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TURNER DRAKE & PARTNERS

Real Estate Counsellors, Brokers & Valuers

Newsletter

LET THE GOOD TIMES ROLL!

It's been a tough ten years for everybody involved in real estate but at long last the tide has irrevocably turned. During the dark days that followed the 1990 market meltdown we felt like the priest who discovers there is no God. The very mention of the words "real estate" caused bankers to blanch, mortgage officers to moan and clients to cower. The sight of our own banker visibly shrinking from us across the table, as though we had some dreadful contagious disease, is indelibly etched in our memory. To all of you who kept the faith and refused to believe in Chicken Little; good on you! Real estate has bounced back. How long will the recovery continue? Read the continuation of the *"The Pre-Millennium Meltdown. Will it Happen Again?"* in this issue of Newsletter.

The recovering economy brings rising taxes as assessment authorities rush to increase property assessments … and municipalities refuse to reduce tax rates. You can expect large tax increases next year unless you take action now. Our Property Tax Division tells you how.

Our Valuation Division are a peripatetic lot: Saint John one day, St. John's the next. The falling cost of communications and travel ensure that we can provide clients with the same seamless service, no matter where their property is located. We have thumbnail sketches on the property markets in several major cities in the Atlantic Region.

Pipelines are thrusting their way through the Maritimes … and causing concern, apprehension and aggravation to some property owners. *Pipe Dreams* explores their right to compensation.

PROPERTY TAX DIVISION

Nova Scotia – Between a Rock and a Hard Place

Although our tax team are able to negotiate reductions in assessment 95% of the time, obviating the necessity and cost of proceeding to the Regional Assessment Appeal Court,

Kearney Lake Road, Halifax, N.S.
($21,000 – 97% in Tax Savings)

occasionally their well reasoned arguments fall upon stoney ground … Happily the Court concurred that this site, unserviced with sewer and water, and far from the madding crowd, lacked the necessary attributes of a prime commercial site, assessed circa $10/ft.². The Court shifted the decimal point a little to the right; to $0.02/ft.² instead. The taxpayer was between a rock and a hard place but they did have the opportunity to obtain relief at relatively low cost. Such may not be the case when the amendments to the Assessment Act, which received Royal Assent on June 8th, are implemented.

Assessment Act Amendments

Prior to the Amendments to the Act, all appeals proceeded to the Regional Assessment Appeal Court, a relatively inexpensive and reasonably quick procedure. Appeals from this Court were heard by the Nova Scotia Utility and Review Board. The Amendments allow the Director of Assessment, a.k.a. a government bureaucrat, to eliminate the taxpayer's first right of appeal, in the case of commercial property or apartment buildings, and instead refer the matter directly to the more formal (and expensive) Utility and Review Board. Presumably the purpose of the Amendment is to discourage appeals by rendering them much more costly. The Amendments also allow the Minister to set up an alternative dispute-resolution process (mediation and arbitration) to replace referrals to the Board. However the bottom line is that appeals will be more costly and prolonged. Worry not, as always, we have a solution. (The Amendments also contain some particularly nasty provisions if you own a railway, pipeline or are a non-resident).

Pre-Assessment Roll Negotiations

On 5th June the Assessment Department mailed out 60,000 preliminary notices to property owners whose Year 2001 assessments increased by ≥ 3%

(Continued on page 2)

IN THIS ISSUE

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(Continued from page 1)

over Year 2000. Two thirds of the notices applied to properties in the Halifax Regional Municipality. The basis for your Year 2001 assessment is the market value of your property, as at the 1st January 1999 base date. The Assessment Department are willing to negotiate reductions in assessment with us **today** even if no preliminary notice has been issued. Please call Tom Mills our Vice President Property Tax Division at 1-800-567-3033 (in Halifax-Dartmouth 429-1811) if you think you are overassessed. He will be pleased to advise you. **If you did not complete and return the Assessment Department's Information Request Form in April, this will be your only chance to contest the assessment. So get cracking!**

New Brunswick – Discount Shopping

Lancaster Mall, Saint John, N.B.
($59,000 – 12% in Tax Savings)

The Appeal Period has now closed for the 2000 tax year. Our New Brunswick tax team, headed by Giselle Kakamousias is hard at work negotiating reductions in assessments. In many parts of the Province the provincial Assessment Department is very professional, probably the best in the country. The basis for your Year 2000 assessment is the market value of your property as at 1st January 2000. If you have appealed your Year 2000 assessment but have not yet engaged our services, call Giselle at 1-800-567-3033. We may also be able to (informally) pre-agree your Year 2001 assessment with the Department.

