TURNER DRAKE & PARTNERS
Real Estate Counsellors, Brokers & Valuers

Newsletter

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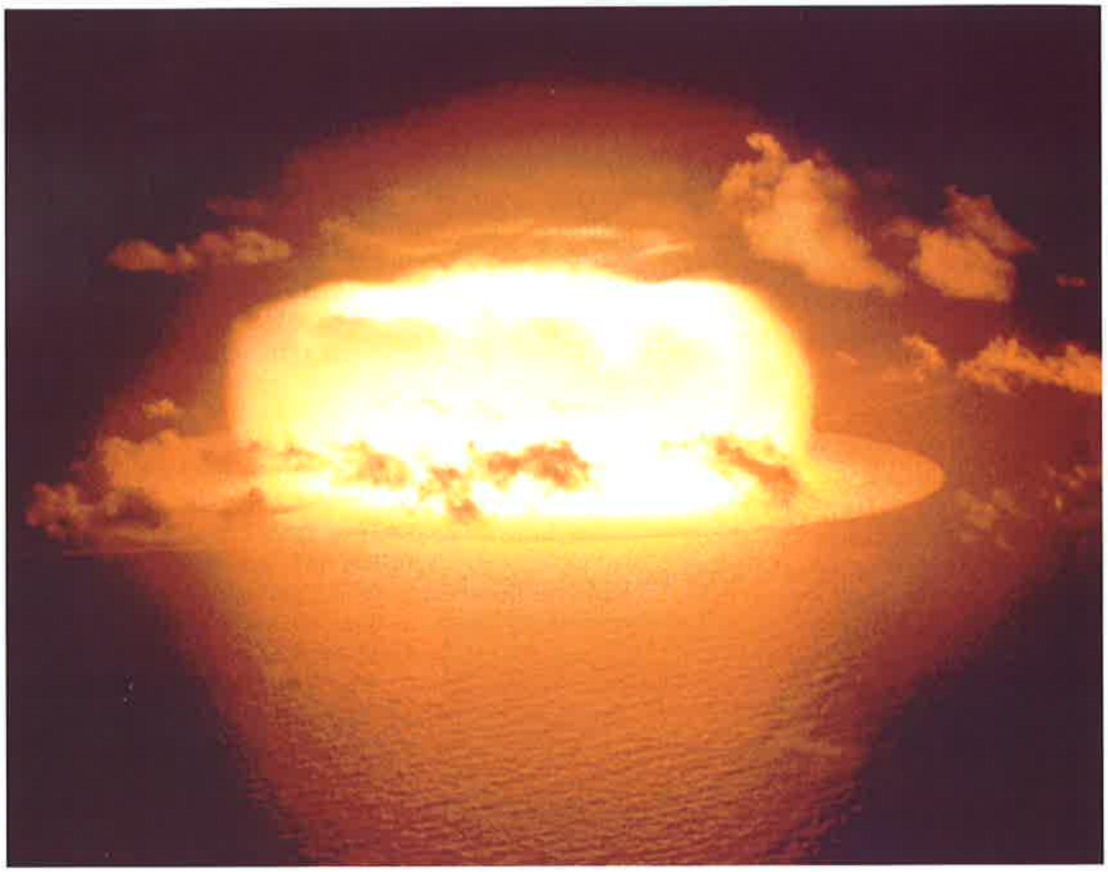
THE ENRON BOMB



Fotosearch

"To be efficient, markets need reliable information. Enron shows the extent to which they are not getting it." The Economist, February 9th., 2002.

The fallout from the Enron debacle continues to spread around the globe. The bankruptcy on December 2nd. 2001 of America's seventh largest company and the behaviour before and after the failure, of its auditor Arthur Andersen, the world's fifth largest accountancy, were initially overshadowed by events in Afghanistan. No longer! As the battle against al-Qaeda wanes, the spotlight is increasingly focused on the transparency, honesty and … well accountability, of accounting practices in the United States and worldwide. In part it is fuelled by anger at a system which allowed senior managers at Enron to pocket millions, shortly before the "restated" accounts rendered the pension plans of less enlightened employees virtually worthless. No doubt other Enron shareholders were pretty peeved too.

