TURNER DRAKE & PARTNERS

Newsletter

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THE ONE CONSTANT, CHANGE!

The advent of November, is a celebration of change. The British, anarchists all, set their kingdom alight on November 5th in a conflagration of celebration honoring Guy Fawkes, a really rather inept gentleman whose attempt to institute change by blowing up Parliament failed because his matches were damp. North Americans beat them to the punch with Halloween: a witches' brew of goblins, youth and high spirits. Fall is the festival of change: welcomed triumphantly with a crescendo of colour. This is the restless season: the time we turn our backs on the lazy hazy days of summer and gird ourselves for the challenges and opportunities of winter. It's also our birthday.

Like many businesses, we welcome change; it offers opportunity. For the past twenty two years we've carefully studied business trends and have built a stable of real estate services designed to assist our clients achieve their objectives. We do not have the resources to cover the entire spectrum of every real estate field; so before adding each new service we've taken stock of our competition, identified where needs are being met least well, and have focussed on that market niche with the aim of excelling in it.

We Supply the Tools

Most firms have profit maximization as their goal: however their time frames differ. Asset management is the strategic process of deciding how to deploy the real estate component of your enterprise so that you achieve your business objective within your time horizon. This involves decisions on acquisition (lease or purchase), disposition, improvement and redevelopment. Our services provide you with the tools to make and then implement, many of those decisions. This is your toolkit:

(1) Valuation and Appraisal
(2) Property Tax
(3) Canadian Urban Econometrics
(4) Lasercad™
(5) Brokerage (Sales and Leasing)

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Valuation and Appraisal

In order that you can select the most cost effective service, one that is precisely matched to your requirements, we offer six valuation and two appraisal products. The most comprehensive products are tools for optimizing your real estate assets; performance appraisals comprising a fiscal, physical and legal audit, the outcome of which is an estimation of the asset value and recommendations on improving its performance within the constraints imposed by your objectives and time horizon.

At the other end of the range are appraisal reports, usually a more limited exercise whose sole purpose is to estimate property value.

Our key competitive advantages are *(1) Market knowledge and (2) expertise*. We are the only firm undertaking valuation and appraisal work in Atlantic Canada that has a Brokerage Division. This gives us a window on the market which cannot be replicated by raking through the dying embers of past sales. This day to day contact is the only reliable method of measuring demand ... and the latter is critical during the hiatus that has existed since 1989. Most property markets in Atlantic Canada have little depth: the absence of a single buyer because they are fully committed on a project, can make the difference between a strong and a weak market. In addition our Compuval™ system gives us access to 60,000 sales extending back to the 1970s, rental information and property records, ... a pool of real estate data that is unmatched ... even by Revenue Canada!

Expertise is a function of education and training. Our valuation personnel are not just appraisers. For the past six years we have hired commerce graduates (≥ B+ average) and have put them through the University of British Columbia's demanding four year Diploma in Urban Land Economics course in addition to our own inhouse training program. Senior personnel participate in our Profession Development Program and specialize in a particular sector of real estate.

Property Tax

Use this service to reduce the taxes of your New Brunswick, Newfoundland, Nova Scotia, Ontario and Prince Edward

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Island properties. We have conducted negotiations and appeals on properties ranging in value from $100,000 to $130 million.

Our key competitive advantage is our *relationship with the provincial assessors.* They do not respect weakness, so initially we focussed on establishing our position through the court appeal system. As a result it is rarely necessary for us to take that route today. However it obviously limits one's negotiating room if the penultimate step, resolution by the Appeal Board, is only available to the assessor. *We therefore typically work on a "fixed fee" rather than the commonly used "contingency" basis.* Remuneration on a contingency basis is expensive for the taxpayer and almost always results in sub-optimal tax savings because of the temptation to suffice i.e. get the best deal for the tax agent rather than the taxpayer.

Canadian Urban Econometrics

This is a practical research service for real estate practioners and is designed to help you solve your real estate problems and explore opportunities. It is particularly germane for real estate developers, or property owners considering redeveloping or changing the use of their property. The service encompasses supply and demand surveys, market studies, highest and best use studies, feasibility analyses, sensitivity analyses, economic impact studies, and trade area analyses.