Regional Assessment Review Board Revived!

Effectively there has been no formal appeal mechanism in the Province since Mr. Lawrence Garvie retired as Chairman of the Regional Assessment Review Board on the 1st April 1999. Since the Board typically hears 200 to 400 assessment appeals each year its absence left rather a hole. On the 8th June a new Chairman, Scott R. MacGregor was appointed by the Provincial government. We understand that he has already started to schedule appeals. Under Mr. Garvie's chairmanship, the Board did an excellent job and although we occasionally demurred with its decisions, there was no doubting its independence. We expect that tradition to continue … if it doesn't we'll tell you …

Prince Edward Island

Prince Edward Hotel, Charlottetown, P.E.I.
($58,000 – 8% in Tax Savings)

The Year 2000 assessment appeal period closed on the 12th June. The basis for your assessment is the market value of your property on the 1st January 2000. There is no "uniformity provision" in the P.E.I. Assessment Act so you can be substantially over-assessed compared to other properties; but be unable to successfully appeal your assessment under the Act if it is less than the market value. This is a problem on the Island, since most properties are now assessed at less than their market value. However the Provincial Assessment Department have always been open to reasoned argument. You should therefore call our Tom Mills (1-800-567-3033) if your property appears to be unfairly assessed.

Newfoundland

All of the province is re-assessed tri-annually. Your Year 2000 assessment is based on its market value as at the 1st January 1996. Next year is a re-assessment year and we expect substantial increases in property assessments. The Province is responsible for assessments in all municipalities other than St. John's and will be mailing out the Year 2001 assessment notices between late September and early December. (The Christmas vacation has previously featured as the favoured mail-out period. No doubt they hoped you would be so full of turkey and Christmas pud, you wouldn't notice). St. John's has taken the bold step this year of pre-publishing the Year 2001 assessments. However they have only mailed out notices to properties assessed at ≥ $0.5 million. The basis for the Year 2001 assessment is the market value of your property as at 1st January 1999. **The St. John's Assessment Department has expressed their willingness to negotiate reductions in next year's assessments with us, now.** We strongly advise clients to take advantage of this opportunity. There will be a $200 filing fee for commercial property appeals if you wait until next year (refundable if the appeal is successful). Our Rick Escott (1-800-567-3033) will be glad to advise you.

Ontario

The Province is now re-assessing all properties for the 2001 calendar year. The basis for your Year 2001 assessment will be the market value of your property as at the 30th June 1999. Since your current assessment utilises a 30th June 1996 appraisal date, you should expect a substantial increase in your assessed value. The bad news will be sent to you at the end of November. We can file a Request for Reconsideration at anytime even though the formal appeal period will not end until 31st March 2001. If you would like more information call Rick Escott or Tom Mills at 1-800-567-3033.

For more information on Property Tax, visit our web site at ***www.turnerdrake.com*** *and follow the links (products → property tax).*

VALUATION DIVISION

Market Intelligence

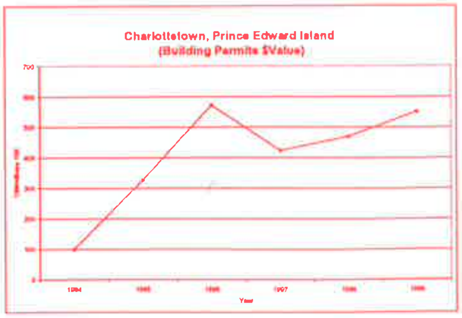
Our professional staff are a peripatetic group, providing clients with a seamless service across the four Atlantic Provinces and Ontario. We asked our Valuation

(Continued on page 3)

(Continued from page 2)

Division to provide Newsletter readers with a thumbnail sketch on some real estate markets in our service area.

Charlottetown, P.E.I.



Source: Charlottetown Department of Planning and Development, June 2000.