Whilst the Enron scandal is the largest and therefore the most dramatic evidence of audit failure it is no isolated case. The Economist reports that over 700 American companies have been forced to restate their accounts during the past four years. Indeed there has been a rash of restated accounts globally: Maxwell and Polly Peck in Britain, Metallgesellschaft in Germany, Cendant, Sunbeam and Waste Management in America, being the most visible before Enron exploded on the world stage. More are on the way: on April 1st. Xerox Corp. agreed to pay a $10 million (U.S.) civil fine to the U.S. Securities and Exchange Commission, and restate its results from 1997 through 2001. Little wonder that the Globe and Mail's Report on Business (April issue) pondered whether investing in the stock market was merely gambling. Like the priest who, faced with

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man's inhumanity to man, continues to believe in God, Report on Business uneasily rejected the gambling argument before tendering as an act of penance, the evidence of Enron, Global Crossing, Bre-X and Nortel. Their logic was less than compelling. Nor was the full page newspaper advertisement by the Chartered Accountants of Canada assuring investors that they were ascertaining if Enron like practices were being perpetrated here, of great comfort. Most Canadians probably believe they already know the answer.

An Excess of Enron

Enron and its siblings are likely to have at least as large an impact economically and geographically as the events of September 11th. The effect will probably be of greater longevity. If one cuts through the wailing, breast beating and gnashing of teeth, there appears to be general agreement that the auditing function failed because of the following weaknesses.

(1) Auditing is self regulated. The accountancy profession polices itself through a system of peer review: a process which has been granted statutory authority. Self regulation is toothless, self serving and an "old boys network" cloaked in the guise of the public good.

(2) The accounting firms earn considerable revenue for consulting activities from the firms they audit. This consulting revenue often far exceeds their audit fees so the audit process is viewed as an entré to the more lucrative work. This creates a conflict of interest since the accountancy may be reluctant to place its consulting fees at risk by rendering an unfavourable (to the management) audit.

(3) Five accountancy firms do the bulk of the auditing work. Little attempt is made to rotate auditors. The management/ auditor relationship becomes too "cosy": audit discrepancies are more likely to be discovered when there is a change of auditors.

Parallels With Real Estate Appraisal

There is a clear parallel between the relationship of appraisers undertaking portfolio valuations for asset managers, and accountants auditing companies. Although no real estate body has yet reacted to the crisis of confidence engendered by Enron, by happy coincidence the Royal Institution of Chartered Surveyors had already struck a Working Party to study the very issues which have now surfaced in such spectacular fashion. The RICS is the world's premier real estate body with 110,000 members in 120 countries. The Working Party, chaired by Sir Bryan Carsberg a Chartered Accountant, published its report in February 2002. It drew upon research conducted by the Universities of Reading and Trent in the United Kingdom on real estate appraisals carried out for financial reporting purposes, commissioned by investment fund managers (pension funds, insurance companies, unit trusts) and property companies. The RICS extended that research to the Appraisal Institute, the largest professional body of appraisers in the U.S.A., and to auditor members of the Institute of Chartered Accountants of England and Wales. The RICS noted that many of the issues highlighted were also applicable to appraisals for secured lending purposes for banks and other financial institutions.

The findings of the Carsberg Report have applicability to Canada particularly as they relate to self regulation (an oxymoron!) and client influence on the appraisal. Our Federal and Provincial governments have shied away from dealing with these matters despite the collapse of many prominent Canadian financial institutions based on faulty real estate loans, during the past twenty years (1983-Crown, Greymac and Seaway Trusts: 1985-Northland Bank and Canadian Commercial Bank: 1992-Central Guaranty and Shoppers Trust: 1993-Confederation Life; Prenor, Security and Dominion, Trusts: 1993-Royal Trust saved by Royal Bank: 1994-Monarch Trust).

