

Valuation Considerations in the Appraisal of Long-Term Leasehold Interests

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Presentation Goals

- To provide an overview of long-term leasehold interests In British Columbia.
- To discuss valuation principals when appraising long-term leasehold interest.
- To consider some of the implications of compulsory land acquisitions on long-term leasehold lands.
- To argue long-term leasehold interests will become more common in the future.



First Some Definitions

- **Fee Simple Interest:** Full ownership of the land
- **Leased Fee Interest:** Fee Simple Interest encumbered by a lease
- **Leasehold Interest:** “The right held by the lessee to use and occupy real estate...”

- **Fee Simple Owner:** The Lessor
- **The Tenant:** The Lessee (may be the occupier or developer of land)
- **The Sub Tenant:** The Sublessee (may sublease the land or buy a leasehold condo)

- **Prepaid Lease :** Lease costs paid at commencement, no annual cost over the term
- **Non-Prepaid Lease:** The tenant pays monthly or annual



Where do we See Examples of Long-Term Land Leases?

- University of British Columbia
- Simon Fraser University
- False Creek in Vancouver
- Port Lands
- Airport Lands
- First Nations Land around British Columbia
- Many municipalities have (or are considering) leasing land on a long term basis.



Why Leasehold and not Fee Simple?

- Motivations Vary
- In some cases (ie. First Nations) land cannot be sold in Fee.
- In other cases developers wish to retain long-term land ownership.



Appraisal of Long-Term Leases

- Valuation methodology will depend on the terms of the lease.
- Value relates to present value of future cashflow over the term of the lease.
- There are three main types of long-term leases:
 - Leasehold land (ground leases)
 - Improved condominium units (stratified)
 - Improved single lessee assets



Appraisal of Leasehold Land

- Is it prepaid or non-prepaid?
 - If prepaid, leases can be compared to fee simple values (if the term is sufficiently long). There will still often be a discount
 - If non-prepaid, the approach will depend on the terms of the leases.
 - Non-prepaid leases are common on Port Lands & Airport Lands
- What does the use clause say?



Appraisal of Leasehold Condominium Units

- The most straightforward assignment... As long as there is comparable data.
- Direct Comparison Approach is typically the best indicator of value
- Can be very challenging in markets with limited data.
- As a lease comes to the end of its term, landlords may be incentivised to buy out the remaining term at a premium.



Appraisal of Improved Commercial Assets

- There are examples throughout this Lower Mainland and Okanagan of Improved commercial assets leased on a long term basis.
- Typically valued using the Income Approach:
 - Capitalization Value
 - Or Present Value over remaining term of lease
- Capitalization rates will increase as the lease term decreases.