Most of the new development activity in downtown Charlottetown throughout the 1990's has occurred on the waterfront. Redevelopment of the Texaco bulk oil storage facility released land for the new cruise ship terminal and other public projects and the area has been transformed into a major tourist-related district of the city. Improvements are still ongoing with the former CN Car Shop building now in the final stages of being renovated into a new Discovery Centre, the first phase of the "Founders Hall" project. The Charlottetown Area Development Corporation (CADC) has been instrumental in funding and managing these harbourfront projects.

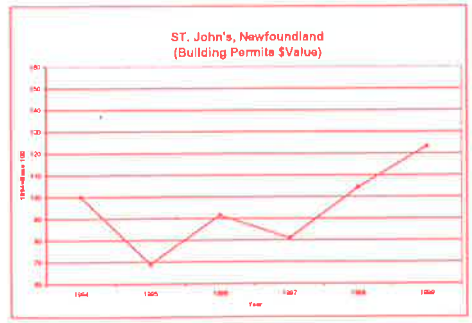
One of the few commercial projects currently underway in the downtown core is the renovation of the former Woolworth's building on Queen Street which will house the Great Northern Knitters operation. However there are several major projects underway in the downtown core which, if they proceed, will have a significant impact on the immediate surrounding area. The City of Charlottetown has recently completed a large land assembly at the southeast corner of University Avenue and Fitzroy Street. It is intended to be redeveloped with a parking garage and other new commercial buildings and will be a significant project that should encourage other new developments in the immediate area. There is also speculation that a new Federal government office building will be constructed on a site to be assembled facing University Avenue between Euston and Fitzroy Streets. The potential land base for that project is around 60,000 ft.^{2}, comprising the entire eastern end of this block. The two corner "window" parcels to that site are vacant and the rest of the site comprises old wood frame buildings in various states of repair. If that project does go ahead it will allow the demolition of the old (1955) Dominion Building on Queen Street (GFA 150,000 ft.^{2}) and the relocation of those Federal Government departments. The Dominion Building land is rumoured to be a redevelopment site for a large Suite hotel.

Outside the downtown core, the last two years have seen a large increase in the inventory of new retail/commercial buildings in the University Avenue corridor, particularly in the West Royalty area. "Big box" retailers including Winners, Sport Chek and Staples Business Depot have emerged, and major new Zellers and Wal-Mart department stores have been built. In total, there are approvals for 360,000 ft.^{2} of new retail space in West Royalty. New and renovated retail/commercial projects have also occurred closer to the downtown core along University Avenue including a new Atlantic Superstore at the corner of Belvedere Avenue, a new Harveys/Swiss Chalet combination store, a new Dairy Queen and a new Source For Sports freestanding store at the corner of Eden Street. The former Oak Tree Plaza at this location has also been renovated to provide modern retail space. New industrial development is also active with several new business/industrial park locations now being planned or developed in communities around Charlottetown (including Cornwall, Stratford and the airport). Residential construction is reportedly very active throughout the Charlottetown area.

In general the Charlottetown area is experiencing growth with a good deal of new development activity, but this is occurring mainly outside the downtown core. Most initiatives in the downtown tend to be government funded projects aimed at promoting and sustaining a viable downtown business core.

St. John's, Newfoundland

The economy of St. John's has improved significantly since the early and mid 1990's, fuelled mainly by offshore oil and gas activity but also from growth in the



Source: City of St. John's Business Information Centre, June 2000.

information technology industry. The last two years have been particularly active, as illustrated by the Building Permits $ Value Graph.

All real estate sectors are improving and new development is active. In the retail sector, the new "power centre" on Stavanger Drive (off Torbay Road) began development in 1995 with the construction of several "big box" stores including Price Club/Costco, Zellers, Kent Building Supplies, Future Shop and Staples Business Depot. There are unconfirmed reports of WalMart and a theatre complex being added on adjoining land, and also reports of land having been optioned elsewhere in the City for new "big box" retail projects.

In the industrial sector, new development is particularly active in the Donovan's Industrial Park in nearby Mount Pearl, as well as the St. John's harbourfront where offshore activity continues to expand requirements for supply bases and related facilities.