Our key competitive advantage is our *breadth of knowledge;* our ability to bridge the gap between an academic analysis and the practical application of the research results. We are able to draw on resources and contacts fostered through our Valuation, Appraisal, Property Tax and Brokerage activities, to test the research results in a "real world" setting.

Lasercad™

This is a property measurement service designed for leasing and property management purposes. We measure each tenant space using the appropriate Standard Method of Measurement. output the data to our Computer Aided Design (CAD) system, and produce laser sharp "as built" drawings. To avoid disputes with tenants, we certify the rentable and usable areas. The Lasercad™ plans are provided in computer readable format. We also provide the software and basic training.

Our key competitive advantage is *quality control and cost.* We have assumed a pro-active role with others who undertake space measurement to ensure that each Standard Method of Measurement is interpreted in a consistent manner. We utilize a precision laser system accurate to within 3 mm ($^1/_8$") and measure to a closing error of ≤ 2% for all interior spaces. We offer two Lasercad™ products; tenant space certificates and perimeter drawings for landlords interested only in the area measurement: full "as built" drawings in hard copy and computer readable media for property owners who wish to deploy Lasercad™ in its full role as a property management tool.

Brokerage - Leasing

Our prime focus is Tenant Representation, whereby we represent the tenant rather than the landlord. Our client is the tenant, or prospective tenant and we enter into a signed contract whereby we are legally obligated to act in the best interest of the tenant. We locate the space that best meets their requirements and negotiate the lease terms with the landlord. The fee that would normally have been paid to the broker (us) as leasing commission, is instead paid to the tenant. The latter then pays us 75% of that leasing commission.

Our key competitive advantages are *(1) a clear written contract, (2) the participation of the tenant in the leasing commission and (3) the deployment of salaried professionals who concentrate only on leasing.* Our Tenant Representation Agreement is straight forward: unambiguous yet well documented. Our salaried leasing personnel have access to details on virtually all of the space available in the Halifax Regional Municipality. It flows into our computer from landlords on a daily basis.

Brokerage - Sales

Our primary focus is vendors of industrial, commercial and investment properties located within a 100 kilometer radius of the Halifax Regional Municipality.

Our key competitive advantages are *(1) our superb marketing program, (2) the support available from our Valuation, Property Tax and Counselling Divisions (3) deployment of salaried professionals who concentrate only on sales, (4) access to the Multiple Listing Service.*

We produce a Master Sales Prospectus (MSP) detailing the fiscal, physical and legal attributes of each property we have listed for sale. We are routinely complimented on the clarity, quality, breadth and depth of our MSPs. We have a comprehensive "target marketing program" and an extensive computer database of prospective purchasers. We circulate our I.C.I. Report detailing the properties we have listed for sale, to 14,000 business and professional recipients, semi-annually.

Most commercial brokers do not belong to the Halifax-Dartmouth Real Estate Board. However it has been our experience that the Multiple Listing Service is a cost effective way of achieving maximum market exposure for properties worth less than $1.0 million.

A Question of Interest

Our ability to avoid conflicts of interest has been key to our success over the years. This is not unusual of course, and we are not claiming bragging rights. Every company faces the situation where they gain information from a client which has the potential to damage the interests of that same client if it is misused. Unless they have a policy in place to deal with that situation, their presence on the business stage is bound to be short lived. In our case we gather information through our valuation activities for example, which could be detrimental to that client if they were disclosed to a competitor, also a client, on another valuation assignment. We are frequently in the situation of having knowledge not known to the marketplace

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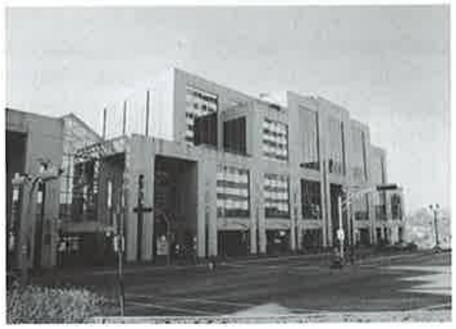
which nevertheless has to be kept confidential. Recently we were approached by a client seeking reassurance that lease data gathered on its buildings as part of an appraisal assignment would not be used by our leasing personnel for prospecting purposes. The client was very embarrassed and made it clear they were only raising the question because it had been raised with them. We had no difficulty of course in giving such an assurance and explained the safeguards we had in place. However the query caused us to go back to a similar request three years ago. In checking with other clients and our friends in the brokerage community we discovered that a specific party is misrepresenting our integrity to a broad audience, presumably in anticipation of thus achieving a competitive advantage. At first we were inclined to treat the suggestion with the contempt it deserved because to do otherwise would lend it credence ... and because it spoke volumes about the integrity of the party concerned. However on reflection we decided that inaction was the more dangerous course to pursue. This sort of poison, once it gains hold, can be levelled at each and everyone of us.

