Bureau du vérificateur général

V.8. Faubourg Saint-Laurent Project—Phase III Land Sale

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V.8. FAUBOURG SAINT-LAURENT PROJECT—PHASE III LAND SALE

1. INTRODUCTION

The Ville de Montréal (the city) is the owner of a significant collection of buildings involving both public and private properties. Public properties include parks, streets and alleys. Other real estate is private property used, among other things, for municipal and borough departments to carry out municipal activities. This property can be acquired or disposed of for residential, industrial or commercial development purposes.

In February 2010, City Council was called upon to make a decision on the sale of a parcel of land with an area of 2,648.8 m^2 located on rue Charlotte (north side), on the east side of rue De Bullion and the west side of avenue de l'Hôtel-de-Ville. It was the third and final parcel of land sold by the city as part of the Faubourg Saint-Laurent Project, which is bound by boulevard René-Lévesque, rue Saint-Dominique, rue Sainte-Catherine and avenue de l'Hôtel-de-Ville.

The group of properties in the Faubourg Saint-Laurent Project, an area of nearly 10,725 m^2, was acquired by the city through expropriation at the beginning of the 1990s. Development activities materialized in 1992 when the Executive Committee gave its permission for lots 38-18, 38-26 and 38-28 to move on to the second phase of Opération Habiter Montréal's residential development program.

From 1993 to 1998, the city tried to find a developer for the sale and development of the lots. In April 1993, the Executive Committee authorized the Service de l'habitation et du développement urbain (SHDU) to make a public call for proposals and approved the sale prices for the lots. In September 1993, the SHDU approved one of the two proposals received. Then, in January 1997, when the developer who had been chosen withdrew, it repealed its decision. In July of the same year, the Executive Committee authorized a second call for public proposals and approved the sale prices. A single proposal that was deemed noncompliant was received at that time. Finally, in November 1997, the Executive Committee once again directed the SHDU to negotiate the private sale of the properties while abiding by the sale prices approved during the second call for public proposals. It was not until 1999 that a developer officially showed interest in the land.

In August 1999, City Council adopted a by-law for the construction and occupation of a real-estate complex on these lots (By-law 99-171). The city and the developer signed a development agreement in September 1999.

Under this development agreement and a subsequent amendment (2001), the three lots were to be sold in sequence according to the established deadlines between March 2000 and March 2003. The transfer deeds for the first two lots (38-26 and 38-18) were signed as agreed within the timeframe. However, it was not possible to sell the third lot (38-28) by the March 22, 2003 deadline for $400,000.

Finally, in February 2010, 10 years after the approval of the development agreement, a draft transfer deed was adopted by City Council for an amount of $1,500,000.

2. AUDIT SCOPE

The goal of this audit is to verify that the city took all of the necessary measures to conclude the sale of lot 38-28 within the prescribed timeframe at a sale price corresponding to the market value at the time of the transaction. We have, therefore, examined whether contractual obligations were respected and how the sale price was established.

Our audit work was conducted primarily in 2010 with the Direction des stratégies et transactions immobilières of the Service des immeubles et des systèmes d'information (SISI) and Ville-Marie borough. It focussed on the years 1999 to 2010, the period that elapsed between signing the development agreement and signing the transfer deed for Phase III. However given our goal, in some cases we had to consider data dating from before this period.

3. FINDINGS, RECOMMENDATIONS AND ACTION PLANS

In the first part of this report, we will present the chronology of events that occurred on and after the signing of the development agreement to the date of the real estate transaction in March 2010. We will also clarify the steps taken by the city to have the developer respect his contractual obligations. Even though our audit focuses on Phase III of the project (lot 38-28), we will also need to refer to the delays attributable to Phase II (lot 38-18). In the second part of this report, we will address the establishment of the sale price for this land, given the time that had elapsed since the signing of the development agreement.

3.1. FAUBOURG SAINT-LAURENT PROJECT—SALE OF LAND

3.1.A. Background and Findings

Under the provisions of the development agreement, the developer agreed to purchase three lots in sequence according to the following deadlines:

- The first (lot 38-26), with an area of 4,432.8 m^2, no later than six months after signing the development agreement (March 22, 2000) for Phase I
- The second (lot 38-18), with an area of 3,643.4 m^2, 18 months after signing the development agreement (March 22, 2001) for Phase II
- The third (lot 38-28), with an area of 2,648.8 m^2, 30 months after signing the development agreement (March 22, 3003) for Phase III

The sale prices of the three lots were $820,000 (lot 38-26), $550,000 (lot 38-18) and $400,000 (lot 38-28) respectively.

In accordance with the development agreement, the draft transfer deeds for the first two lots (38-26 and 38-18) were approved by the Executive Committee on December 1, 1999 and March 21, 2001 respectively.

On November 12, 2001, City Council approved an amendment to the development agreement, postponing the signing of the transfer deed of the third lot (38-28) by one year (until March 22, 2003) and the deadlines for beginning and completing the work on the second and third lots (38-18 and 38-28).

