

Newsletter

Winter 1998/1999

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UPDATE

Remember when each year used to have twelve months, 365 days, 8,760 hours and ... well you get the idea. 'Tis no longer the case, time has shrunk, barely do we welcome one new year ... and the next is upon us. All of us are now attempting to do more with less and whilst the official statistics on productivity cast doubt on the effectiveness of our collective effort so far, a sea change has occurred in the way business and government operates. The market meltdown in 1990 toppled real estate from its pedestal. No longer an icon of corporate stability and wealth; its role has been subsumed to the operational imperatives of the enterprise. Real estate has been relegated to the ranks ... it is now just another asset which has to earn its keep every hour of every day.

Many businesses have divested themselves of their real estate, preferring to rent rather than own. Real estate investment trusts (Reits) have been a useful vehicle for facilitating this process. We continue to place Reits under the microscope in this issue.

All businesses, and some levels of government are attempting to reduce the cost of operating their real estate assets. Our Property Tax Division is saving clients millions of dollars annually. Unfortunately we are unable to report our most spectacular successes in Newsletter, it is too public a forum. However it is not unusual for us to save a client **several hundred thousand dollars a year on a single property**. This issue brings you up to date on property taxes in the four Atlantic Provinces and Ontario. With the falling cost of travel, we can now offer a cost effective property tax service in most of the country. Tom Mills is our property tax guru. However we have delegated responsibility for New Brunswick to Giselle Kakamousias and Ontario to Rick Escott. All can be reached at 1-800-567-3033.

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Risk management is a challenge, compounded by property ownership. If you own real estate, read our article on fire insurance. It won't help you sleep better but you will be able to fine tune your policy to better fit within your risk management/cost constraints. If you require further information Mike Turner (1-800-567-3033) may be able to help (maybe not!).

Greater competition breeds er ... fear! Appraisers in Nova Scotia have witnessed a decline in their business over the past decade because of emili, CMHC's risk management system which virtually eliminates the need for residential appraisals. Their misery has been doubly compounded. The private sector has increasingly turned to more knowledgeable sources for commercial real estate advice. The real estate market has, and is, changing rapidly and appraisal firms used to raking through the dying embers of past transactions have been unable to keep up. As a result property owners have sought more pertinent advice. They have turned instead to commercial brokers, property managers and management consultants. In a desperate attempt to force property owners to utilise only their services, the Nova Scotia Association of the Appraisal Institute of Canada *ever so quietly* initiated a private members' bill on 23rd November 1998 to grant themselves a monopoly on "appraising" in the province. Did they succeed? Read on and find out ...

Looking for office space in Greater Halifax? Want to invest instead? You may be in for a surprise. Our Brokerage Division casts some bread on the water for you ...

PROPERTY TAX DIVISION

First, The Good News ...

Property prices are starting to increase again in many parts of the country ... and so too are property assessments. In our target area, Atlantic Canada and Ontario, tax assessments are based on the market value of the property as at a fairly current base date. (The actual base dates vary by province). Purchases by Real Estate Investment Trusts (Reits) over the past three years have raised market, and provincial assessors' expectations. Most Reits are transmutations. In their former life they were closed end mutual funds, property companies or pension company portfolios (see Canadian Reits in this issue of Newsletter). Their property portfolios were transferred to the Reit as a single package at a price based on an appraisal. Sometimes the reported allocation of the sale price between

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the various properties is arbitrary, and is based on a uniform price per unit eg. suite, so that values are overstated for some properties and understated for others. This has repercussions too for the tax assessment of other properties which have not sold since it offers prima facia evidence of increasing property values for the asset class, which may not in fact have occurred. (Provincial assessors are always more disposed to believe price increases than decreases, so re-assessments tend to be a one way street).

Nova Scotia



Kentville, Kings County, N.S.
(\$23,800 – 25% in tax savings)

The Nova Scotia assessment notices will be mailed on 11th January 1999. You only have 21 days in which to appeal. Your appeal notice must be received by the assessment department on or before 1st February 1999. The basis of your 1999 realty assessment is the market value of your property on the 1st January 1997 (the base date).

Generally speaking the assessment department has been slow to realise that property values for certain asset classes have increased. Uniformity of assessment is mandated by the Nova Scotia Assessment Act however. If your property assessment increased because you purchased it recently, you may still have grounds for appeal if the revised assessment is higher than that of similar properties, even though its assessment is at, or lower than its "base date" market value.