The office sector has been the least active in terms of new construction, but there have been declining vacancies over the past 2 to 3 years and increasing rents in the existing office inventory. New construction will be inevitable if the trend continues. The last major office project in the downtown core was Phase 2 of Cabot Place (135,000 ft.^{2}), completed in 1992. We are not aware of any major new office projects in suburban areas within the past 10 years, other than mixed industrial/office buildings built primarily for owner-occupation. The only significant new project in the downtown is the $36 million Civic Centre and Convention Centre complex which is currently under construction. There have been very recent (public) reports of a possible new 300,000

(Continued on page 4)

(Continued from page 3)

ft.² office/convention centre project on the east side of the downtown. There is public opposition to the zoning change required and it is too soon to say when (or if) it will proceed.

In general, the local economy is improving and real estate markets are active.

*For more information on our Valuation services visit our web site at **www.turnerdrake.com** and follow the links (products → valuation).*

THE PRE-MILLENNIUM MELTDOWN. WILL IT HAPPEN AGAIN? *(Continued From Last Newsletter).*

Bank Lending; The Human Factor

Rising vacancy rates in the 1980s were a clear indicator that supply was outstripping demand. It is not difficult to predict vacancy rates. Why then did developers and the banks place so little importance on this key indicator and instead prefer to extrapolate historical increases in rents and market values? The Wharton study concludes that humans, unlike pachyderms, forget … and perhaps wishful thinking played a part too. In synopsis their study found:

(1) Developers have imperfect knowledge about future demand and forthcoming supply and since the construction period often spans two to three years may continue to bring new space on stream several years after vacancy rates have started to rise. Thus real estate cycles may occur simply because of forecast errors and lags in the adjustment of the stock of commercial structures.

(2) Increases in the price of real estate may increase the economic value of bank capital to the extent that banks own real estate. Such increases will also increase the value of loans collateralized by real estate and may lead to a decline in the perceived risk of real estate lending.

(3) The banks suffered from disaster myopia (as did we). Specialists in cognitive psychology have found that decision-makers, even trained statisticians, tend to formulate probabilities on the basis of the "availability heuristic", *the ease with which the decision-maker can imagine that the event will occur.* In most of the countries studied, at least one generation had passed since the last crash in real estate prices. Indeed, in most instances prices had climbed steadily upward for a significant period. Consequently the repayment record on real estate loans was relatively good in comparison to other types of lending. Even when evidence indicating over-supply surfaced, such as rising vacancy rates, it was ignored because of cognitive dissonance … the conflict between the factual evidence and the banker's belief based on experience that "it just wasn't so". When confronted by the evidence that challenged the competence of their decisions, bankers first ignored it, then rejected it and finally accommodated it by changing other beliefs in order to protect their self-esteem as prudent lenders.

Disaster myopia was shared by a large number of banks because it was conducive to "herding" in which banks take on similar exposures. Being part of a group provides apparent vindication of the individual banker's judgement, and some defence against *ex post* recriminations if the sky falls in. It is also the result of competition from other banks with disaster myopia, which may force banks who don't suffer from it to ignore the probability … or lose business.

Standard accounting practices are useless in pricing low frequency shocks that occur so infrequently that they are not captured in the usual reporting period. This problem is often compounded by the practice of recognising fees (which may be considerable in some lines of real estate finance) up front, when the loan is booked, rather than amortising them over the life of the loan. And loans officers whose salaries and bonuses are based on short-term profits may take a similar length view of the transaction because they expect to be elsewhere ... in another job, perhaps in another institution, by the time problems emerge.

Once a shock, i.e. property crash, occurs, disaster myopia may turn into disaster magnification. The availability heuristic may exacerbate financial conditions because, just after the shock has occurred, it is all too easy to imagine another sharp decline in real estate prices and subjective shock probability will rise well above true shock probability. The resultant increase in mortgage rates and/or credit rationing will put further downward pressure on real estate prices and may escalate the retreat in property values into a rout. (It did!).

(4) The banks had inadequate data and weak analysis on which to base their loan decisions. Appraisals are of limited usefulness to lenders, they show only what past market values have been, not what they are likely to be during the term over which the loan must be serviced and paid. Using data from the United States, the Wharton study found that appraisals of office buildings were 30% too high based on existing supply and demand, and 50% too high when buildings already started at the appraisal date, came on stream. *(Appraisals are probably*

(Continued on page 5)

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even less valid in Canada since the banks insist that the appraisals be commissioned by the borrower, a practice illegal in the United States and other countries, for rather obvious reasons). Uncritical reliance on current market values lead to errors in underwriting since the value at the date of the loan had little relevance to the expected value of the property when the loan was to be repaid.