The RICS Working Party determined that:

(1) Self regulation was ineffective and the use of regulatory powers was largely reactive, i.e. only when things go badly wrong and are reported (usually by the aggrieved party) is action taken. The Working Party recommended instead that appraisal firms implement a Quality System which focuses on process rather than outcome. Compliance should be monitored by internal and external audits. The latter to be undertaken by an independent body **not** a peer review group.

(2) Appraisal firms should declare the total fees they earn from the party commissioning the appraisal and the length of their relationship, so that third party users of the report could gauge the fiscal influence that had been exerted.

(3) Draft reports and meetings with the party commissioning the report *"provide clients with an opportunity to influence the outcome of the appraisal, potentially to the advantage of their organization, or to their own personal advantage (through, for example, annual bonuses linked to the performance of their property portfolios which in turn is linked to the outcome of the appraisals)".*

The Working Party did not condemn draft reports and meetings but advocated that detailed notes be kept of the discussion together with information on any changes in the appraised value.

(4) The Working Party recognized that it may not be economically feasible to rotate appraisal firms and suggested instead that the *appraisal personnel be changed each time.*

Canada: A Status Report

Everybody in Canada has paid dearly for the failure of the financial industry and the appraisal profession to clean up their act. We continue to bear that cost today: it's as if the sorry parade of financial institution failures from 1983 to 1994, never happened. At the time we wrote to the Federal Canada Deposit Insurance Corporation (CDIC) as well as the Federal Office of the Superintendent of Financial Institutions (OSFI) suggesting that "*most of the problem of biased and inflated appraisals could be avoided if real estate loan regulations mandate that the appraiser contract directly with the mortgagee rather than the mortgagor. This will remove an obvious conflict of interest".* CDIC and OSFI both responded, essentially saying it was the other's responsibility and that neither could govern the conduct of appraisers since this was a Provincial responsibility!

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The cost of the bank, trust and life company failures was borne by every taxpayer, bank user, policy holder in Canada, as well as by the creditors of the institutions that failed. The bank and trust companies were, and continue to be back-stopped by the CDIC. The life companies created an industry (i.e. policy holder) financed body, the Canadian Life and Health Insurance Compensation Corporation (CompCorp) in January 1990, to perform a similar role to the CDIC. The biggest cost to Canadians however, lies in the difficulty and cost of financing real estate. Prior to 1990, banks and trust companies were the primary source of finance for commercial mortgages of ≤ $1.0 million: the life companies performed the same function for larger loans. The commonly stated loan to value ratio was 75% of the property's market value. Today all commercial mortgages are more difficult to obtain even at the current loan to value ratio of 65% and loan sources continue to evaporate, particularly in Atlantic Canada for ≤ $0.5 million mortgages. Although the credit unions have taken up some of the slack, mortgages are less available and more costly. The life companies have only recently returned as a source for higher value loans (≥ $2.0 million), joining a couple of the banks that stayed the course, and conduit financiers such as Merril Lynch, GMAC, et al.

(1) Self regulation has actually been legislated in New Brunswick and Nova Scotia! The United States responded to their Savings and Loan debacle in the late 1980's by eliminating self regulation and imposing State regulatory controls on appraisal activities including the requirement that all appraisals undertaken within the jurisdiction of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) be undertaken **only** for the mortgagee. The Federal Government also ordered the appraisal industry to initiate appraisal standards: these became the Uniform Standards of Professional Appraisal Practice (USPAP). *No similar action was instigated in Canada: in fact the Appraisal Institute of Canada, the largest trade organisation in the country alarmed at the events in the United States, redoubled its efforts to persuade gullible Provincial governments to legislate self regulation!* Their gall was breathtaking: "Public Money Private Greed" Terence Corocoran and Laura Reid's book on the 1993 Greymac, Seaway and Crown Trusts affair noted that "AACI", the Appraisal Institute of Canada's designation was "an acronym that was often said to mean Appraised According to Client's Instructions, implying that official appraisal reports were of little real value to serious real estate investors". Ten years later Rod McQueen made a similar observation in his book "Who Killed Confederation Life?". Nevertheless AIC members were successful in promoting private member's bills legislating self regulation for appraisers in New Brunswick (1995) and Nova Scotia (1998). The Nova Scotia bill went through all three readings in ten days … just before the House broke for its Christmas vacation. There was no publicity or consultation with consumer groups or impacted parties: it was sneaked through in virtual secrecy. We found out about it after the event; the MLA who tabled the Bill did not appear to have read it … he thought it was a consumer protection Act! Apparently he was in good company: at least one party caucus didn't know what they had approved.