The proposed amendments to the Assessment Act reported in our Fall issue of Newsletter have not been approved by the Legislature (yet).

There is some good news if you have appeals pending with the Utility and Review Board. New Board members have been appointed and appeals are expected to be processed quickly this winter and next spring.

When you receive your assessment notice, don't panic. We will be mailing you a set of decision rules on 12th January. They will help you decide whether to proceed with an appeal. If, heaven forbid, we miss you, or if you would like to discuss a possible appeal, please call Tom or Giselle toll free at 1-800-567-3033 (429-1811 in Greater Halifax).

New Brunswick



Ferdinand Blvd., Dieppe, N.B.
(\$17,300/annum – 14% in tax savings)

The New Brunswick assessment notices will be mailed on 1st March. The appeal period has been halved to 30 days, starting in 1999. Assessors in several jurisdictions have warned us of a province wide mandate to complete their appeal review process by the end of June. There appears to be a concerted effort by the Assessment Department to discourage appeals by condensing the appeal and review periods. Don't get trapped! Contact us as soon as you receive your assessment notice.

We understand that "heavy industrial" properties will be re-assessed for the year 2000. The Assessment Department has already started on this re-assessment and their calculations disclosed to us thus far, indicate increases of 40%. Since the tax rate includes a Provincial component, increases in assessment of this magnitude will result in a similar tax increase too. Our Property Tax Division is well experienced in this type

of property: pulp mills, mines, smelters, etc. with assessments of \$100 million or more. Be pro-active, don't wait until the year 2000. If you own this type of property call our V.P. Property Tax, Tom Mills (1-800-567-3033) now.

The basis for your 1999 assessment is the market value of your property on the 1st January 1999. We will publish a set of decision rules which you will be able to use to decide whether your property is overassessed. They will be mailed at the beginning of March. If you haven't received them by the 8th March please call Mike (1-800-567-3033).

Prince Edward Island



Richmond St., Charlottetown
(\$3,700/annum – 7% in tax savings)

Relax, the Prince Edward Island assessment notices will not be mailed until the 30th April. The basis of your assessment is the market value of your property on the 1st January 1999. We are not expecting substantial assessment increases until the year 2000.

Newfoundland

All of the appeal periods have now closed. If you have filed an appeal and require professional advice, please call Tom Mills toll free at 1-800-567-3033.

Ontario

*Oh What a Tangled Web We Weave,
When First We Practice to Deceive.*

Sir Walter Scott.

Our last issue of Newsletter (Vol. 2 No. 61) reviewed the re-assessment drama in Ontario. If you are struggling to keep up with the steady flow of amendments as the Ministry of Finance ducks and weaves, this update may help. (If you

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deposited our last Newsletter in your round filing cabinet and now regret that impulse, call Patti at 1-800-567-3033 for another copy). Here we go ...

Tax Increases

In the "416 exchange" area of Greater Toronto, the municipality has capped tax increases at 2.5% for three years. The Province has now brought forth legislation which will limit tax increases on commercial and industrial property throughout the remainder of the province. Increases will be limited to 10% (1998), 5% (1999) and 5% (2000). This limit applies to the municipal and education portions of the property tax. You may experience property tax increases in excess of these limits if you have made physical changes to your property, changed its use (eg. vacant space becomes occupied), or if the municipality decides to increase the tax rate!

Gross Lease

The Province abandoned business assessments (which were levied only on the occupier) and instead rolled this tax into the property tax rate. In so doing they shifted the tax burden from the tenant to the landlord. The latter can recover this portion of the tax from the tenant for the 1998 taxation year, provided they give the tenant notice by the 15th December 1998.

Appeal Period

The appeal period for the 1998 taxation year has been extended to the 31st December 1998. It has not been easy getting the assessors' attention. They are extremely busy, morale is low and there is talk of hiving off the assessment department into a separate corporation on the New Brunswick model. Older assessors are therefore hoping for an early retirement package. We don't have that option. Rick Escott is our man about Ontario. If you have appealed your assessment Rick can be reached at 1-800-567-3033.