The new provisions stipulated that the developer was to begin construction of the buildings within 12 months from the date of the transfer deed and to completely terminate construction 30 months from the same date at the latest. The construction deadlines were as follows:

- Second lot (38-18) – since the transfer deed was signed on March 22, 2001, the deadline for beginning work was March 22, 2002 and work was to be completed by September 22, 2003.
- Third lot (38-28) – bearing in mind the postponement of the date for signing the transfer deed to March 22, 2003, the developer agreed to begin construction of the buildings within the 12 subsequent months (by March 22, 2004 at the latest) and to complete construction 30 months later (by September 22, 2005 at the latest).

As the disposal of these properties was part of the Opération Habiter Montréal, the Service de l'habitation was responsible for this file up until that time, including direct negotiations with the

developer and recommending approval of the development agreement and transfer deeds for the first and second lots (38-26 and 38-18). On January 1, 2002, following municipal restructuring, the Division de la gestion des immeubles externes of the Direction des immeubles (today known as the Division évaluation, transactions et services immobiliers of the Direction des stratégies et transactions immobilières [DSTI]) became responsible for real-estate brokerage activities for all city property. Accordingly, the Division de la gestion des immeubles externes became responsible for the disposal of the third lot. When the Faubourg Saint-Laurent file was transferred, the developer had met his obligations for Phase I construction, whereas he was in default of two elements in Phase II: payment of the balance of the sales price expected on March 22, 2002, and meeting the deadline for beginning construction work. Our audit allowed us to ascertain that measures were taken by the Division de la gestion des immeubles externes beginning in 2002 to enforce compliance with contractual obligations for the second lot:

- In March 2002, a first letter, sent by the division manager, reminded the developer that he was in default and asked him to indicate his intentions to comply with his contractual obligations immediately.
- In September 2002, not having received any response from the developer, the division manager sent him a second letter to remind him once again of his non-compliance, and to inform him that the city was considering exercising its right to annul the contract and repossess the property.

In December 2002, the developer confirmed in writing that the construction of Phase II would begin on May 1, 2003 at the latest, instead of March 2002. He also asked the city to confirm this agreement, to amend the development agreement accordingly and, of course, to postpone the deadlines for the acquisition, construction and completion of Phase III.

FINDING

Following this proposal by the developer, the Division de la gestion des immeubles externes did not follow through with the city's its right to annul the contract and repossess the Phase II property, but waited for additional information from the developer on the new project deadlines.

Because of the new responsibilities transferred to the boroughs in the 2002 municipal restructuring, it was not until April 2003 that the Direction de l'habitation, under the Service du développement économique et urbain, transferred the Faubourg Saint-Laurent development agreement to Ville-Marie borough. Note that the boroughs became responsible for adopting, amending and applying various development by-laws for urban planning (e.g., zoning changes)

and issuing building permits. During this transfer, the Direction de l'habitation prepared a progress report including the outstanding non-compliance.

In the fall of 2003, as the developer had still not submitted the requested information on Phase II construction delays and had not acquired the third lot scheduled for March 2003, the Division de la gestion des immeubles externes resumed its attempts to impose compliance with the development agreement contractual obligations. We noted that two other letters were sent to the developer in this regard:

- In September 2003, the section manager reminded the developer about the outstanding construction requirements and the balance owing on the sale price of the second lot (38-18) and the sale of the third lot (38-28). The Division de la gestion des immeubles externes asked to be informed, as soon as possible, of the developer's intentions, as the city could repossess the property.
- In November 2003, the division manager once again reminded the developer of the outstanding conditions for the second and third lots. As the balance of the sale price for the second lot had been owing since March 22, 2002, the same date that construction work was to begin, payment of interest on the balance of the sale price was expected within 10 days. Unless the developer provided relevant documents showing that the beginning of construction was imminent, the city would grant the developer no postponement for construction or payment and would exercise its right to annul the agreement and repossess the above-mentioned property.

We also noted that the steps taken by the Division de la gestion des immeubles externes for the second lot (38-18) allowed the city to collect the complete and final balance of the Phase II land sale price several weeks later and interest accrued to that date. The developer also submitted a new construction schedule for Phase II. The developer also agreed to contact the city notary at the beginning of 2004 to proceed with the purchase of the third lot (38-28) and deliver a construction schedule.

To make the extension for the Phase II construction deadlines official, City Council approved an amendment to the development agreement on February 24, 2004 that was aimed in particular at postponing the start of construction to March 15, 2004 and the completion date to September 22, 2005.

With specific reference to the sale of the third lot (38-28), the developer did not meet his commitment.

FINDING

We did not discover any evidence that the Division de la gestion des immeubles externes took any action between November 2003 and December 2006 to make the developer honour his contractual obligations. According to the information obtained, no project manager was appointed to follow up on these contractual obligations during this period.

FINDING

Our audit revealed, however, that during this period the developer remained active with Ville-Marie borough. He mentioned in a letter having advised city representatives as early as June 2004 of his intention to acquire the Phase III lot (38-28) and having discussed construction with them. The developer also formally sent Ville-Marie borough's Direction de l'aménagement urbain et des services aux enterprises a specific project study request to raise the height of the building on avenue de l'Hôtel-de-Ville by two stories. We did not find evidence of authorization from the DSTI allowing the developer to discuss this type of zoning change. In spite of the unfavourable opinion rendered by the Direction de l'aménagement urbain et des services aux entreprises, the file was presented to the borough council for consideration in case it might nevertheless want to proceed with the project.

