

The 'tear-down' trend



A major factor in the Greater Vancouver and Lower Mainland real estate marketplace of British Columbia in the last five years is the 'tear-down.' With ever-increasing land acquisition and lot creation costs (construction servicing, municipal fees and consultant costs), the tear-down builder has emerged from a minor influence in the dynamics of real estate to a major force shaping the nature of competition.

A tear-down is an existing single-family dwelling on an existing lot (known as a 'lot-of-record') that is acquired for the specific purpose of tearing down the existing dwelling and then constructing a new single-family dwelling within the existing zoning by-law provisions and allowable building footprint. Under this scenario, no rezoning or subdivision (with associated costs) is applicable, and no development cost

charges (DCCs) are payable. No GST is payable on the purchase, as the acquisition is of a 'used' existing single-family dwelling. Also, since the lot-of-record exists, no design guidelines are registered against the title and, thus, there is no requirement to build to a certain neighbourhood standard, or no requirement to obtain approval from a developer's design consultant as to house style, house materials or landscaping treatment.

A significant amount of residential building construction costs can be saved by this method of acquisition, assuming the builder opts for a standard other than what would typically be prescribed by design guidelines for the neighbourhood. For these reasons, and in these particular situations, the existing building does not contribute utility to the land. The sale price of a tear-down property tends to set the upper limit of value of competing similarly-located and similarly-sized newly-subdivided vacant lots. This is because, as far as new dwelling size and design are concerned, the tear-down builder only has to conform to the setbacks of the existing zoning and, therefore, can build to the maximum floor area ratio and lot coverage permitted by the existing zone.

In most cases, the highest and best use continues to be a single-family residential building lot. Tear-down situations tend to occur in neighbourhoods where existing single-family residential land uses are dominant. It is most noticeable in areas that are older and well established with existing infrastructure, and is foremost for properties fronting arterial roads. This is because older dwellings are situated fronting arterial roads, simply because arterial roads were the first roads constructed in early

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emerging communities. This trend is not found in emerging areas or newly-established neighbourhoods.

Besides the City of Surrey, the author has observed this trend occurring in many other sub-markets within the Fraser Valley/Greater Vancouver areas of British Columbia, including Richmond, Vancouver, Burnaby, White Rock, Port Moody, New Westminster, Coquitlam and Delta.

This trend is not prevalent or applicable to major housing builders in the residential development industry, but rather occurs and applies to smaller builders and ‘end-user builders.’

End-user builders are those participants that acquire the tear-down, not for the purpose of constructing a new dwelling and reselling for profit, but for the purpose of constructing a new dwelling for their own use and occupation. Major housing builders tend to develop large tracts of land for new communities or neighbourhoods and, thus, the tear-down issue is not a business plan consideration for these builders.

The reason why this nuance of the residential construction and development business is important to appraisers and other marketplace observers is that an accurate picture of the single-family lots created vs. single-family building permits issued (‘lot absorption’) cannot be determined without specifically blending in or accounting for demolition permits issued, where the tear-down trend is common. Generally, local governments only report lots created and building permits issued without reporting the relationship of demolition permits issued. If local governments do provide this information, it is generally not readily accessible.

	Tear-down (lot-of-record)	Newly-subdivided lot
Location	Index 1: Fronts arterial road, Surrey. Near Index 2	Index 2: Fronts arterial road, Surrey. Near Index 1
Sale price	\$375,000	\$350,000
Property purchase tax	\$5,500	\$5,000
Total transfer cost (excluding minor legal and registration costs)	\$380,500	\$355,000
Price per ft. ² (base rate)	\$50.45/ft. ²	\$49.58/ft. ²
GST	n/a	\$21,000
Demolition costs (typical), includes lot grading	* \$15,000	n/a
Gross purchase costs	\$395,500	\$376,000
Parcel size	7,433 ft. ²	7,060 ft. ²
Price per ft. ² (gross rate)	\$53.21/ft. ²	\$53.26 ft. ²

* a demolition permit application will trigger a hazardous materials inspection report requirement to determine the extent, if any, of asbestos and other possible contaminants, which will have to be safely removed before a final demolition permit will be issued.



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For example, let us assume that, within a particular local government, during a particular month of the year, this local government reported that there were 177 single-family building lots created by way of final approval being granted via subdivision registration, and, during this same monthly time period, this local government reported 138 building permits issued for single-family dwelling construction. On this basis, these published statistics would lead an observer to conclude that the lot absorption ratio for this particular month is at 77.97% (138/177).