REITS (CONTINUED)

Ah! There is Life After Death

It is tempting to dismiss Canadian Reits as a reincarnation of the real estate mutual fund industry that briefly flourished in the 1980s ... and all but perished in the 1990 property collapse. After all RIOCAN Reit was begat of Counsel Real Estate Fund; MD Realty is now CREIT; Roycom Summit Fund, SUMMIT Reit and so on ... However there are important differences. The 1980s style real estate pooled funds basically came in two guises, both fatally flawed. The closed end pool had a fixed life, typically 10 to 15 years. Money from the sale of investment units was used to acquire real estate assets. Investors either held their investment for the fixed life of the fund, when the properties were sold, or attempted to sell their investment units privately. Liquidity was low, and the fixed life of the fund ignored the reality of property market cycles. By contrast the open ended pool had no fixed life. Investment units were continually offered for sale by the promoter and the fund pursued a program of real estate acquisition or sale, concomitant with market conditions. The investors could redeem their units at any time based on the appraised value of the real estate assets in the fund. The open ended pool thus had the virtue of liquidity its closed-end sibling lacked ... and since the value of the investment units was a mirror of the underlying real estate asset value, they were negatively correlated with the stock market. Unfortunately they suffered from "appraisal lag". Because appraisers formulate their opinions using historic data, they underestimate values when the market is rising and overestimate them when it is falling ... In any event the 1990 market meltdown was so sudden and severe the pools were overwhelmed with redemptions and most had to re-organise as closed-end pools. They have re-emerged as Reits. However the investment units are now sold on the stock exchange at prices which reflect their risk/return tradeoff versus competing stocks and bonds. To a very large degree therefore the value of the investment unit has been "uncoupled" from the worth of the

underlying real estate asset and only reflects its immediate cash flow generating capability. Reits therefore focus on acquiring property whose cash flow is "accretive" i.e. produces a higher return than that demanded by the Reit's own investors in the stock market. They have been aided in this quest by the 1990 property market collapse. The renaissance in rental rates, riding on the country's economic recovery east of the Rockies, has created an ideal investment climate for the Reits and they have taken full advantage of it.

The Real Estate Race

"In 1992, Germans used 170 million condoms, Britons used 160 million. The French used 100 million. We can catch up, but we must go faster."

Philippe Douste-Blazy, France's Health Minister.

And that is probably a sentiment too, shared by many Reit acquisition managers. The past three years have presented buying opportunities the like of which we may never witness again. However as the economy recovers and pension funds accept that the sky is not falling, real estate will, we believe, return to its appointed position in the firmament. Public real estate companies have invested heavily in Canadian real estate, though Reits are still in the vanguard in Atlantic Canada. This is who they are, what they do, when, why and where they do it ...

Reits, The Five Ws

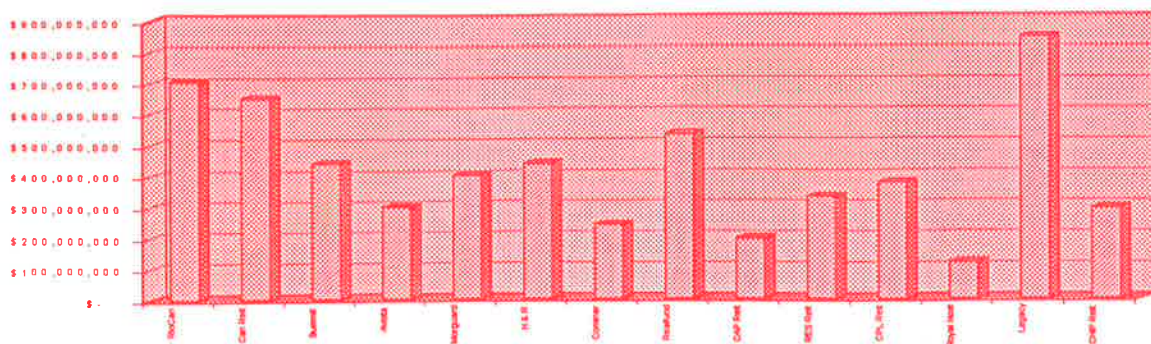
The growth of Canadian Real Estate Investment Trusts has been meteoric. As at the 31st December 1997 their assets totalled approximately \$6.8 billion (we've cheated a little by including Cominar Reit which did not commence operations until 31st March 1998). Several of the Reits were formerly closed end mutual funds and thus started with portfolios diversified by asset class and location. Two, CAP Reit and RES Reit, focus on apartment properties since they are less risky: the loss of a tenant does not have the same impact on cash flow as would be the case with a retail, office