In October 2005, the borough council finally decided to turn down this file. Our audit examination shows that the developer continued his discussions with other borough stakeholders to advance his request.

The Division gestion du portefeuille et des transactions (formerly called the Division de la gestion des immeubles externes) resumed its attempts to have the developer respect his contractual obligations in January 2007.

FINDING

On January 10, 2007, the DSTI requested a legal opinion from the Direction du contentieux to determine whether the city could proceed with a call for public proposals for the sale of this property. According to the information obtained, it was the first request for a legal opinion referred to the Direction du contentieux in this file since the developer's defaults had been recorded.

Before it had even received the response from the Direction du contentieux on January 18, 2007, the DSTI, through the project advisor, sent a registered letter to the developer informing him that the development agreement and subsequent amendments were cancelled through non-compliance with certain essential conditions. To justify this decision, the DSTI cited article 10 of the development agreement, which requires the developer to rectify a default situation within 60 days:

> *[TRANSLATION] "In spite of all special provisions herein and subject to all its other rights and remedies, the city can cancel the agreement if the developer neglects to remedy any default attributed to him by virtue of one or any of the provisions of this agreement within sixty (60) days from a notice to this effect."*

The DSTI was first referring to its letter of November 3, 2003 in which the developer was advised of the default in purchasing the third lot (38-28). The DSTI was also referring to the developer's reply dated December 2003 in which he indicated his intention to communicate with the city's notary at the beginning of 2004 to proceed with the purchase of this property. According to the DSTI's claims, since this condition had not yet been met, in spite of the notice of default and the 60-day extension, the city was no longer bound by its commitment to sell the 38-28 lot to the developer.

Even before it received the legal opinion it had requested, the DSTI received a letter of formal notice from the developer in which he expressed his strong objection to the city's arguments. He maintained that he was not only interested in developing the property, but claimed that he had advised the city as early as June 2004 of his intention to acquire it and that he had been discussing construction of Phase III with municipal authorities since that date.

FINDING

The Direction du contentieux finally rendered its legal opinion on February 7, 2007. It did not completely share the DSTI's interpretation with regard to the letters sent to the developer in 2003 and 2007. The letters sent by the city to the developer in 2003 were more than three years old and, in reconstructing events, the behaviour of both the city and the developer could lead one to believe that the city had decided not to assert its right to cancel the agreement during this period.

As for the last letter sent by the DSTI dated January 18, 2007, the Direction du contentieux maintained that it could be considered the 60-day notice required in the agreement's "Default" clause.

FINDING

It would have been preferable if this letter had been signed by the department manager or, at the very least, by a person in authority, rather than by a real-estate consultant. The Direction du contentieux also believed the DSTI was duty bound to obtain City Council authorization to send a 60-day notice as stipulated in the development agreement. If the developer was in default and not able to acquire the property within that period, the agreement could be cancelled as a matter of right. Consequently, the launch of a new call for proposals would be possible only when the relationship with the developer had been severed.

In March 2007, an executive summary to cancel the development agreement for the purchase of the third lot (38-28) for $400,000 was prepared, but it was never approved by the Executive Committee and, accordingly, was never presented to City Council.

FINDING

According to the information obtained, the real-estate strategy committee had first verbally commissioned the DSTI to negotiate a compromise with the developer. Even though City Council had not given its consent for closing a sale through mutual agreement, lengthy negotiations were undertaken and resulted, in October 2008, with the submission of an offer to purchase by the developer that was valid until March 2009. Following the developer's failure to comply with this deadline, a verbal legal opinion from the Direction du contentieux would have confirmed that this offer to purchase was null and void. According to the information obtained, the director general and the director of corporate affairs at the time still recommended negotiating the transfer deed. A second offer to purchase was submitted by the developer in July 2009. Even though it was valid until September 2009, a draft transfer deed was approved by City Council in February 2010 and the transfer deed was signed by the two parties in March 2010.

In short, over the 10 years that elapsed between signing of the development agreement (September 1999) and signing the transfer deed (March 2010), measures were taken by the DSTI to finalize the sale of the third lot.

FINDING

We believe that insufficient effort was made at a suitable time to compel the developer to respect the contractual obligations initially authorized by City Council in an acceptable period.

FINDING

The letters addressed to the developer in 2002 and 2003 regarding the non-compliance observed in phases II and III and in 2007 to cancel the development agreement were not corroborated by the Direction du contentieux before being sent.

FINDING

We also observe that a period of four years passed between the time the developer's non-compliance was noticed and the moment when a legal opinion was requested. It was, moreover, only at that time that the DSTI learned that its procedure did not concur with the Contentieux's intentions. Furthermore, it had neglected to inform the elected officials of the actions it intended to take before cancelling the development agreement. This unduly prolonged the timeframes for complying with the provisions of the contract and, ultimately, finalizing the transfer deed.

FINDING

DSTI contract compliance monitoring was not always rigorous and was even non-existent from November 2003 to December 2006.

This three-year period, during which no representative of the DSTI reminded the developer that he was in default in acquiring the Phase III property, led him to believe that measures would not be taken to enforce the contractual clauses. He even believed he could go ahead with modifying the building plans and make representations to have the zoning changed.