(2) Conflicts of interest are the rule, rather than the exception. Commercial appraisals for financing are almost always undertaken for the mortgagor. Our suggestions to the financial institutions that they commission the appraisal, are fiercely resisted. Asset Managers too usually commission appraisals from the same appraiser on the same property each time they require an updated value. It is quite usual for the same appraiser to undertake appraisals of the entire portfolio year after year … and to supply other consulting services such as property tax, financing appraisals, and so on.

(3) Asset managers almost always request Draft Reports, the conclusions of which have to be discussed prior to the issuance of the final figure: most insist on this commitment before they will commission the assignment. Typical are the following instructions we recently received from a Life Company **"A FULL DRAFT copy of the report's entire net income analysis and valuation sections, as well as all valuation-related material contained in the report's appendix (e.g. DCF—Supporting printouts, detailed comparable information, land valuation, etc.) is to be sent to The Asset Manager and xxx xxx two weeks prior to the appraisal's due date".** These instructions are usually directed to specific appraisers, rather than the firm. In this instance we advised the Life Company that it was against our company policy to undertake "Draft" reports and they decided not to proceed with us. (In fairness we should add that we recently had a similar experience with a regional Life Company and they readily agreed to waive the requirement. They also decided to pursue a policy of commissioning appraisals from different companies).

*For the full text of the Carsberg Report visit the RICS web site at **www.rics.org/val**.*

PROPERTY TAX DIVISION
Prince Edward Island

The Provincial Assessment Department expects to publish its 2002 Assessment Notices around April 30th. 2002. The basis for your assessment is your property's market value on the January 1st. 2002 base date. You can reflect the economic aftermath of September 11th in your assessment. If your business is impacted by tourism, either directly because you are a hotel, motel, restaurant, campground, entertainment facility, airport, etc., or because of the "knock-on effect", you have strong grounds on which to challenge your assessment. There is no "uniformity" provision in the P.E.I. Assessment Act so you cannot legally challenge your assessment on the grounds that it appears excessive when compared to similar properties. However, it has been our experience that assessors are open to reasoned argument based on Asset Class Profiling. Last year we built ACP into our database query system Compuval™ and now utilise it to compare assessments within and across asset classes. Only the most obdurate assessors (there are some) fail to take action when faced with evidence of blatant over-assessment. ACP requires dedication since you have to gather

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information on sales and assessments within the municipality across all asset classes, if you are to establish the true basis employed by the Assessment Department. Typically this will be about 70% of market value. If your property's assessment exceeds this figure, you are over-assessed. You also need to gather assessment information on similar properties within the same asset class as your property, and express this data on a unit basis for comparative purposes.

We expect the assessment appeal period to run between April 30th and June 12th. If you think you are overassessed be careful not to limit your grounds of appeal. We suggest that you use the following wording. *"The assessment is excessive, unfair, and any other grounds that may appear." We suggest that you call us before you file your appeal: Rick Escott our P.E.I. Tax Team Leader will be pleased to review it with you. He can be reached toll free at 1-800-567-3033 (e-mail **rescott@turnerdrake.com**).*

New Brunswick: Making News

Crown Street, Saint John, N.B.
($41,000/annum — 31% in Tax Savings)

You should have received your year 2002 assessment notice on March 1st. In order to contest your assessment you must have filed your appeal by March 31st. The basis for your assessment is the market value of your property on January 1st. 2002. Thanks to the New Brunswick Assessment Review Board November 13th. 2001 decision *(N.B. Publishing Co. and Director of Assessment)* you are able to reflect the economic impact of the September 11th. terrorist attacks in your property assessment.