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CANADIAN REITS				
	Year Ending 31st December 1997			
Name (Commenced Operations)	Total Assets	Portfolio Size	Leverage	Comments
Riocan Reit (29 June 1995)	\$796,309,844	8,108,000 ft. ²	44%	Antecedent: Counsel Real Estate Fund. Focuses on leading edge retail property: specifically Community, Neighbourhood and free standing campus (power centres) preferably with anchors such as Junior Dept. Stores, supermarkets, state of art movie theatres and national retail chains. Diversified geographically across Canada.
CREIT (1 Oct. 1996)	\$653,631,000	7,829,190 ft. ²	43%	Antecedent: MD Realty Fund. Attempts to eliminate non-systematic risk by diversifying geographically and by asset class. Portfolio of retail (57%), industrial (24%), office (17%) and apartments (2%). Very diversified geographically across Canada. Now entering United States (Chicago) market.
Summit Reit (31 Dec. 1995)	\$443,238,343	6,148,049 ft. ²	44%	Antecedent: Roycom Summit Fund. Attempts to eliminate non-systematic risk by diversifying geographically and by asset class. Portfolio of retail (60%), industrial (24%), office (9%), apartments (7%). Fairly diversified geographically across Canada, and in the United States (Carolinas).
Avista Reit (22 July 1997)	\$376,445,000	4,092,000 ft. ²	40%	Antecedent: Canada Life Assurance Company (81 properties) in Canada. Promotes themselves as an "institutional" Reit. Portfolio of retail (52%), industrial (26%), office (22%). Property is located in three provinces (Alberta, Ontario, Nova Scotia).
Morguard Reit (14 Oct. 1997)	\$475,453,000	5,072,517 ft. ²	38%	Antecedent: 60 property portfolio managed by Morguard and owned by twelve Canadian pension funds. Portfolio of retail (28%), industrial (21%), office (40%), mixed (9%), miscellaneous (1%). Property is located from Quebec westwards in Canada.
H & R Reit (23 Dec. 1996)	\$455,473,546	4,791,504 ft. ²	44%	High quality portfolio of retail (8%), industrial (28%), office (64%). All of its office properties are located in Greater Toronto Area and immediate environs apart from one building in Los Angeles, CA. Industrial properties are all "build to suits" for major tenants. Focuses on quality of tenant covenant and long term leases to contain risk.
Cominar Reit (31 Mar. 1998)	\$291,084,000 (31 Mar. 1998)	3,073,659 ft. ²	46%	Antecedent: 51 property portfolio owned by Dallaire family. Portfolio of retail (50%), industrial/mixed (18%), office (32%), in Greater Quebec City area.
Realfund Reit (1 June 1993)	\$647,655,000	4,427,653 ft. ²	39%	Antecedent: First City Real Fund. Portfolio of retail (77%), industrial (4%), office (4%), other (15%). Property is well distributed geographically across Canada, and in the U.S.A. (3%).
CAP Reit (1 June 1997)	\$236,551,030	3,887 apts.	60%	Focuses entirely on apartments, Luxury (25%), Mid-Tier (35%), Affordable (40%), in order to reduce risk. Apartment demand is driven by demographics rather than the economy and the impact of individual vacancy in any one building is lower than is the case with commercial property. Property is located in Ontario and Nova Scotia.
RES Reit (24 Oct. 1997)	\$428,426,000 (24 Oct. 1997)	6,838 apts. plus 209,042 ft. ² ancillary commercial space.	57%	Antecedents: Property portfolios owned by Greenwin Properties Group and Lehndorff Tandem Properties Group comprising 32 apartment buildings and one townhouse complex. Focuses entirely on apartments, Luxury (20%), Mid-Tier (75%), Affordable (0%), Ancillary Commercial (5%). Property is located in British Columbia, Alberta and Ontario.
CPL Reit (6 May 1997)	\$440,145,000	43 homes with 5,969 beds plus management of 12 homes with 1,627 beds.	42%	Antecedent: Central Park Lodges Ltd. healthcare facilities. Focuses entirely on nursing homes in Canada. (This is the only Canadian health care Reit). Contains risk by investing in an industry where supply is effectively controlled by provincial governments' ability to pay for nursing home care via licensing. Property is located in every province other than Saskatchewan and Atlantic Canada.
Royal Host Reit (1 Oct. 1997)	\$186,406,000	18 hotels with 1,610 rooms.		Focuses entirely on mid-market hotels/motels: Upper Mid Market (51%), Mid Market (9%), Economy (18%), Resort (22%). Property is located in all provinces other than Ontario, Quebec and Prince Edward Island.
Legacy Reit (10 Nov. 1997)	\$893,464,000	11 hotels with 5,569 rooms, 489 suites.		Antecedent: Canadian Pacific Hotels portfolio. Focuses entirely on Luxury (83%) and Upper Mid-Market (17%) hotels. The former are "classic" hotels in the grand Victorian tradition, virtually national monuments. Property is located in all provinces other than Manitoba, Saskatchewan and Newfoundland.
CHIP Reit (1 July 1997)	\$444,703,000	23 hotels with 5,444 rooms.		Focuses entirely on Upper Mid-Market (40%) and Mid-Market (60%) hotels. Property is located in all provinces other than Manitoba, New Brunswick, Newfoundland.