When the DSTI resumed monitoring the file in January 2007, after more than three years of inactivity, we note that it ignored the actions taken by the developer during this period. Consequently, at the time it informed the developer of its intention to cancel the development agreement, the city received formal notice signifying that other delays were to be expected in finalizing the transfer deed.

FINDING

The position of the real-estate strategic committee (March 2007) that was hoping to negotiate a solution with the developer also had the effect of creating additional delays in concluding the sale. During the period from March 2007 to March 2010, the DSTI attempted to have the developer comply with the purchase offers he submitted, but the position of the municipal administration was to encourage tolerance to reach middle ground.

FINDING

In conclusion, we are of the opinion that the carelessness displayed by both the DSTI and some managers in the municipal administration in handling this file and the lack of communication between the DSTI and Ville-Marie borough could have led the developer to believe that the city had no real desire to have the initial contractual obligations respected. Several letters were sent to the developer, none of which resulted in any concrete results. We might even suggest that the developer hardly worried about them. This situation resulted in undue delay of the Phase III land sale (more than seven years) and, as a result, the start of construction. Consequently, the city lost the tax revenues it had initially expected.

We are aware that the audit of the sale of the Phase III lot refers to shortcomings that occurred several years ago. However, the circumstances at the origin of such a situation are always of current interest and measures must be taken to make sure they do not reoccur.

This simply means that the DSTI must systematically assign someone to be responsible for monitoring contractual obligations for both development agreements that affect it and transfer deeds approved by City Council. Coordination mechanisms must be set up between the DSTI and the boroughs to exchange relevant information and take the steps required to formalize exemption clauses in a timely manner.

For example, in this case, follow-up of contractual obligations will be essential over the next two years as, under the transfer deed signed in March 2010, the developer must strictly adhere to the requirement to complete construction work within the 30-month period following the signing of the contract, which would be September 2012. In the event that this construction work is not terminated in the specified time, a provision stipulates that the developer will pay the city $2,000 per day of default until he has signed an instrument transferring the building back to the city. As

construction work had not started as of the date of our audit report (February 2011), we believe that rigorous monitoring is required to make sure that contractual obligations are respected so the project can progress as anticipated.

In the event the developer breaches his contractual obligations, the DSTI should advise the Service des affaires juridiques et de l'évaluation foncière (formerly designated as the Direction du contentieux) as quickly as possible so it can intervene at the appropriate moment to settle the dispute.

3.1.B. Recommendations

We recommend that the Direction des stratégies et transactions immobilières systematically designate someone to monitor all contractual clauses in development agreements that affect it and transfer deeds, so appropriate decisions can be made in a timely manner and minimize the consequences for the city if there is any non-compliance.

We recommend that the Direction des stratégies et transactions immobilières establish mechanisms for obtaining all relevant information from the boroughs to ensure that projects evolve according to the provisions in the applicable development agreements and transfer deeds. Then, if necessary, steps required to formalize exemption clauses can be taken at the appropriate time.

We recommend that the Direction des stratégies et transactions immobilières notify the Service des affaires juridiques et de l'évaluation foncière as quickly as possible every time it notices a departure from the contractual obligations in the applicable development agreements and the transfer deeds so as to assert the city's rights and settle the dispute as soon as possible.

3.1.C. Action Plan of the Relevant Business Unit

1) *[TRANSLATION] "There is someone in charge of monitoring all of the contractual clauses referred to in the transfer deeds for which the Direction des stratégies et transactions immobilières is responsible. A computer application has been developed to systematically monitor all transfer deeds.* ***(Planned completion: March 2011)***

   The DSTI is generally not responsible for drafting or monitoring development agreements. The people responsible are usually in other city departments or in the boroughs.

In the event the DSTI should become responsible for such agreements, they would be treated as indicated above." ***(Planned completion: December 2011)***

2) *[TRANSLATION] "The DSTI has implemented a mechanism to adjust prices (in the deeds of transfer) according to an increase in project density that could result in developers requesting zoning changes. This mechanism will be structured so that the sale price reflects the real value of the property if zoning changes. Monitoring could also be carried out by the person in charge of overseeing the transfer deeds."* ***(Planned completion: December 2011)***

3) *[TRANSLATION] "The person in charge of monitoring the transfer deeds initially notifies the client of the non-compliance. If the situation is not remedied immediately, a notice will be sent to the Service des affaires juridiques et de l'évaluation foncière for appropriate follow-up.* ***(Planned completion: March 2011)***

Project officers will oversee development agreements." ***(Planned completion: December 2011)***

3.2. FAUBOURG SAINT-LAURENT—SETTING THE SELLING PRICE OF THE LOT

3.2.A. Background and Findings

In this situation, where a period of 10 years elapsed between the approval date of the development agreement (September 1999) and the date authorities approved the draft transfer deed for the Phase III property (February 2010), we have evaluated to what extent the established sale price corresponded to market value. We will address the establishment of the sale price at two different periods: when the development agreement was drawn up and later, when the transfer deed was finalized with the developer.

Setting the Selling Price for the Development Agreement

Under the development agreement authorized in September 1999, the Phase III land sale would be signed by March 22, 2003 at the latest for $400,000. The payment terms were:

- 10% on signing the transfer deed
- 90% within 12 months of signing the transfer deed, without interest (by March 22, 2004 at the latest)

As part of our audit, we found that, when the development agreement was signed, the sale price of $400,000 was based on a market value established two years earlier (in April 1997), whereas

the payment of the balance was not due until March 2004. We believe that is very unlikely that the market value of a property located in the heart of downtown Montréal would have remained unchanged during all of those years.