Prior to the Board's ground breaking decision, conventional wisdom based on their earlier rulings had held that events which were known **before** the base date were to be ignored if they did not occur until **after** the base date. Their November 13th. 2001 decision changed the water on the beans and was particularly opportune in the light of September 11th. N.B. Publishing occupied a multi storey industrial in Saint John constructed in 1963 specifically for the purpose of accommodating a printing press and related services necessary to publish a newspaper. On November 11th. 1997 the newspaper made public its decision to transfer the printing to Moncton early in 1998. The newspaper was still in operation in the building on January 1st. 1998, the base date for the 1998 assessment year, so the Provincial Assessor ignored the plant closure and assessed the building as though this was not going to take place. The Board thought this ludicrous and in tones of mounting incredulity observed that the Assessor *"believes that the Assessment Act requires him to focus on conditions on January 1st. 1998 no matter what happens, no matter how catastrophic an event takes place on January 2nd. 1998 and even if you knew this event would happen in November of 1997".* The Board then declined to support the Assessor's position.

The decision has obvious relevance to any property adversely impacted economically by the events of September 11th: hotels and motels, airport and air transport, aerospace manufacturing, trucking terminals, et al. However its scope can clearly be extended to any event known before January 1st 2002 whose impact may not occur until after that date. So, if you own a hotel, gas station, fast food outlet or other commercial facility that is adversely effected by a highway re-routing you do not have to wait until the event has actually occurred, for tax relief. If your major tenant informs you they will not renew their lease; Wal-Mart decimates your town centre's retail values with the announcement of their proposed greenfield site store; or any future event becomes public knowledge that adversely effects your property; the impact can be reflected in a lower assessment.

*For professional assistance with your appeal, call our New Brunswick Tax Team Leader, André Pouliot at 1-800-567-3033 (e-mail **apouliot@turnerdrake.com**).*

Nova Scotia—Terminal Taxes

Yarmouth, N.S.
($78,000 — 20% in tax savings)

You should have received your year 2002 assessment notice on January 14th. In order to contest your assessment you must have filed your appeal by

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February 4th. (out of province taxpayers had an additional 10 days if they applied for an extension). We've had a number of cases again this year where taxpayers missed the appeal deadline. Tough, you are out of luck: enrol your property in our PAMS™ Property Tax Manager program and avoid overpaying taxes in the future. The Province of Nova Scotia has a sorry history of squandering your wealth (your children's future too); don't encourage them. We are handling 40% more appeals this year than last and our PAMS™ Property Tax Manager program has uncovered tax savings that would have otherwise been overlooked.

The General Level

The basis for your assessment is the market value of your property on January 1st. 2000 having regard to its existing physical state on December 1st. 2001. However, and this is the kicker, the Assessment Act also provides that all properties have to be assessed in a *uniform manner*. Case law has established that this uniformity has to be applied across, rather than within, asset classes: hotels cannot only be compared with other hotels, the comparison has to be with all commercial assessments in the municipality. This "General Level of Assessment" is calculated by dividing the sum of the assessments, for those properties that have sold around the January 1st. 2000 base date, by the aggregate of their sale prices. If the General Level of Assessment is 0.70, then all properties whose assessment exceeds 70% of market value at the January 1st. 2000 base date, are over-assessed. Service Nova Scotia insists their General Level of Assessment is close to 1.0 … ***there is no reason to believe that this is correct.*** Our sampling of Halifax Regional Municipality indicates a General Level of Assessment of 0.74. We have not computed figures for the other municipalities but expect that they will be even lower.