All of us face and deal with potential conflicts of interest: our ability to do so successfully is a measure of our longevity in business. The policies and procedures we employ are very clear: there is no ambiguity. Our Brokerage Division does not utilize confidential lease or other information for prospecting or other purposes. There is no reason for them to do so. All are salaried employees: indeed the only employee on our entire staff remunerated on a commission basis, is our residential appraiser ... and he works from home. Our professional staff sign confidentially agreements as a condition of their employment. They have everything to lose and little to gain by violating confidentiality ... and since our computerized reporting system tracks all jobs, any breach would be very apparent, very quickly. We cannot recall any incident involving breach of confidentiality in our twenty two years in business: nor do we expect to in the next twenty two!

PROPERTY TAX DIVISION

Nova Scotia



Alderney Drive, Dartmouth, N.S.
($85,700/annum - 13% in tax savings

Although we are able to negotiate settlement of most tax appeals, it is sometimes necessary to take the matter to court in order to get the correct assessment. We are fortunate in having an excellent litigation team. Our Lee Weatherby, who prepared the technical report and rendered the expert testimony in this case, is an outstanding expert witness. However technical experts alone don't win cases: their function is to assist the court by providing complete, unambiguous and unbiased testimony. In order to do so, they need competent legal counsel with a firm grasp of the technical issues involved. In our experience lawyers with a good understanding of real estate and financial modelling are a fairly small group. Because of our litigation experience we work with most of them. We were lucky enough to work with one such lawyer on this case: Joel Fischaud with the Halifax office of Patterson Palmer Hunt Murphy.

Proposed Amendments to Assessment Act

The province has proposed a number of changes to the Assessment Act to make it a "clearer, more user friendly statute". They fail to achieve that objective. Tom Mills, our Vice President, Property Taxation Division has reviewed the proposed amendments and casts the following pearls before the swine:

Business Occupancy, a tax levied on the occupants of commercial space, is currently assessed on the period of occupancy. So if you occupy, or vacate space, during the municipality's fiscal year, you pay a pro-rated share of the Business Occupancy Tax. The proposed amendments eliminate pro-rated taxation but provide for a new business occupancy assessment each time the business moves into other premises. As presently drafted a business moving during the fiscal year would pay business occupancy on both its old and new premises, for the full year. *This will rather cramp the style of business: effectively they will pay a one year Business Occupancy Tax* ***penalty*** *each time they move.*

The appeal period is to be extended from 21 to 45 days from the date the assessment notices are published. However the Province intends to discontinue mailing the assessment notices if the assessment remains unchanged from the previous year, so property owners and occupiers will not realize the appeal period is running ... unless they are in the habit of reading government advertisements in the newspaper. *This will be very effective in reducing appeals and is a "first" in Atlantic Canada. Taxes will still increase of course, because the municipality sets the tax rate. However a taxpayer, faced with an increased tax burden will be "out of time" to appeal since the tax notices are issued* ***after*** *the expiration of the appeal period.*

The notice of appeal must include "the specific reason for the appeal" and the appeal is restricted to the particulars set out in the notice. *This is an attempt to limit the appellant's ability to manoeuvre after the appeal has been filed.*

If you appeal your assessment and the Assessment Department refuses to amend it, they will issue a second assessment notice which you must appeal (again!) ... but you do have another 45 days in which to do so. *Appellants will now have to proceed through a double appeal process to get their case before the Regional Assessment Appeal Court.*

The provincial assessor is now allowed to correct assessment errors outside the appeal period. However they are not **required** to do so. *There is an analogous provision in the present Act and some assessors refuse to exercise their discretion if it will result in a reduced*

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assessment. There is no provision (nor is any proposed) to compel them to rectify the error.