FINDING

The fact that an increase in the property's market value up to the date of payment was not taken into consideration could be considered of benefit to the developer. In this regard, the *Municipal Aid Prohibition Act* (R.S.Q. chapter I-15) stipulates "*no municipality shall, directly or indirectly, assist any industrial or commercial establishment [either] by giving or lending money or other security, or in giving the use or ownership of any immovable.*" The fact that no interest was charged either on the balance of the sale price during the 12 months following the signing of the transfer deed could also be considered a benefit for the developer.

We are of the opinion that the development agreement should have required that the sale price be updated at the time of final payment and should also provided for the payment of interest on the balance of the sale price to avoid granting undue advantage to the developer.

We also compared the sale price of the Phase III land in the development agreement ($400,000) with various values known in 1999 (Table 1). We note that each of the values used for our comparison, with the exception of the 1997 value, is greater than the established sale price ($400,000): the purchase cost ($4,231,853), the municipal evaluation in effect at the time ($739,600) and the estimated market value in 1993 ($715,000). This leads us to believe that the sale price set in the development agreement ($400,000) was underestimated.

This comparison also makes us question the original cost of the expropriated property compared not only to other known values in 1999 (Table 1) but also to those that existed between 1988 and 1991 at the time of the acquisition (Table 2). We observe that the acquisition cost is higher than the values known in 1999 (Table 1). We understand that this was an acquisition by means of expropriation and that the cost resulting from such a purchase procedure is generally higher for the purchaser.

As for the known values between 1988 and 1991 (Table 2), we notice that the acquisition cost was close to the market value at the time of expropriation. However, our questions remain when we compare the market value set at the time of expropriation ($3,630,000, Table 2) with the

market values for this same property established four years later (in 1995) at $715,000 (Table 1) and eight years later (in 1999) at $400,000 (Table 1) for the development agreement.

FINDING

We find it strange that the market value of the property in 1999 represented no more than 11% of the value that had been established at the time of expropriation. Our audit did not reveal the justification for this depreciation.

FINDING

Even if the original cost was too high ($4,231,853) or the selling price was underestimated ($400,000), this transaction represented a major financial loss for the city.

Table 1—Faubourg Saint-Laurent: Comparison of Property Prices and Other Data in the Development Agreement

	Lots			
	38-26 (Phase I)	**38-18 (Phase II)**	**38-28 (Phase III)**	**Total**
Location	North side of boul. René-Lévesque, between rue De Bullion and avenue de l'Hôtel-de-Ville	South side of rue Charlotte, between rue Saint-Dominique and rue De Bullion	West side of avenue de l'Hôtel-de-Ville, to the north of boul. René-Lévesque	
Land area	4,432.8 m^2 (47,715.8 ft^2)	3,643.4 m^2 (39,219.0 ft^2)	2,648.8 m^2 (28,624.3 ft^2)	10,725.0 m^2 (115,558.8 ft^2)
Area in %	41%	34%	25%	100%
Acquisition cost[1]	$3,656,984	$3,834,513	$4,231,853	$11,723,350
Depreciation allowance[2]	$2,427,934	$2,618,870	$2,665,690	$7,712,494
Net depreciated cost (1997)	$1,229,050	$1,215,643	$1,566,163	$4,010,856
Selling price in the development agreement (Sept. 1999)	$820,000	$550,000	$400,000	$1,770,000
Net loss on disposal	$409,050	$665,643	$1,166,163	$2,240,856
Municipal assessment (1995-1997 assessment roll)	$1,233,100	$980,400	$739,600	$2,953,100
Market value appraisal (1993)[3]	$1,809,600	$1,175,000	$715,000	$3,699,600
Market value appraisal (1997)[4]	$820,000	$550,000	$400,000	$1,770,000

[1] Phase I: properties acquired through expropriation, primarily in 1991.
Phase II: properties acquired mainly through expropriation between 1989 and 1992.
Phase III: properties acquired by expropriation in 1991.
[2] Depreciation posted between 1991 and April 1997.
[3] Appraisal conducted as part of the 1993 public call for proposals.
[4] Appraisal conducted as part of the 1997 public call for proposals.

Table 2—Faubourg Saint-Laurent: Comparison of the Property Acquisition Cost (Phase III) with Other Known Values (at the time of expropriation) (1988 to 1991)

Evaluation	Vacant lot	Business and damages	Total
Fair market value[1]	$3,630,000	$1,032,157	$4,662,157
Acquisition cost[2]	$3,258,526	$973,327	$4,231,853
Land value[3]	$294,910	–	$294,910

[1] Value established by an external firm (in 1991) to support the city's position when the notice of expropriation was contested by the primary expropriated party.
[2] Cost negotiated in the course of an out-of-court settlement including the business. The cost was allocated in the same proportions as those established for the fair market value.
[3] Land value in effect in 1988, the year in which the notices of expropriation were delivered to the expropriated parties.