For the purpose of this example, let us also assume that 29 of the 58 demolition permits issued during this same month for single-family dwelling demolition specifically applied to tear-downs for the purpose of constructing new single-family dwellings on the existing lots, and that the remaining 29 demolition permits applied to demolitions occurring for highest and best use changes due to land-use or zoning changes, or they are dwellings being demolished on acreages as part of larger subdivision projects. Because no new lot is created on an existing lot that undergoes the cycle of ‘demolition-permit-issued, old single-family-dwelling-demolished, new single-family-dwelling constructed,’ then the observer, in order to arrive at an accurate estimate of the lot absorption ratio, would need to account for the ‘de-facto’ lots created by the issuance of demolition permits to arrive at the correct ratio of 66.99% (138/177+29).

By not accounting for de-facto lots, a pronounced margin of error occurs. The reason that a de-facto lot would need to be accounted for in the analysis is because a ‘building permit issued’ is recorded in the statistics, but, because the new single-family dwelling is to be constructed on an existing lot-of-record, no corresponding ‘lot created’ record is accounted for in the relationship. Without the inclusion of de-facto lots for these particular circumstances, the lot absorption ratio for this particular statistical month analyzed would be overstated, resulting in an incorrect conclusion, in this case

by 10.98%. Using the included lot absorption study sheet for the City of Surrey indicates that, by not accounting for de-facto lots created during 2007, an inaccurate number of 335 lots would result, or nearly 10% of the total of new lots created (3,382 lots).

The lot absorption study sheet provides the actual numbers of single-family building lots created and single-family building permits issued for the City of Surrey during 2007. This information is based upon the six major sub-markets comprising the entire City of Surrey, with a 2007 population in excess of 410,000 people. This data does not address other forms of housing such as multi-family, which, as a matter of interest, was 1,797 townhousing permits and 2,450 apartment permits issued for 2007, for a total of 4,247 multi-family units. For 2007, there was an actual total of 673 single-family demolition permits issued within the City of Surrey. The author has estimated that approximately 20% of these permits are attributable to lands where the highest and best use was not single-family residential, but rather undergoing redevelopment to other forms of land-use via rezoning. The author further estimates that approximately 30% of these permits are attributable to acreages as part of a larger single-family residential subdivision project. In these particular cases, a de-facto account is not necessary, since, for example, if the existing single-family dwelling is being demolished on a 2.0-acre residential subdivision development site slated for 10 single-family lots, over the course of development and building construction, the City records 10 new lots created and 10 building permits issued. In this particular case, a de-facto account would only be necessary if the local government only recorded nine new additional lots created (assuming the existing parcel to be one lot already), with a corresponding 10 building permits issued.

A further consequence is that, of the actual total of 673 single-family demolition permits issued within the City of Surrey for 2007, 50% of this actual number results in an

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estimated 335 single-family demolition permits being attributable to an impact on the true absorption rate of lots. The observed visual evidence of this tear-down trend, along with the sheer total number of actual (673) single-family demolition permits issued within the City of Surrey for 2007, provides direct support of the premise that tear-downs impact the true absorption rate of lots. In this case, a negative actually proves the positive by posing the question: how could 335 demolition permits of existing single-family lots in one year (2007) not impact the absorption rate of lots?

The following is a typical case study of the economics involved in comparing the net property acquisition costs of acquiring an existing single-family dwelling lot for re-development purposes (tear-down existing older dwelling and rebuild new dwelling) vs. acquiring a newly-created (newly-subdivided) single-family zoned vacant lot. Both example parcels sold during the same period of time in the same general location. Even if we were to assume that the builders of these two example parcels were to construct an exact same dwelling plan on each of the two parcels, during the same construction period, resulting in the same or nearly the same residential building construction costs for each of the newly-constructed dwellings, the land component costs are essentially equal on a land per-square foot basis:

This cost comparison analysis demonstrates that costs incurred (both direct and indirect) to acquire a tear-down lot is a feasible exercise

for the tear-down builder. On an initial base rate basis, the difference between the two is only \$0.87/ft.² (\$50.45/ft.² - \$49.58/ft.²). This price gap actually narrows when the property purchase tax, GST and demolition cost factors are considered, resulting in a \$0.05/ft.² (\$53.21/ft.² - \$53.26/ft.²) difference. Depending upon the specific status of the owner or the intent of the buyer, in some cases, the GST cost component for the newly-subdivided vacant lot will be a flow-through cost, which will be passed onto the ultimate buyer of the final lot/dwelling combination. In these cases, no GST rebate is available to the end-user, because there is no rebate available for a home that sells for \$450,000 or more and this would be the case when the lot value alone is \$350,000 or more.

This information demonstrates that appraisers and other marketplace observers, when providing advice or reaching conclusions on the relationship between lots created and building permits issued, should be careful to account for net demolition permits where the tear-down trend is common, in order to accurately determine lot absorption. 🏡

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