Apartment hotels will attract the (much higher) commercial tax rate. Currently they are assessed as residential property.

Mediation or arbitration may be available as an alternative to the present court process.

Regional Assessment Appeal Court

Our comments (Newsletter Vol. 2 No. 60) may have given the erroneous impression that an assessment appeal before this Board is a lost cause. Such is not the case: many of the chairpersons are independent thinkers with a good grasp of their subject. In most cases we would have no hesitation in recommending this avenue of appeal. We also note that the proposed amendments to the Assessment Act provide alternative routes of appeal that can be utilized in the other instances.

Ontario

Highland Road, Kitchener, Ontario
($9,100 in tax savings)

Taxing times in Canada's heartland ... ah well, welcome to (current) market value assessment. The assessment of each property in the province is now based on its market value on the 30th June 1996. This is a dramatic change: prior to 1998 assessments were (supposedly) based on market values ranging from 1949 to 1992, depending on the municipality in which the property was located. It is much easier now to correct an over-assessment.

In addition, the Province has abandoned business assessments (which were levied only on the occupier) **and instead have rolled this tax into the property tax rate.** New Brunswick has used this method of taxation for many years. It places the entire tax burden on the property owner: however it is possible to pass the occupancy portion back to the tenant in Ontario.

Property assessment is the Province's responsibility: the tax rate itself is determined by the municipality in

which the property is located. The property taxes are calculated by multiplying the assessment by the tax rate. However in the "416 exchange" area of Greater Toronto, the municipality has capped tax increases at 2.5% per year for three years. Don't be lulled into a sense of false security by this tax cap ... it will catch up with you. *If you are over-assessed, appeal, no matter where your property is located.*

The Province categorizes each property into a specific property class. There are potentially twelve property classes and a number of sub-classes. Examples of the property classes are: residential/farm, multi-residential, commercial, industrial, large industrial, etc. The sub-classes are essentially the vacant portions of some of the twelve property classes. (No doubt you are tempted at this point to reach for a more lucid explanation. Go ahead. The official document is Regulation 282/98. It makes mind numbing reading and contains gems such as "Land in the new multi-residential property class is not included in the multi-residential property class."). The property classification is significant because municipalities can, and do apply different tax rates to each property class and sub-class. Take a look at these examples of 1998 tax rates:

Property Class	Sub-Class	Property Tax Rate Per $100 of Assessed Value (incl. Business Occupancy Tax)	
		Toronto	Halifax
Residential		$ 1.26	$ 1.54
Multi-Residential		$ 4.65	$ 1.54
Commercial		$ 7.64	$ 5.90
Commercial	Vacant	$ 5.35	$ 3.93
Industrial		$ 10.66	$ 5.90
Industrial	Vacant	$ 6.93	$ 3.93

A single property assessment can be split into more than one property class ... and the portion that is vacant can fall within a sub-class.

It is critical therefore to ensure that your property is properly classified ... and is not over-assessed.

Appeal Period

The Minister of Finance has publicly stated that the appeal period is to be extended to 31st October 1998. If you have any concerns about your assessment (quantum and/or classification) you should file an appeal. There is a Provincial filing fee of $50 per non-residential assessment. If you would like professional assistance with your appeal please give us a call at 1-800-567-3033. If your property is in the Greater Toronto Area, Rick Escott is your man. If it is located elsewhere in the province, Tom Mills will assist you.