It was equally important to monitor indirect exposure, since this may be as debilitating as direct exposure. For example, if a bank has lent heavily to non-bank financial intermediaries such as finance companies that engage in real estate lending, it may be taking on substantial additional exposure to real estate.

(5) Bank lending is subject to what the Wharton study termed "perverse incentives". Due to disaster myopia or competition from banks suffering from disaster myopia, lenders accepted higher loan-to-value ratios, weaker guarantees or loose loan covenants. They were encouraged to do so by the "moral hazard problem"; the belief that they would be protected from financial disaster by government action because virtually every country had erected a safety net for depository institutions. Supervisory authorities too were hesitant to admit the scale of the crisis until it was well developed because, like the bankers, they too were subject to cognitive dissonance. They were also reluctant to raise questions that would reflect on the quality of their oversight and they were apprehensive that they would escalate the problem by raising public awareness of it.

Then there is wishful thinking. The bank may prefer to extend a workout loan to enable the borrower to keep current on interest so that the bank can delay (perhaps indefinitely) the costs of writing down the book value of its outstanding exposure. They may do so in the hope too that real estate prices will return to levels attained before the collapse. Supervisory authorities in the countries studied encouraged this policy of forbearance. It actually resulted in greater losses because banks and developers "went for broke" ... they took higher risks because they had little to lose.

"The Pre-Millennium Meltdown. Will It Happen Again?" will be concluded in the next issue of Newsletter.

COUNSELLING DIVISION

Expropriation – Pipe Dreams

Atlantic Canada's first natural gas pipeline stretches 568 Kilometres from Goldboro, Nova Scotia to St. Stephen, New Brunswick on the U.S./Canada border.

Gas Pipelines

Thereafter it continues through Maine and New Hampshire into Massachusetts to connect with the existing North American pipeline grid at Dracut. The trunk line through the Maritimes together with the Halifax, Saint John and Point Tupper gas laterals constructed by Maritimes and Northeast Pipeline fall under the National Energy Board Act. The other provincial lines are governed by the pertinent (New Brunswick or Nova Scotia) Expropriation Acts. Whilst there is a large body of published case law for the latter, we've been unable to locate much information on arbitrations conducted under the N.E.B. Act. Many of the disputes proceed to mediation instead so there is a paucity of published decisions. We are going to make decisions available by posting them on our web site **www.turnerdrake.com**. So if you have copies of any arbitration decisions on compensation claims arising out of pipeline acquisitions, share them with your fellow men (and women) by sending them to us.

Apprehension, Aggravation ... Some Compensation

The N.E.B. Act arbitration case *Brian Burke and Trans Canada Pipeline* involved the laying in 1993, of a second pipeline within an existing 30 m (98 ft.) wide pipeline easement; and the acquisition of a temporary 20 m (66 ft.) wide working easement contiguous to it for construction purposes for 3 months. Both the existing and the new pipeline were laid below ground so that Mr. Burke could continue to utilise the surface. The easement was covered with mixed brush. Stone fences had previously been installed across the easement at each end where it crossed Mr. Burke's property, to discourage snowmobilers and all-terrain vehicles. They were ineffective. Mr. Burke's residence was located at least 300 m (984 ft.) away from the easement. The property was situated in Rolph Township, Renfrew County, Ontario. The Arbitration Committee's most significant decisions on the various heads of claim, were as follows:

(1) **Apprehension of Pipeline Explosion.** Mr. Burke and his spouse Jane Dickerson, had inspected the destruction resulting from a 1994 pipeline

(Continued on page 6)

(Continued from page 5)

explosion near Latchford, Ontario which encompassed an area that would include their residence, should a similar incident occur involving the subject pipeline. The Committee concluded that the Burke's apprehension was not a compensable item because, (1) the arbitration hearings did not apply to "claims against a company, arising out of the activities of the company", and (2) living alongside a pipeline was no more stressful than day-to-day events such as vehicular traffic.