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DISTRIBUTION OF CANADIAN REIT ASSETS (DECEMBER 31st, 1997)



or industrial property, and demographics rather than the economy dictate rental levels. By contrast, Royal Host, CHIP and Legacy specialise in hotels. Legacy affords investors the opportunity to buy part of a Canadian heritage property such as the Royal York Hotel in Toronto, but Royal Host and CHIP mix it up with mid-market hotels. These are higher risk properties which should offer superior returns. RIOCAN is the only Reit that specialises in retail: President Edward Sonshine waxes lyrical that this is "almost a magical time" and indeed the happy juxtaposition of low interest rates and a depressed property market have provided buying opportunities that we have not witnessed during the past thirty years. We have detailed the 14 Canadian Reits in the table on the previous page.

REITS will be continued in the next issue of Newsletter.

FIRE INSURANCE

Our previous articles (Newsletter Vol. 2 Nos. 58 & 60) apparently so obscured the subject that one exasperated client charged us with the task of ensuring that he had adequate fire insurance to rebuild his buildings and replace his equipment. Ah! Yes, well here goes ...

Chose the Correct Basis for Insurance

The two (mutually exclusive) bases for insurance are Replacement Cost and Actual Cash Value. Provided that you intend to (and can) replace, repair, construct or re-construct the property on the same site with new property of like quality and like occupancy, insure it on a Replacement Cost basis.

Get the Replacement Cost Right

Have the property professionally appraised before taking out the insurance, and file the appraisal with your insurance company at that time. It is then unlikely to be challenged if you subsequently have a claim. You can also purchase "inflation protection"

which will insure the buildings (but not your process equipment) against rising costs, based on the Statistics Canada Non-Residential Construction Price Index. You should update your insurance whenever you make major changes, and at least every five years. If you don't have inflation protection, update it annually. This is relatively inexpensive since we hold the original specifications on our computer.

You should also purchase a "Building By-Laws" endorsement to cover additional costs imposed by by-laws, regulations or ordinances of law. For example, you may be required to demolish or render safe and slightly the fire damaged portion of the building immediately ... well in advance of your reconstruction work. This insurance endorsement will **not** cover you if the zoning by-law prohibits reconstruction of the building because it is a non-conforming use. Quite often buildings no longer meet the municipal zoning by-law because the allowable use, set back, or height requirements have changed since the building was originally constructed. If you cannot rebuild, your insurance will only compensate you on an Actual Cash Value basis ... of which more, later!

Consider a Functional Replacement Cost Endorsement

Some buildings and much machinery may not be replaceable, often because technology has rendered it obsolete. In the case of a machine being replaced by a more modern equivalent, for example a 486 computer with a Pentium, compensation will be assessed on the Replacement Cost of the current model, or the insured value, whichever is the lesser cost. However if the manufacturing process has so changed that you cannot replicate it, the insurer will only pay on an Actual Cash Value basis. The compensation is unlikely to fund your world cruise ... much less put you back in business. However, not to despair, there is a solution: you can purchase a Functional Replacement Cost Endorsement. This allows you to replace the fire-damaged property with a "better" machine or building ... provided of course that you have sufficient insurance coverage to fund the cost.

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Actual Cash Value - The Last Resort

If you don't intend, or cannot, replace the building or machinery you will be compensated on an Actual Cash Value basis. At first blush this suggests that you insure on this basis under these circumstances, to save on the premium. However by doing so, you expose yourself to the risk of having insufficient coverage under the co-insurance clause (Newsletter Vol. 2 No. 60) unless you have a complete fire loss.

One insurer advised us that attempting to define "Actual Cash Value" was analogous to "nailing jelly to the wall". Well perhaps, the explanation in a previous Newsletter (Vol. 2 No. 60) probably gets as close as it is possible to get without subjecting the matter to court for a property specific ruling.