New Brunswick

The New Brunswick appeal period expired on 30th April so if you failed to file, you'll have to wait until

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Rothesay, New Brunswick
$11,200/annum - 25% in tax Savings)

next March to do so. We are still working on a number of 1998 appeals with the provincial assessment department, the former ominously named Geographic Information Corporation and now the much friendlier sounding Service New Brunswick. We find that most of the assessors are open to a reasoned approach supported by a well documented position paper. *We typically work on a fixed fee rather than the more common "contingency", basis.* The latter is expensive for the client and relatively ineffective since it is not possible to take cases to court. (Appeal Boards will not place any reliance on evidence tendered by an expert who has a financial interest in the outcome of the case). This is sometimes a difficult point to get across to property owners since most cases are settled by negotiation. However it obviously limits one's negotiating room if the penultimate step, resolution by the Appeal Board, is only available to the assessor. Remuneration on a contingency basis almost always results in sub-optimal tax savings because of the temptation to suffice i.e. get the best deal for the tax agent rather than the taxpayer. Our two step process, audit and negotiation; is designed to ensure that the client does not spend money unnecessarily. Only when our audit of the assessment records reveals the property to be over or unfairly assessed, will we proceed to the negotiation stage. It makes sense therefore to undertake the audit now, rather than wait until next March and the commencement of the 1999 appeal period.

If you would like to explore the matter further please call Giselle Kakamousias toll free at 1-800-567-3033.

LITIGATION

Does it Meet the Standard?

The adoption in January 1989 of the Uniform Standards of Professional Appraisal Practice (USPAP) in the United States was we believe, a major step forward. They govern both methodology and reporting standards for appraisal assignments and are a Federal Government response to the Savings and Loan fiasco. Essentially the U.S. government, shuddering under the impact of back stopping a potential $200 billion (US) loss under its deposit insurance Act, told the appraisal industry to get its act together or it would do so for them. Our Federal Government did not issue a similar order despite the property lending based collapse of many of our financial institutions. However the Canadian Deposit Insurance Corporation (CDIC), who insure most of the banks and trust companies, was spurred into issuing its own appraisal regulations in June 1991. In 1992 the Appraisal Institute of Canada warned its members that its own standards no longer met those required by the CDIC, and eventually in January 1994, adopted USPAP. They are now the de jure standard in the U.S. and the de facto standard in Canada.

Unfortunately USPAP has never been embraced with great enthusiasm in Canada: it represented such a quantum leap in standards, many appraisers felt that clients would not cover their increase in fees ... particularly since it had no government backing. In theory the Appraisal Institute of Canada monitors its members for compliance: in practice however the Institute only responds to complaints from the public ... and most of the latter, if they have heard of it, probably assume USPAP is a new kind of baby formula. The result is a twilight world: all appraisers certify they comply with USPAP; some actually do so.

In view of these threats to USPAP the Supreme Court of Nova Scotia decision in the case "S-Marque Inc. and Richard Homburg et al" (S.H. 113589) is particularly welcome. The judge hearing the case, the Honorable Suzanne M. Hood, is a former solicitor with the City of Dartmouth. She has extensive experience of real estate expropriation, and hence appraisal standards. The appraisal report tendered in evidence had been prepared by an accredited appraiser member of the Appraisal Institute of Canada. It contained the usual compliance statement, "This type of report includes a comprehensive level of detail and the presentation of detail follows the requirements of the Uniform Standards of Professional Appraisal Practice (USPAP)". The good judge begged to differ. Refusing to take the compliance statement at face value, she painstakingly measured each section of the appraiser's report against the relevant USPAP standard, found it repeatedly failed the test, and threw out the expert testimony.

This case is significant because it clearly establishes that expert appraisal evidence has to meet USPAP. This, rather than the expert's qualifications and experience, is the first and critical test applied by the court. The case is revealing because it indicates a judicial familiarity with USPAP, and the willingness of

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the court to use the standard to evaluate evidence (and in this case to find it lacking) rather than simply accepting the USPAP compliance statement at face value.

REITS

Inoculation Against the Flu?

The Asian flu; Japan caught it first and rapidly infected its geographic and economic neighbors. As the contagion spreads, oozing outwards like some miasmic smog, stockmarkets cough, hack, falter and sometimes fail. Australia and New Zealand, their economies tied to the Far East, are now enveloped in its clammy embrace. Our own dollar has lost 11% of its value since the year began, measured against the U.S. greenback ... prompting some American artists at this year's busker festival in Halifax to pitch for more generous tips to meet their shortfall. Ah well, we'll only ask half of them back next year.