Even if we now know that the sale of the third lot for $400,000 did not take place, the facts observed with the Phase III property also lead us to wonder about how the selling prices for the Phase I and Phase II properties were set. Comparing the selling price for these properties ($820,000 and $550,000) with other values appearing in Table 1—the municipal assessment (1995-1997) ($1,233,100 and $980,400), the market value in 1993 ($1,809,600 and $1,175,000) and the acquisition costs ($3,656,984 and $3,834,513)—lead us to believe that the selling prices established in 1999 for the development agreement were also underestimated.

FINDING

We wonder about the acquisition cost of the other properties, as they had each depreciated by 66% (Phase I) and 68% (Phase II) in 1997.

Setting the Selling Price for the Transfer Deed

Following the dispute in 2007 between the city and the developer regarding the Phase III property, the DSTI was directed to negotiate the best possible agreement. Since the selling price agreed to in 1999 no longer represented the parcel's market value, a new selling price had to be set. The DSTI's Division évaluation et expertise was mandated to do this on January 29, 2007. The information used for this appraisal was, specifically, size, the by-law authorizing the construction and occupation of a rental housing development for this project specifying the construction of at least 75,000 ft^2 of living space on five and six floors, and finally, the construction of 125 residential units pursuant to the development agreement. On March 15, 2007, the market value was established as a range varying between $2,125,000 and $2,250,000.

FINDING

According to the information we obtained, the DSTI used this market value to set a target price of $1.9M as the basis for negotiations for selling the parcel. During our audit, we were not able to find documentation supporting this amount or the reasons for which the market value had not been used as the target price.

FINDING

Negotiations between the two parties began in 2007 and carried on until October 2008, the date on which the developer made an offer to purchase. The sale price negotiated was $1,500,000. We were not able to find any documentation supporting this amount either.

Subsequently, new discussions were held, which delayed signing of the transfer deed, originally set for March 2009. A new offer to purchase, preserving the $1,500,000 selling price was signed on July 19, 2009. This last offer to purchase was valid until September 2009, the date at which a\ transfer deed was supposed to be signed.

FINDING

In December 2009, before having the draft transfer deed approved by City Council, DST sent a file to the strategic real-estate committee. There we discovered information estimating the market value of the land (in December 2009) to be between $3,500,000 and $4,000,000 and that the sale price of $1,500,000 was a compromise. We should clarify that the Division transactions immobilières updated this market value. We found no documentation supporting this new market value.

In January 2010, when the executive summary to have the transfer deed approved by City Council was being finalized, the Division transactions immobilières once again directed the Division expertise et évaluation immobilières to produce a brief and preliminary update of the lot's value. In a note dated January 25, 2010, the Division expertise et évaluation immobilières indicates that, considering the delay allowed for fulfilling the mandate, a brief list of relevant transactions that had taken place in the downtown area during the 2006-2009 period had been made. Furthermore, the Division expertise et évaluation immobilières mentioned that it had been informed that the number of planned units in the project had increased from the original 125 to 139. This information signified that the market value estimated in March 2007 had been

underestimated by $250,000. However, as of January 25, 2010, the new appraised market value was set at $3,300,000.

FINDING

As part of our audit, we compared the transfer deed selling price ($1,500,000) with the target price for negotiations ($1,900.000), the March 2007 market value assessment ($2,125,000 to $2,250,000), the market value update in December 2009 ($3,500,000 to $4,000,000), the January 2010 market value ($3,300,000), the municipal assessment ($2,052,000) and finally the acquisition cost ($4,231,853) (Table 3). The results of our comparison reveal that the selling price was lower than the original cost, the market values established since March 2007 and the municipal assessment.

Table 3—Evaluations Compared to the Transfer Deed Selling Price (March 2010)

Evaluation	Amount	Selling price for the March 2010 transfer deed	Variance
Target price used for the negotiations	$1,900,000	$1,500,000	$400,000
Market value—March 2007 (for 125 units)	$2,125,000 to $2,250,000	$1,500,000	$625,000 to $750,000
Market value—March 2007 (for 139 units)	$2,375,000 to $2,500,000	$1,500,000	$875,000 to $1,000,000
Update of the Market value—December 2009	$3,500,000 to $4,000,000	$1,500,000	$2,000,000 to $2,500,000
Market value—2010	$3,300,000	$1,500,000	$1,800,000
Municipal assessment (1997-2010 roll)	$2,052,800	$1,500,000	$552,800
Acquisition cost (1991)	$4,231,853	$1,500,000	$2,731,853
Net book value (March 2010)	$388,227	$1,500,000	($1,111,773)

Considering that the market value established in March 2007 ($2,125,000 to $2,250,000) is the one that prevailed at the time the sale price was established at $1,500,000, the variance between the two values ranges between $625,000 and $750,000. We did not find any documentation justifying this difference. According to the information obtained from the DSTI director, by adding various charges borne by the developer, such as site clean-up, archeological inventory and retaining the security deposit paid by the developer when the development agreement was signed, to the $1,500,000 sale price, the transaction would have amounted to between $2,000,000 and $2,200,000.

