. After the city committed to building the athletes' village for the 2010 Olympics two administrations ago, municipal staff waited too long to get the project underway. These delays created a host of costly problems, which were ultimately dealt with by the developers' company, Millennium Development Corp., to get the project completed on time.

These delays and the resulting costs were not the developers' fault, yet the city assumed they would bear the costs which were then supposed to be magically passed on to buyers.

2. The city delivered the development site with contaminated soil. Though the city would normally be responsible for cleaning up the soil on its own property, the developer was forced to pay more than \$20 million to remove the contaminants. That process caused a further delay in construction of at least three months, which in turn led to higher costs because of overtime for workers.

3. The project's late start created a situation in which the development was being built at the same time as it was being designed. The city also imposed the highest possible "LEED Gold" environmental standards of design after the developer had been enticed into the deal based on the lower "LEED Silver" standard.

The rushed construction and the scope of environmental changes imposed by the city resulted in massive cost overruns that would have been impossible for any developer to control.

4. The project's late start and Olympic-related complications contributed to a transaction structure that made the project almost impossible to finance on normal lending terms. As a result, the developer had to seek out financing that bore a high interest rate that added probably another \$50 million to the development. Normally, a project would be fully designed and costed out, then pre-sold to the public and financed at normal bank rates of interest, which are now about three per cent. The city threw standard development procedures out the window and the developers had to bear the extra costs.

5. With all the additional costs foisted on the developers, the project's basic hard construction cost ballooned to about \$450 per square foot compared with other large-scale developments that were being built at the same time in the normal marketplace at about \$300 per square foot.

The environmental and construction acceleration costs (picture men and women working 24 hours a day, seven days a week, incurring massive overtime charges) caused at least \$125 million in extra costs. When one

adds the additional interest that was paid because of the deal structure, the additional financial burden on the developers approaches \$175 million.

6. Once the city took over the project financing, it in turn borrowed the money at an interest rate of about 2.5 per cent. Even though the city was substantially responsible for many of the project's cost overruns due to timing and environmental delays, it would not pass all the interest savings on to the developer. When I suggested to the city that this would be a fair thing to do, I was summarily rebuked.

It is worthwhile to also note that when the city now says that the developer owes more than \$560 million in debt including accrued interest, you have to remember that what the city owes to its own lenders is probably \$30 million less than that, because the city's incurred rate of interest is much less than the developer is being forced to pay the city.

7. The developer had to endure a host of issues associated with the Winter Games, which affected more than just the costs. For instance, the sales program had to be essentially halted for security reasons just when a world of customers had come to visit. And, of course, during that time the city's interest clock kept ticking.

8. Some people at city hall have been saying things about the development that have substantially damaged the project's salability and brand reputation -- something that no sensible lender would do.

Peter and Shahram Malek did an incredible job getting this project delivered on time for the Olympics after facing every possible obstacle. To wholly blame them for the project's financial difficulties is neither right nor fair.

So what is the real financial condition of this project? The value of the market condos after paying sales commissions, marketing costs and further interest charges is about \$500 million. In addition, the extra residential rental tower and the commercial space in the project are together worth about \$70 million, so the total net asset value is about \$570 million.

The city now owes about \$530 million on its debt, so the surplus of about \$40 million could be applied to the remaining purchase price for the land on which the developer purportedly still owes the city \$170 million.

If the city works with the developer and does no further harm to the project, now called Millennium Water, the city will pay off its debt and receive another \$40 million attributable toward the land sale, which would be a positive outcome. Though the city would receive about \$130 million less than the original land sales price, it will get about what it deserves, given its costly conduct.

Unfortunately, the developer is facing a loss of all its equity investment of about \$60 million, and though the city now wants the Maleks to kick in more money, that would be plainly foolish.

If the city thinks it can sue the developer for the balance of the land price originally owed, then the biggest construction litigation case in British Columbia's history would probably ensue. That would only enrich the lawyers, damage the project further and dredge up so much toxic mud that city hall would be shaken right off its murky foundations.

Of course, the mayor realizes that this all could become politically explosive and he is understandably trying to distance himself and his political colleagues from any culpability. However, if a major legal battle ensues then it will be impossible to avoid all the flying mud, particularly when city officials have said things that have damaged the project's reputation and sales.

City staff and council should take the advice of experienced real estate professionals, such as the very capable Bob Rennie, and get all inexperienced hands off the tiller. The litigation lawyers should be kept away from the deal.

October 16 - 18, 2010

Millennium Water is one of the finest environmentally conscious projects ever built. It is located in a beautiful spot in one of the world's greatest cities. It will prove to be tremendous success in the long-run. All it needs is experienced calm hands to guide it through the selling stage. Peter and Shahram Malek are decent, award-winning developers. They deserve to be treated with respect and handed a silver medal for delivering the project on time for the Olympics despite all the difficulties they faced.

Rob Macdonald is president of Macdonald Development Corp. and a director of the Urban Development Institute.