It's also caused the Kondratieff believers amongst our readers to proclaim that the end is nigh. Nikolia Kondratieff was a Russian economist who in 1920, postulated the existence of a "long wave", a underlying economic cycle with a length usually cited as 50 to 60 years and averaging 54 years. Superimposed on this long wave is a medium length cycle averaging 17 years ... and on top of that is the normal business cycle with a duration of four to five years. The troughs grow progressively deeper as each coincides. The big bang occurs when all three cycles hit bottom together: an event roughly scheduled to coincide with the end of this millennium. [Newsletter Vol. 2 No. 52]. Nikolia was a man of considerable integrity and astonishing imprudence. Upon discovering that communism, not capitalism was fatally flawed he relayed the important news to Stalin ... and was promptly incarcerated. But we digress, Ken Giffin CA (1-902-468-1273), our long wave guru hints that Atlantic Canada, buoyed by the recent oil and gas discoveries may surf through. If he is willing to share his thoughts with us, we'll pass them on to you. In the meantime let's take stock ... well maybe not stock ...

Thanks to the Asian flu, the stock market presents what Garth Turner (no relation), would have us believe is a great "buying opportunity" ... and what Kondratieff fans regard as the gathering clouds of the big storm. How can you inoculate yourself against the latter whilst still enjoying the fruits of the former? We're going to tell you. So turn off the phone, close those files, stand and face North Street, Halifax, promise to utilize our services exclusively in the future ... and read on.

The Efficient Frontier

The risk/return tradeoff is a simple concept, the greater the risk, the higher the return investors demand as compensation. In 1952 Harry Markowitz developed a model to accommodate risk in a portfolio setting and thus gave birth to a host of acronyms the most prominent of which are MPT (modern portfolio theory) and CAPM (capital asset pricing model). Since risk is defined as the volatility of the return, it is possible to diversify away non-systematic risk by spreading your money over at least 14 stocks, choosing investments that are counter-cyclical. So you need to select investments whose returns are negatively correlated ... as the return on one investment declines, the return on another increases. That way you maximize your return for a given degree of risk. The various investment portfolios which produce the greatest return for each given degree of risk can be plotted on a line called the efficient frontier. You then select the portfolio mix lying on this "efficient frontier" which meets your personal risk/return trade-off. But of course you know all that! The trick is to create a portfolio which lies on the efficient frontier. Be patient, we're getting there! In 1994 University of British Columbia professors, Stan Hamilton and Robert Heinkel investigated the role of real estate in a pension portfolio. They looked at data from the fourth quarter 1972 to the fourth quarter 1992, a period which covered the high growth 1970s, the recession in the early 80s, the stock market crash in 1987 and the property market meltdown in 1990. They discovered that investment quality real estate was negatively correlated with bonds (R = - 0.154), and marginally negatively correlated with stocks (R = - 0.022 with TSE300 Total Return Index). [Perfect correlation is stated as R = ± 1]. They concluded that Canadian pension funds, which currently have less than 4% of their assets in commercial real estate, could reduce their risk by increasing this allocation to between 5% and 15%. Their data actually showed 5% (conservative), 23% (risk tolerant) and 31% (aggressive), but perhaps mindful of the recent market meltdown they opted for the more judicious recommendation.

Hamilton and Heinkel also looked at Real Estate Investment Trusts focusing on American data, since REITs were not yet a Canadian phenomena. Although REITs are a real estate investment vehicle, the units transact on the stock exchange not the real estate market, and they exhibit the characteristics of the former rather than the latter. REITs are quite highly correlated with stocks (R = 0.72), though less so with bonds (R = 0.45). They don't have the same potential as real estate in the raw, to reduce risk in an investment portfolio. The good doctors indicated portfolio allocations of 1% (conservative), 14% (risk-tolerant) and 28% (aggressive).

The Hamilton Heinkel study is available from the Bureau of Asset Management, U.B.C. (ISBN 0-88865-522-3). Don't be cheap, buy it! We can't loan you our copy, its overdue ... The event omitted by their study is the buying opportunity afforded by the 1990 market meltdown. If you are a Garth Turner adherent or a Kondratieff fan you will wish to leave us at this point. However if, like the late Andrew Sarlos, you believe that real estate has already taken its kicks, whilst the stock market is in the last leg of this bull, you may want to read on ...

Ah! There is Life After Death

(But you will have to wait until our December issue to read the good news ... REITS will be continued ...).