$$\text{Capitalized Value} = \frac{\text{NOI}}{\text{Capitalization Rate}}$$

$$\text{Present Value} = \frac{1 - (1/(1+r)^n)}{r}$$

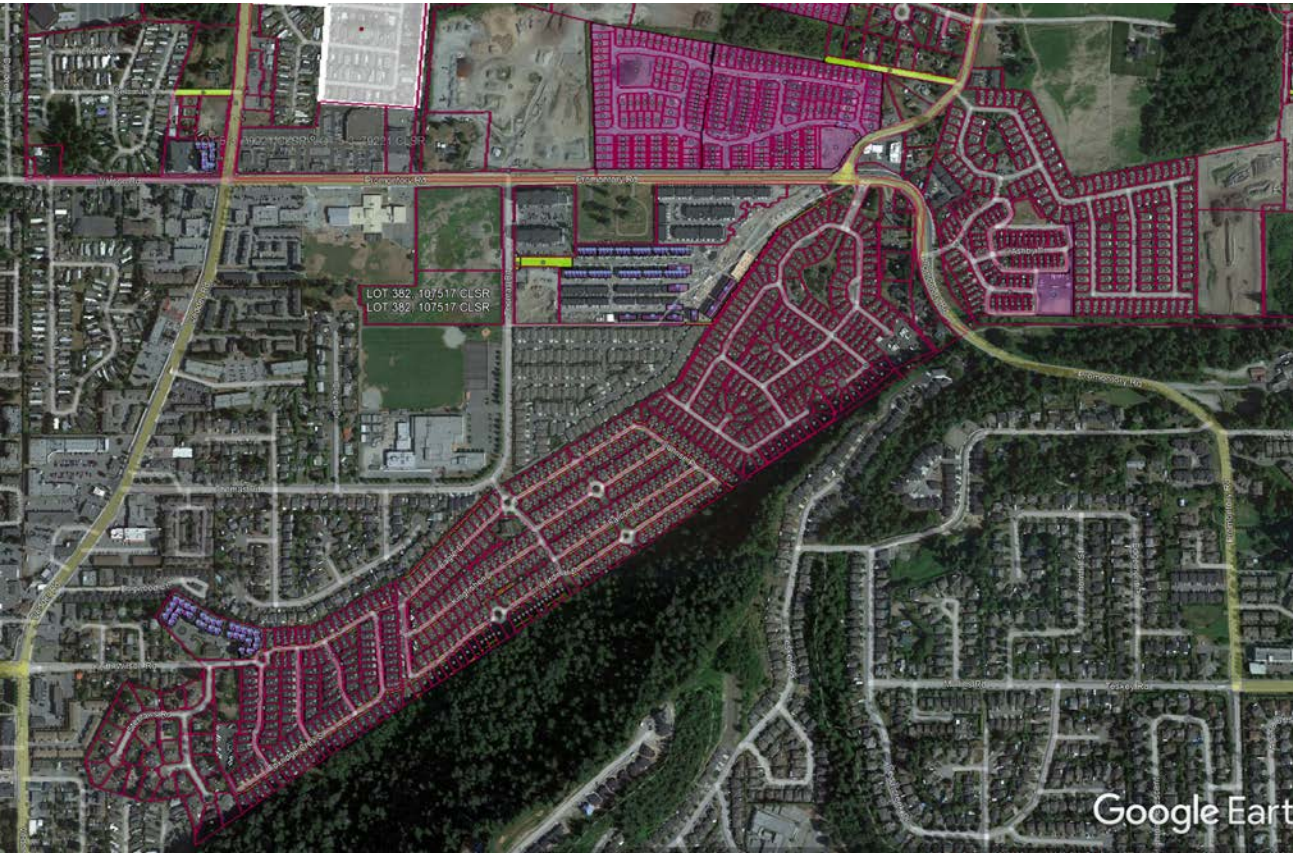


Leasehold Discounts vs Fee Simple

- There is a general perception that leasehold land should sell for less than fee simple land.
- This is not always the case (i.e. UBC).
- Discount relates the availability of other options.
- For examples: UBC vs. Chilliwack leasehold

Lease Term in Years	Prepaid Lease Value as a % of Fee Value
99	96%
80	95%
75	90%
70	85%
65	80%
60	75%

Leasehold Discounts: Chilliwack vs. UBC



The Downsides of Long Term-Leases

- New 99 year leases function similarly to fee simple land... at first.
- Closer to the end of term buyers become more reticent.
- With only 30 years remaining, financing becomes difficult.
- With 10 – 20 years remaining it may be difficult to amortize the cost of needed repairs.



Why is this relevant in an Expropriation Context?

- Long-Term Lessees are owners under the Expropriation Act.
- Compensation will be case specific and may be impacted by Specific Expropriation Provision in the Lease.
- Most Leases will have an Expropriation Provision, however, these typically only apply for full acquisitions or partial takings that destroy the improvements.



Case Studies



Case Study #1: A Long-Term Non-Prepaid Interest

- Lions Gate Business Park is a leased on a long-term, non-prepaid basis from the District of North Vancouver.
- 52 years remaining on the lease.
- The property sold \$22,600,000. Purchased by a Life Insurance company.