FINDING

We should remember, however, that the last market value set in January 2010 was $3,300,000, which varied $1,100,000 to $1,300,000 from the set selling price, minus the costs assumed by the developer. Our audit did not find justification of the difference between the last market value and the negotiated sale price, in addition to all the other costs assumed by the developer. Considering the existence of the *Municipal Aid Prohibition Act* (R.S.Q., chapter I-15), we are of the opinion that the DSTI should have documented the variances to show that favours were not granted to the developer. In the absence of such justification, we are not able to affirm that the transaction was concluded at fair market value.

When the sale of the land was to be approved, we found that the DSTI gave City Council the following information so that they could make an informed decision:

- Sale price of $400,000 initially agreed upon when the development agreement was signed
- Cash sale price of $1,500,000, taxes not included
- Readjustment of the selling price at a rate of $22.62/ft^2 for any additional square footage should By-law 99-171 be amended
- Market values of the building as of March 15, 2007 ($2,125,000 and $2,250,000) and as of January 2010 ($3,300,000)
- Municipal assessment of $1,026,300 based on this lot's area of 1,324.3 m^2
- Net book value of the property of $388,227

The DSTI also specified that the city had obtained other benefits, such as retaining the $100,000 security deposit collected prior to signing the agreement and the developer's assumption of Phase III costs for lot clean-up and an archeological inventory, which is carried out prior to any excavation

The executive summary also indicated, for information purposes, that the tax revenue generated by the sale of this property and the construction of the building would be in the order of $375,000 per year.

FINDING

In conclusion, even though several relevant items of information were provided by the DSTI, we consider that City Council did not receive some information that would be essential for making an informed decision about this transaction. The executive summary fails to disclose three important elements: the original cost of the property ($4,231,853), the 91% depreciation of the original cost between 1991 and 2007 ($3,843,626) and the municipal assessment of $2,052,800 for the total lot area. Explanation of the variances between the last market value and the sale price of $1,500,000 minus the costs assumed by the developer were not provided, either. In light of the information communicated to the authorities, we cannot state that the transaction was concluded at market value because information needed for that evaluation was omitted.

FINDING

Even though the DSTI estimated the project's tax benefits at $375,000 per year, City Council did not have a financial analysis of the project (including estimated cash flows and the selling price along with the acquisition and the carrying costs).

Such information would have allowed City Council to be more knowledgeable about the payback period for the city investments in Phase III and make a decision about its practicality.

3.2.B. Recommendations

To be in compliance with the *Municipal Aid Prohibition Act* when entering into development agreements with developers, we recommend that the Direction des stratégies et transactions immobilières:

- **evaluate the possibility of adding provisions to update the selling price to take into account fluctuations in the market value of the land in question in relation to the timeframe specified in the terms of payment**
- **anticipate adding provisions for an interest rate applicable to the balance of the sale price until the developer pays**

To demonstrate beyond any reasonable doubt to what degree the selling price set for the sale of the property corresponds to market value, we recommend that the Direction des stratégies et transactions immobilières document the following in its project file:

- **justification for the target price used to negotiate the selling price of a building belonging to the city**
- **the number of concessions granted to the developer that have an impact on the sale price established.**

We also recommend that the Direction des stratégies et transactions immobilières include in executive summaries for approval of a real estate sale, all relevant information—explanation of variances between the selling price set plus the costs assumed by the developer, market value on the date of the transaction and original cost—to assure authorities that the city is not granting any undue benefits to the purchaser.

Furthermore, we recommend that the Direction des stratégies et transactions immobilières attach a financial analysis of the development to executive summaries for approval of real estate property sales, to inform authorities about the payback period for investments made by the city. We should clarify that this financial analysis should take into consideration acquisition costs, carrying charges, selling price and cash flows generated by the project.

3.2.C. Action Plan of the Relevant Business Unit

1) *[TRANSLATION] "As a rule, transfer deeds provide for construction within 24 to 36 months following the signing of the conveyance. In these cases, no price adjustment is made for fluctuations in the market value. We usually do not have responsibility for agreements where timeframes are longer (as in development agreements). However, we note that we will have to consider this if the DSTI is ever responsible transactions spaced out over time.*

   We will see to the establishment of such a mechanism in the next review of our procedures." ***(Planned completion: September 2011)***

2) *[TRANSLATION] "In DSTI procedures, the selling price is supported by a detailed opinion of the market value from one of DSTI's accredited appraisers or an external accredited appraiser whose report is examined by a DSTI appraiser. All executive summaries presented to authorities for the sale of a property therefore include the market value.*

   Any concession or consideration forming part of a sales transaction must be accompanied by validation of its monetary value. This practice is already in effect, particularly when deducting expenses for clean-up or infrastructure costs assumed by the developer from the selling price." ***(Planned completion: March 2011)***

3) *[TRANSLATION] "All costs and values related to the transaction are already included in executive summaries. Information on different evaluations (book value of buildings, market value, sale price) is found in the transaction summary attached to the executive summary. We will add, when it is available, the original cost of the property in the transaction. We will verify that all the costs assumed by the developer are found in the executive summaries."* ***(Planned completion: March 2011)***

4) *[TRANSLATION] "The DSTI is working with the Service des finances to use the financial analysis model developed by the Services des finances for major projects. As soon as it is available, this model will be used for all real-estate sales."* ***(Planned completion: June 2011)***

3.3. OVERALL FINDINGS

Several events occurred during the Faubourg Saint-Laurent Project between the time the development agreement was authorized by City Council (September 1999) and the date the Phase III land sale transaction was adopted by City Council in February 2010 and signed by the parties in March 2010. We stated our audit findings in the two preceding sections of this report (Sections 3.1 and 3.2). We also addressed recommendations to the business units involved so that corrective measures could be taken to prevent such events from recurring.