(2) **Realty Taxes Paid on the Pipeline Easement.** The Arbitration Committee disallowed this claim, ruling (correctly) that Mr. Burke could seek a reduction in his assessment to the degree that his property was depreciated by the easement.

(3) **Reduction in Value of Adjacent Property and Tree Farm.** The Arbitration Committee disallowed this claim on the grounds that the original easement had already done the damage and that no incremental loss occurred by virtue of the second pipeline.

(4) **Compensation for the Lands taken for the Easement.** Since the new 10 m (33 ft.) wide easement lay within the existing 30 m (98 ft.) wide easement the Arbitration Committee awarded only a nominal $500 ($50 per metre of width), on the grounds that Mr. Burke's reversionary interest in the land was not further diminished.

(5) **Compensation for Temporary 20 m Working Easement.** The Arbitration Committee's award was based on the annual rental value of the working easement, computed as 10% of its capital value.

(6) **Compensation for Annoyance and Aggravation During Construction.** Although the construction activity on Mr. Burke's property occurred on only 19 days during the three month construction period, the Arbitration Committee determined that he had no way of knowing when it was to occur. The Committee also recognised the disruption to Mr. Burke and his family covered the entire summer of 1993; construction also occurred on neighbouring property; it disrupted Mr. Burke's access to lands on the other side of the easement during construction; it meant that he had to deal with the timber cut from the working easement at a time not of his choosing; and he had to deal with Trans Canada Pipelines representatives from time to time. The Arbitration Committee was particularly impressed with Jane Dickerson's evidence: the pre-blast inspection of their home, the residence shaking because of the blasting, the noise of the bulldozers and heavy equipment from dawn to dusk, and the intrusion of "sight-seers" watching the construction process with scant regard for the Burke's privacy. The Arbitration Committee awarded $3,000 compensation ($1,000/month) and made it clear that the sum reflected the fact that the residence was at least 300 m (984 ft.) away from the construction activity.

(7) **Compensation for Ongoing Annoyance and Aggravation.** The Arbitration Committee noted that the only permanent outward change was the impact of the temporary working easement which had effectively increased the 30 m wide swath to 50 m. Since the rock fences at each end of the permanent easement were ineffective the increased width of the swath would further encourage hunters, snowmobilers and all terrain vehicles. The Arbitration Committee awarded $1,000 for this incremental loss ($50 per metre of width).

*For more information on Expropriation Case Law follow the links on our web site **www.turnerdrake.com** (products → counselling→ expropriation → case law).*

BROKERAGE DIVISION

Sales

Our sales team has a well deserved reputation for successfully marketing difficult properties … so much so we are running out of product! (The fact that the real estate market has roared back over the past twenty-four months has also helped). There is now a strong demand for virtually every type of real estate. Small office buildings (≤ 6,000 ft.^{2}) which were persona non grata just two years ago are "hot" … and apartment buildings situated on Halifax Peninsula are a collector's item. We have purchasers for most types of real estate. Prices have now reached their pre-recession (1989) levels; however there is still some "upside" in the office and industrial sectors. If you would like to sell your property please call Verna Turner at 429-1811 (1-800-567-3033 outside Halifax/Dartmouth). Several clients familiar with our marketing program have asked if we can dispose of property located outside Nova Scotia. We can and will. Through our NAI network partners we market property world-wide.

Leasing

Our leasing specialist Russ Allen has an encyclopaedic knowledge of industrial, office and retail space availability in the Halifax Regional Municipality … which makes him a good man to have on your side if you are expanding, contracting or moving. Gone are the days when tenants could pick their preferred location and chose the space. Vacancy rates continue to shrink and we've had a number of instances where tenants have lost their chosen space because they decide to take a few days to "think it over". Landlords are increasingly obtaining their asking rent and there is no longer much "give and take".

Much of the new demand emanates from Information Technology (IT) companies: they are expanding rapidly. Firms related to offshore oil and gas activity are an additional source of demand showing strong growth. We expect expansion of these two sectors to escalate over the next twelve months. There are still some good deals available on sub-lets, but they are getting more difficult to find. If you are seeking space, or would like to sub-lease, give Russ a call at 429-1811 Ext. 329.

*We have some property still available for sale or lease. Visit our web site **www.turnerdrake.com** and follow the links (products → brokerage).*