Case Study #1: A Long Term Non-Prepaid Interest

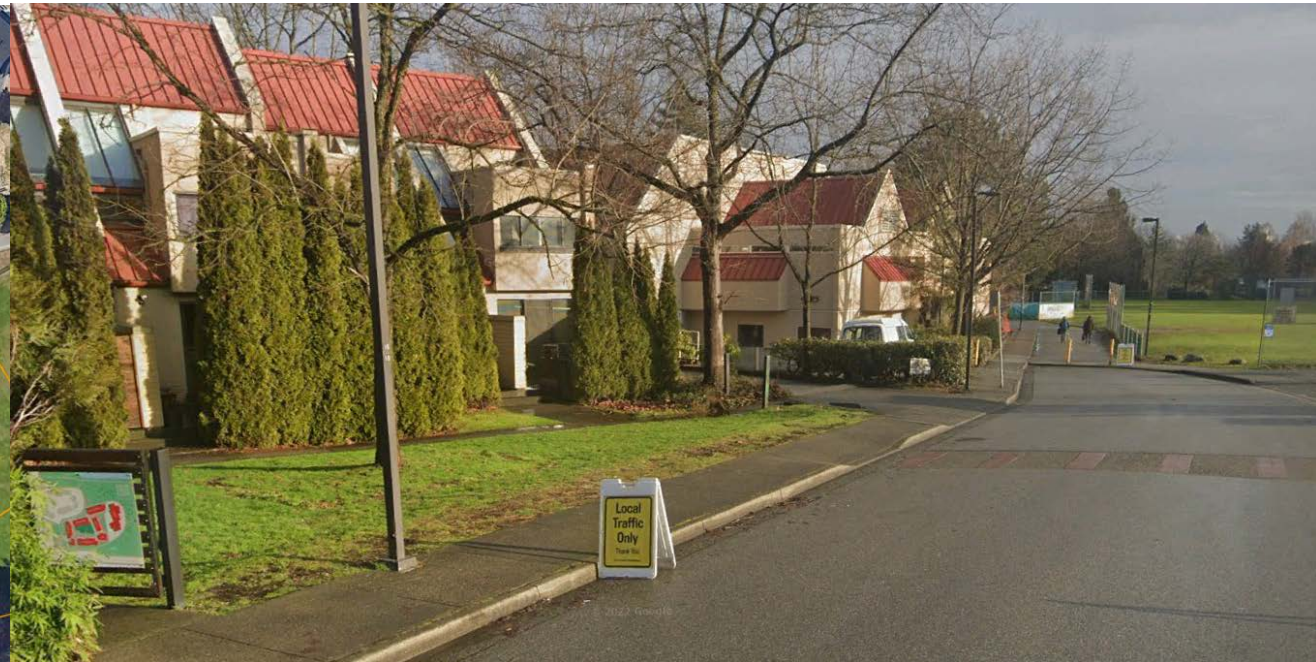
- Indicated Capitalization Rate 5.8% which is 225 bps – 250 bps higher than fee simple
- IRR: 5.43% (no growth)
- Indicated discount from fee simple values = +/-40%.