If you would like a copy of our brochure on Fire Insurance, please call Patti at 429-1811 or toll free 1-800-567-3033.

PRIVATE CLUB COUP: APPRAISAL MONOPOLY IN NOVA SCOTIA

On 3rd December 1998, The Nova Scotia Association of Real Estate Appraisers (NSAREA) a private club, was granted the right to provide appraisal and value related counselling advice in the province, by the Nova Scotia Legislature. Prior to that date consumers were free to purchase this advice from the most cost effective and knowledgeable source: often commercial and residential real estate brokers or consultants. Henceforth such action will attract fines ranging from \$500 to \$5,000, with the possibility of a six month jail term. There are a few exceptions most notably auctioneers, accountants, business valuers or licensed real estate agents who provide value estimates in conjunction with their normal course of business. Thus, real estate brokers/agents will be able to offer advice in conjunction with listing a property for sale or lease ... but will not be able to offer such advice for a fee where no listing is contemplated.

The NSAREA is effectively the

provincial branch of the Appraisal Institute of Canada (AIC). Many of their members have suffered financially during the past decade because of computerisation, the growth of more knowledgeable consumers and increased competition. "Emili", CMHC's computerised risk management system has decimated demand for residential appraisals and appraisers who supply this market have experienced a substantial decline in business. Despite their efforts at the Federal level the AIC were unable to undo the effects of emili and warned its members that demand for residential appraisals would continue to decline in the future. Unfortunately for them, their other avenue of revenue, commercial appraisals, has also experienced declining fees. Business clients, firms increasingly run by accountants, commerce undergrads or MBAs, have greater knowledge of financial analysis than most appraisers and no longer need their services. If current real estate knowledge is required they often prefer to turn to commercial real estate brokers. This process has been exacerbated by the rapid changes in the real estate markets, triggered by the 1990 recession. Faced with the choice of seeking advice from an appraiser who has to rely on raking through the dying embers of past transactions, or a commercial broker active in the marketplace on a daily basis, many business owners opt for the latter, more pertinent source.

The Appraisal Institute of Canada has attempted for many years to legislate business for its members. Its efforts in the larger provinces failed but it was successful eventually, in New Brunswick. Despite objections from consumer and business groups (including ourselves), legislation was approved in 1995. The Nova Scotia Real Estate Appraisers Act is essentially a mirror of its new Brunswick counterpart. However it attracted no similar opposition in Nova Scotia because its introduction on 23rd November was never advertised and it proceeded through to proclamation in 10 short days! Members of the AIC who wished to oppose the Bill were not informed that Bill 86 had been tabled, until after the Act had been proclaimed on the 3rd

December ... nor were the Consumers Association of Canada, the Halifax Dartmouth Real Estate Board, the Metropolitan Halifax Chamber of Commerce, et al. The Liberal back benchers who tabled the legislation as a Private Members Bill thought it was a consumer protection Bill and was apparently unaware that it had not been exposed to industry or public debate.

No matter, it is now law unless the Legislature decides to repeal it ... and we are now members, albeit reluctantly, of this new monopoly.

Oh happy days! So if you would like advice from licensed real estate appraisers who also happen to be commercial brokers give us a call.

If you would like a copy of Bill 86 you can download it from the Nova Scotia Government Web Site: [/www.gov.ns.ca/legi/lege/bills/57th_1st/1st_read/b086.htm](http://www.gov.ns.ca/legi/lege/bills/57th_1st/1st_read/b086.htm)

BROKERAGE DIVISION Greater Halifax

Looking to rent office space? What a difference a year makes. The vacancy rate for Halifax Central Business District now stands at 4.5% for Class A space and 10.5% for Class B. Overall vacancy in the C.B.D. is now 8%. Office vacancy data extending back to 1975 indicates that this market is historically in equilibrium at 6%: new construction occurs when it falls below this point. However in order for new construction to be economically feasible, the current net absolute rents will have to increase by 50%. We expect this to occur over the next twenty four months.

Looking to buy? Industrial properties in the parks are now attracting multiple bids ... what a pleasant change! Demand is strong for good quality apartment buildings especially on Halifax Peninsula. Vacancy is low and seasonally adjusted rents are rising slowly. Office buildings are in demand again: quite a change from six months ago. Small retail malls are attracting some interest.