We have grouped our major findings together, however, so the reader could have a better understanding and overview of the major factors impacting the transaction of the Faubourg Saint-Laurent Project Phase III land sale and those that had an impact on the entire project.

- Significant involvement of the strategic committee and senior management in this file. For example, the verbal mandate received from the Comité stratégique immobilier in 2007 to negotiate an out-of-court settlement following the formal notice sent by the developer.

- Lack of resolve by the DSTI to apply certain clauses of the development agreement, particularly the start and end of Phase II work and signing the Phase III transfer deed.

- Unjustified delay between the time the DSTI noticed that the developer had defaulted on certain requirements (March 2002) and the time the Direction du contentieux was asked for a legal opinion (January 2007).

- The DSTI's lack of rigour in monitoring the provisions in the development agreement. No project manager was assigned to the file for a three-year period (November 2003 to December 2006) to ensure that the terms of the contract were respected.

- A great deal of tolerance displayed towards the developer by the Service de l'habitation et du développement urbain (prior to 2002) and the DSTI (after 2002) that resulted in two amendments to the development agreement (2001 and 2004). This tolerance also allowed the developer to make two offers to purchase that were not accepted (October 2008 to July 2009) before the agreement to sell Phase III land was finally signed by the two parties.

- Lack of coordination between Ville-Marie borough and the DSTI, which created ambiguity and slowed the negotiation process with the developer. The latter was discussing a change to By-law 99-171 (concerning the construction and occupation of a real-estate complex in Faubourg Saint-Laurent) with the borough Direction de l'urbanisme, whereas the DSTI wanted to have the Phase III part of the development agreement terminated.

- Substantial variances between the market values established in 1991 ($3,630,000), 1993 ($715,000$) and 1997 ($400,000).

- Three market values were also established at different dates (2007 to 2010) to support the negotiated sale price, but all of them were greater than the negotiated sale price appearing on the sales agreement approved by City Council in February 2010.

- 1991 purchase price of the expropriated Phase III property ($4,231,853) greater than the negotiated sale price in the land contract ($1,500,000 plus the costs assumed by the developer) approved by city council in February 2010, 20 years later. Nothing explains this situation, especially in consideration of the following three points:
  - The lots targeted by the Faubourg Saint-Laurent Project present a strategic location in the heart of downtown.
  - The surrounding sector is made up of major building complexes (Hydro-Québec, Complexe Desjardins, Guy-Favreau Complex, CHUM, the Monument-National theatre, Place des Arts, etc.).
  - The lot is well located in relation to the public transportation system.

- Fair market value established in 1991 for Phase III ($3,630,000) higher than the fair market value established at $715,000 two years later (1993) and also higher than the fair market value established at $400,000 four years later (1997).

- 1991 municipal assessment ($294,210) much lower than the purchase price ($3,258,526[1]).

  1997 municipal assessment ($739,600) greater than the sale price established for the development agreement ($400,000).

  2010 municipal assessment ($2,052,800) greater than the negotiated sale price ($1,500,000).

- Price paid in 1991 ($4,231,883) for Phase III was very high in comparison with the net book value that was only $388,227 19 years later.

- Even though City Council had much of the relevant information when it approved the transfer deed with the developer in 2010, some information needed to make the decision was not disclosed, such as the total acquisition cost ($4,231,853), the significant depreciation over the years (approximately $3,800,000) and the assessed land value for the entire parcel.

This is a file marked by irregularities and lacking due diligence in past years.

Keep in mind that the city acquired three lots for residential development in the city centre for $11,723,000 during the 1990s and that these lots were sold for $830,000 (Phase I lot, 2001), $550,000 (Phase II lot, 2004) and $1,500,000 (Phase III lot, 2010) for a total of $2,870,000.

The project proposed by the developer initially provided for the construction of buildings representing investments of $60,000,000 with 837 housing units. We are aware that the financial aspect, although very important, is not the only criteria to consider in evaluating the overall project. However, nothing indicates to us, from reading the documentation or from discussions with the individuals we met with, that it constitutes a one-of-a-kind residential development that would explain the variance between the purchase price and the selling price.

It is difficult to understand that properties located in the heart of downtown could depreciate over the years and be worth only 34% of the purchase price for Phases I and II in 1997 and only 11% for Phase III in 2010. Barring exceptional circumstances, the property values should have appreciated with time and not the reverse. We therefore have

[1] Purchase price excluding the business.

to make the logical deduction that the prices paid at the time the properties were acquired were too high or that the selling prices for these same properties were too low, or a combination of the two. It is difficult to determine which one of these elements is responsible, because several relevant pieces of information date back more than 20 years. However, one fact remains: there is still considerable variance between the purchase price and the selling price to the developer. All the information gathered shows that the selling price was undervalued and represented only a fraction of the purchase price, which resulted in a major and very real financial loss for the city. We can affirm, without a shadow of a doubt, that the transaction was concluded to the benefit of the developer.