Case Study #2: Partial Taking

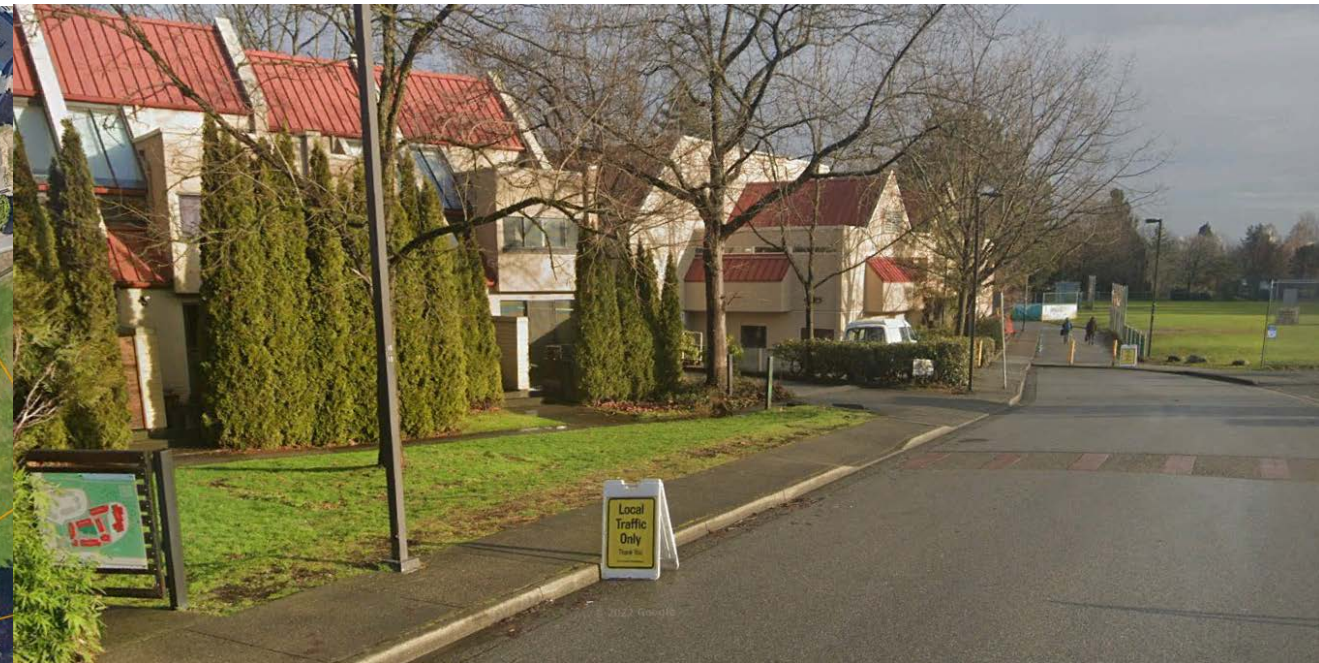
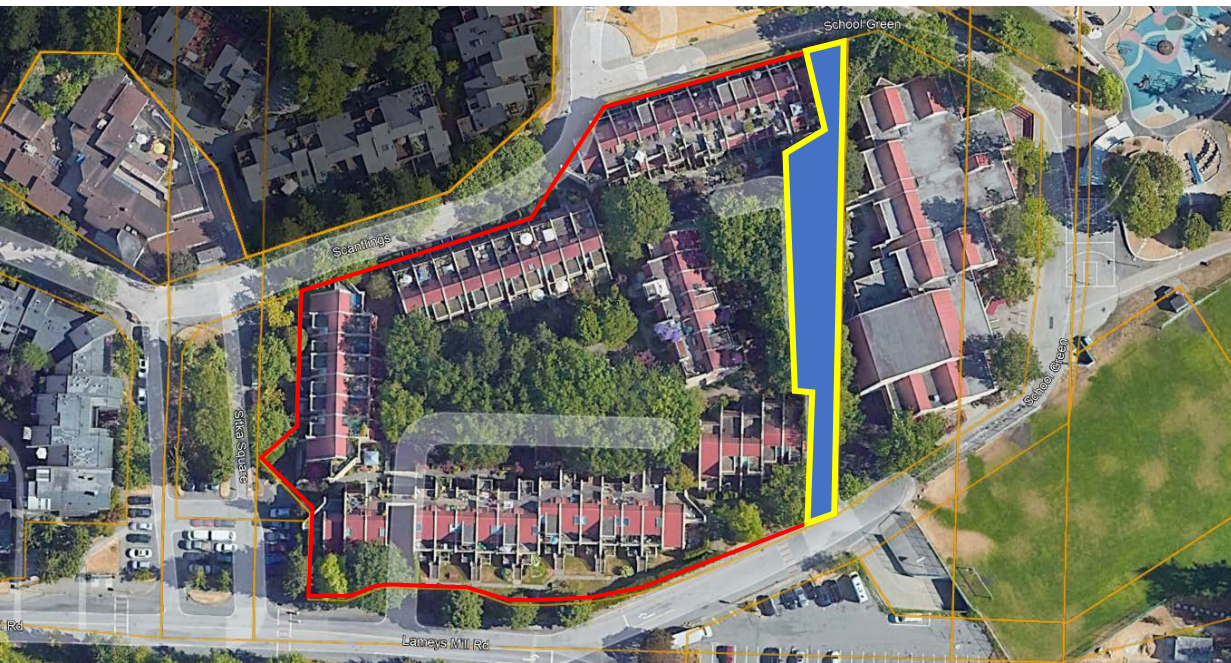
BC Hydro proposes a partial taking on Leasehold Land:

