



# First Unitarian: Theia's Market Building Proposal Details

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## **Preamble:**

The City of Ottawa has recognized that we are both in a climate crisis and a housing crisis. First Unitarian has a very unique opportunity to address both of those issues through facilitating development of a rarely used, likely slightly contaminated, gravel parking lot. Even better, the Church has the opportunity to secure long-term financial sustainability in the face of congregational aging and provide housing for a diversity of people.

## **Key Takeaways on Market Development:**

It is an unfortunate misconception that a real estate developer can do whatever they would like to. The reality is that the built-form is heavily regulated through the City (Official Plan, Secondary Plan, site plan and building permit), and that the key financial metrics are set by lenders (who themselves are heavily regulated). We walked the committee through a presentation entitled 'Market Development 101', that provided the committee with insight to how market development happens within the City of Ottawa. Some of the key takeaways included:

1. It is possible to leverage land value to generate a positive return;
2. Development, on this scale, has relatively low margin, but generates significant returns by using leverage (loans), and given the overall size of the investment (\$85m project), the annual returns can be quite significant;
3. A developer-partner would need to provide a guarantee on the loan. That is, if the project experienced difficulties, the developer would need to pledge other assets to cover any potential losses. A developer providing this guarantee would expect some reasonable return given the risk and effort. Given the expertise required and the significant risk, it is not recommended that the Church aim to fully self-develop the project;
4. Lenders (including CMHC) will require a minimum debt-service-coverage to fund the project. The ratio varies, but a reasonable assumption is 1.3. That is, a lender will require covenants in place that keeps net operating income (income after expenses such as utilities, cleaning, property taxes etc) 30% higher than the debt-service (monthly mortgage payment). The rationale for this is that a bank wants to make sure that even in a case of high-vacancy in the building or unexpected expenses, the owner would still be able to pay all of the operating costs and



make loan payments. Given this requirement, a minimum amount of surplus is actually required in order to finance a market-building, and stay onside with lender-covenants.

5. An owner can spend the surplus as they see fit. Although it may not be possible to lower rents to as low of level as desired by the Church, the Church could use excess surplus to set up a philanthropy fund which could be used to subsidize individual rents, fight poverty in the community, advance reconciliation or sustainability, or any other host of uses the Church would like to promote.

## **The Proposal**

What is being proposed for the market component is finding a market developer partner who would work in collaboration with the Church to develop the project. Over and above the land value, some cash equity would be required, and a significant amount of loan would need to be secured. The developer would raise the required equity, secure the financing, provide the guarantee, and for that service they would collect a percentage of the surplus cash flow from the project. It would be important to secure a developer rooted in strong values, with a history of socially and environmentally responsible development.

## **Ownership**

It is important to the Church that they maintain a level of ownership of the land. The initial expressed preference was for the Church to lease the land to a developer. Unfortunately, financing high-rise residential development projects on leased land is a challenge, with little in the way of modern precedent in Ottawa. Instead of a lease, we would propose using a Limited Partnership structure to allow the Church to maintain a majority ownership in the land while providing an acceptable way for the developer to achieve financing.

A Limited Partnership is a way of structuring a business. Every Limited Partnership (LP) also has a General Partnership (GP). The liability for the LP is capped at the value invested in the business (in this case, the land), whereas the liability for the GP is unlimited. The GP has day-to-day operational responsibility for the project, whereas the land ownership rests with the LP.

In our case, this is how we are recommending it would work:

1. A developer-partner is secured. They would ultimately be the GP for the project and would have day-to-day responsibility for bringing the project to life. The developer partner would be responsible for providing whatever cash equity is required, overseeing development, and would ultimately take on the risk for any budget overruns. They would report out on a regular basis to the Church;
2. A Limited Partnership and a General Partnership is formed. The land would be placed into the Limited Partnership, who would become the new legal owner of



the land. Assuming RCFI financing could be procured, the Church would continue to be owner of +/-80% of the shares in the Limited Partnership;

3. The GP would develop the project, with a regular reporting back to the LP (including the Church);
4. The General Partnership, in exchange for taking on the risk, assembling the cash equity, and running the project, would receive a development management fee (funded through a combination of cash equity and bank financing), and a share of the surplus profits. The LP (the Church) would receive the majority of the surplus cash, to be used to support the long-term financial viability of the Church and for philanthropy.