- Property is improved with a 50 year old leasehold Co-Op. 30 years remain on existing lease.
- Highest and best use at the end of the lease term is for higher density development.



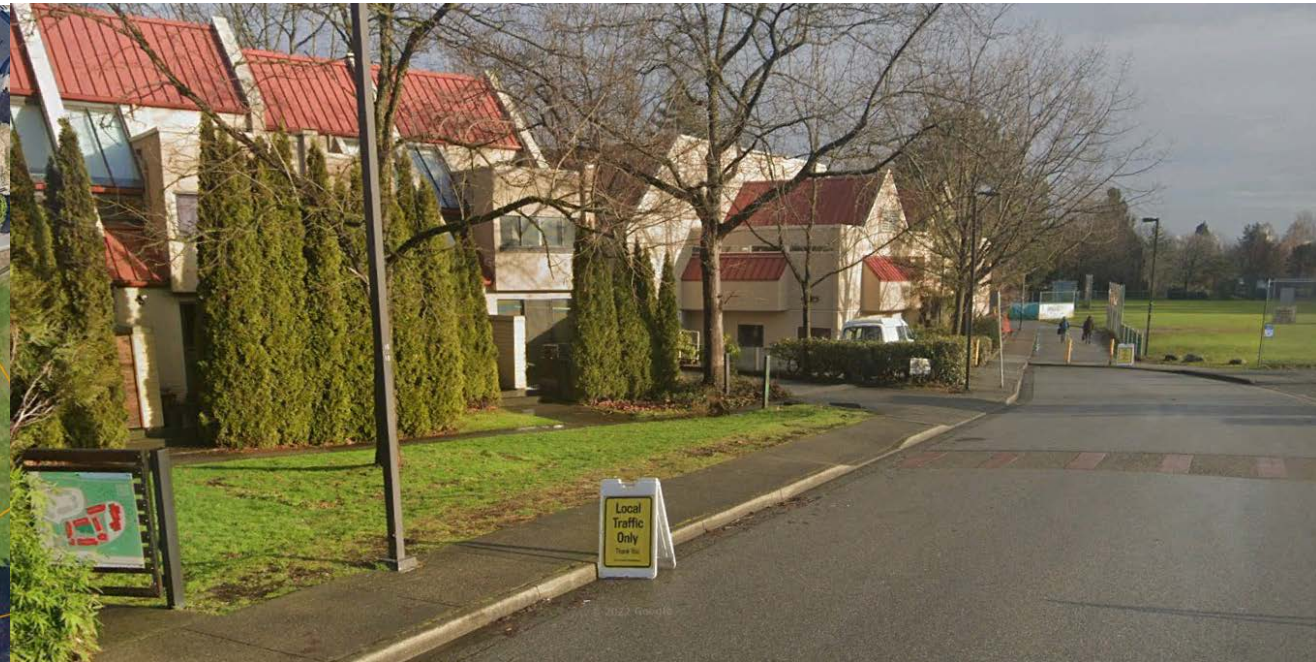
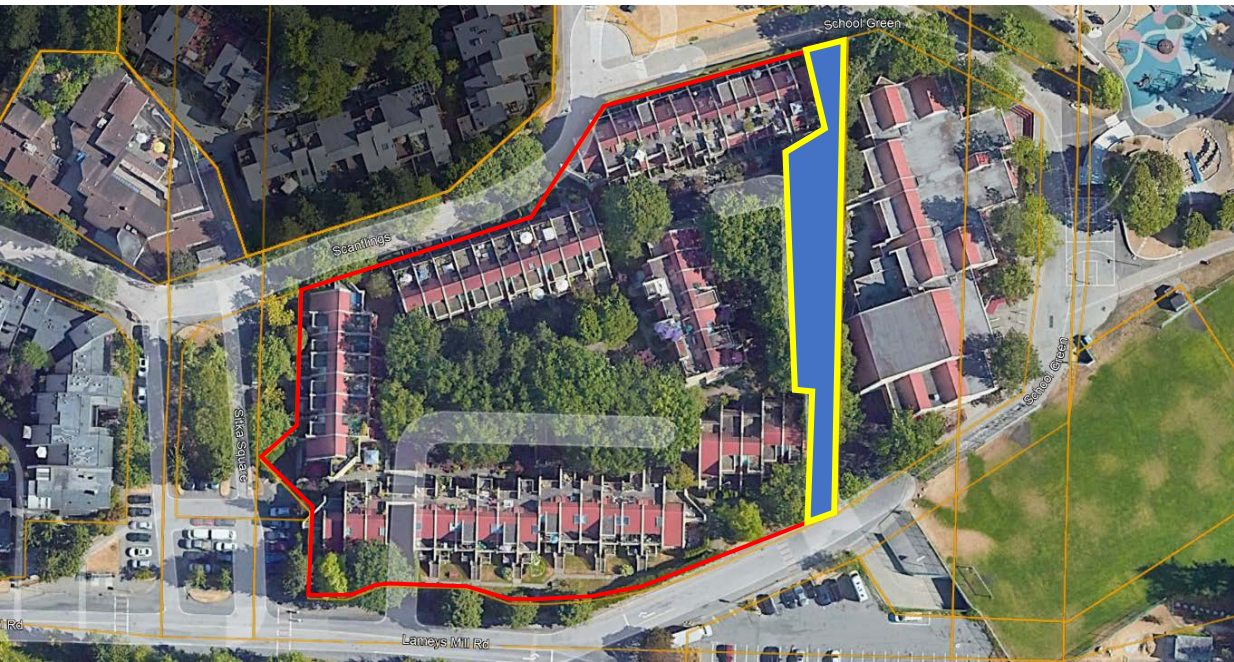
Case Study #2: Partial Taking

- Undersurface partial taking will not impact existing use of the land
- Who are the owners?
 - The Lessor: City of Vancouver wants compensation based on highest and best use. May argue there is injury based on that use even though HBU cannot be realized for 30 years.
 - The Lessee: Must be compensated based on the terms of their lease.
 - Does Leased Fee Interest + Leasehold Interest = Fee Simple Interest?



Case Study #2: Partial Taking

- Fee Simple Value: $5 \text{ FAR} \times \$450/\text{buildable sq.ft.} = \mathbf{\$2,250/\text{sq.ft. of land}}$
- Leased Fee Value: PV for 30 years of $5 \text{ FAR} \times \$450/\text{buildable sq.ft.} = \mathbf{\$520/\text{sq.ft. of land}}$
- Leasehold Value: $1 \text{ FAR} \times \$600/\text{buildable sq.ft.} \times 30 \text{ yr. Leasehold Discount (60\%)} = \mathbf{\$240/\text{sq.ft. of land}}$
- Where did the land value go?



Long-Term Land Leases will (Probably) Become More Common

- The Lower Mainland (and other areas of BC) are running out of land.
- Discounts fall as acceptance increase.
- Discount fall when there are fewer fee simple options.
- We are seeing growing interest from developers who see an opportunity to retain ownership while also benefiting from development profits.
- Political pressures may reduce the willingness of government to sell land in fee simple.
- This is a common form of ownership in Europe where land is scarce.
- Leasehold can allow for creative reduced cost / social housing initiatives.



Thank you!

Questions/Comments