## **Governance**

Governance of the Limited Partnership and General Partnership would be laid out in the legal agreements for the LP and the GP, with regular reporting. We would recommend a reporting rhythm, such as:

- Monthly check-ins between the developer and the Church committee;
- Quarterly investor reports to the Church (LP);
- Annual General Meeting.

Ideally the reporting is based on a triple-bottom-line basis, environmental, social and financial metrics.

The legal agreements would stipulate key criteria as they related to ensuring the development was being environmentally and socially responsible.

## **Returns & Pro Forma**

We have undertaken extensive financial modelling of this project to ensure that a market building, largely targeting average income-earners, would be viable. We used the definition of affordable used by CMHC in their RCFI program to guide the development of the pro forma. Assuming the proponent was successful with RCFI financing, the project is very much viable, creating attractive returns for the Church.

The pro forma makes the assumption that the Church puts only the land into the deal, with the developer responsible for all remaining equity, securing debt, and for taking on the risk of the project.

It will take several years for a project of this size and scale to become fully occupied. Prior to building occupancy and stabilization<sup>1</sup>, no returns should be expected (this could take five years). Once stabilization has occurred, long-term financing is typically put in

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<sup>1</sup> Stabilization is a real estate term to mean the building has reached the expected long-term vacancy rate and is functioning as to be expected. On a building of this size, that is likely approximately 18 months following first occupancy.



place (often referred to as 'take-out' financing, as it takes-out the construction loan). In the first year of stabilization, the model demonstrates a total surplus cash flow of \$587,696. A proportion of that would go to the developer-partner as asset management fees and a profit-share accompanying taking on the risk for the project; a further proportion would go to other LP investors (a minority). Modelled net returns to the Church would be as follows:

First year following stabilization: \$320,882

At year three following stabilization: \$395,325

At year five following stabilization: \$469,787

It is difficult to predict the state of the market, and the state of Church finances, over a decade from now, but our hope is that this would be sufficient cushion to ensure the Church remains solvent indefinitely into the future, while also having surplus to use to support missional objectives. One of the positive attributes of real estate is that it adjusts for inflation, and over time, as the loan gets paid off, the cash distribution should get a little better.

There are risks associated with the modelled returns. We have used a 50 year amortization period to help drive better affordability, but that increases risks of market disruptions, and relatively little equity is built up in the building over the first decade. Interest rates are currently low from a historical point of view, which is subject to change, and that could impact returns. Inflation, particularly related to construction pricing, is also a concern. Your developer-partner would put in place strategies to manage these risks.

## **Sustainability**

The Church has made it clear that sustainability is mission-critical, and any building on the site must demonstrate a high-level of environmental performance. The scope of work for this project did not include doing any design work, engineering or energy modelling, but it is possible for us to provide some high-level commentary on sustainability aspirations for the building. It is extremely unlikely that a developer partner would be able to achieve full Passive House energy performance in a taller building, built within market constraints. However, the following sustainability measures should be explored by the developer partner:

- Electrification of the building to eliminate need for natural gas;
- Geoexchange heating and cooling (may require third-party provider and off-balance sheet approach);
- Passive solar design principals;
- Energy efficient design;
- Energy Star appliances;
- Low carbon (i.e. mass timber) material choices;
- Green roof;



- Use of FSC wood for millwork and potentially flooring;
- Provision of rooftop or balcony gardens;
- Low-flow fixtures;
- Extensive indoor or covered bike racks;
- Education on move-in around sustainability lifestyles.

Given the proximity to LRT, a combination of affordable and market housing, facilitation of active and public transit, and a high-level of sustainable design, this would be a demonstration of low-carbon infill housing.

## **Timelines**

It is critical to understand the length of time it would take to complete a project of this size and complexity. Timelines subject to change, but here is an illustrative timeline:

December 2021 – May 2022 – selection of a developer-partner and formation of legal agreements;

May 2022 – August 2022 – preliminary design concepts and preconsult with City;

September 2022 – September 2023 – rezoning process to allow for multi-unit residential on the property;

June 2023 – November 2023 – site plan agreement and further design work (overlapping with rezoning);

December 2023 – March 2024 – construction drawings and submittal for permit;

Spring 2024 – commencement of construction

Spring 2026 – occupancy

January 2027 – full building stabilization

January 2028 – first annual distribution

Although the Church is not in immediate financial need, the timeline illustrates that this is a long process, and requires the Church to be proactive and look years into the future.



## Sample Images

### Central Presbyterian/BOSA Properties tower





Zibi Block 206







## The Merit