For professional assistance with your appeal call our Nova Scotia Tax Team Leader Giselle Kakamousias (e-mail ***gkakamousias@turnerdrake.com****)* at 1-800-567-3033. If you have a major industrial property Tom Mills, our Vice President Property Tax, is your million dollar man (e-mail **tmills@turnerdrake.com**).

Newfoundland—The Big Lick is Over

The City of St. John's undertakes its own assessments and usually publishes them just before Christmas … in the fond hope no doubt that you will be too full of turkey and cheer to notice. However last year they published the year 2002 notices in June: this year they started to mail out the year 2003 Assessment Notices in February 2002. Who knows what awaits for re-assessment year 2004: a Christmas eve 2002 mailing perhaps? And in a moment of mental aberration they forgot to send notices to us for properties enrolled in our PAMS™ Property Tax Manager program. Oh what a tangled web we weave, our efforts to deceive …

The big lick is over: the City of St. John's Assessment Department applied a stamp to their remaining Assessment Notice on February 14th. You had until March 12th to appeal. The basis for your assessment is the market value of your property on the January 1st 1999 base date. However the assessment legislation also includes what is commonly known as a "uniformity" provision, so even if your assessment is lower than your property's market value on the base date it may still be overassessed. *If you require professional assistance with your appeal, call our Newfoundland Tax Team Leader Rick Escott at 1-800-567-3033 (e-mail* ***rescott@turnerdrake.com****).*

If your property is located outside St. John's, you can expect your year 2003 assessment Notice in November 2002. Year 2004 is the re-assessment year for the entire province so you should not expect an increase until then, unless you have altered your property.

Ontario—Fast Food: Slow Walk-in

Ajax, Ontario
($6,000 — 5% in Tax Savings)

Your year 2003 assessment will be based on the market value of your property as at the 30th June 1999. This will be the last year of the tri-annual assessment cycle so your assessment should remain unchanged from last year unless there have been physical changes to the property. We anticipate that your year 2003 Assessment Notices will be mailed out around mid November. The deadline for filing your appeal with the Assessment Review Board is March 31st 2003. However we can negotiate on your behalf with MPAC, the Provincial assessment authority, at any time. If you have any concerns about your current assessment please call Rick Escott (e-mail **rescott@turnerdrake.com**) or Tom Mills (e-mail **tmills@turnerdrake.com**) toll free at 1-800-567-3033.

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

IT'S A ZOO OUT THERE

"I guess I should warn you, if I turn out to be particularly clear, you've probably misunderstood what I've said." United States Federal Reserve Board Chairman Alan Greenspan.

Are you overwhelmed by a world of Greenspeak? Do you despair of finding time to focus on your bottom line? No? Well, there's no point in reading any further then: pass this article along to someone less fortunate.

If however, you harbour an uneasy suspicion that you are road kill on the information highway … and you own or occupy property in Atlantic Canada or Ontario, we have the solution. On September 22nd 2001 we launched our Action Alert! program. This free service is directed to every decision maker with a Client Area on our web site **www.turnerdrake.com**. Each Action Alert! provides information on time sensitive issues which impact on your bottom line. The subject matter is relevant, succinct and well researched. Since occupancy and realty taxes are usually the single largest property operating expense they provide the greatest opportunity for reducing costs. Action Alert! contain details on precedent setting court cases, often unpublished elsewhere. If you don't save money as a result of Action Alert! we'll refund your entire subscription price and fire you as a client.

Our Property Tax Division has been involved in many of the property tax cases published in Action Alert! so we have intimate knowledge of them. However, we are not partisan. Action Alert! includes cases we have lost as well as won … and covers cases too in which we were not involved. It is the most comprehensive source of information on cases recently decided by the New Brunswick Assessment Review Board (the Board refuses to publish its decisions). Action Alert! also provides tips and insider information disgorged by our Compuval™ system and is the only independent source for the General Level of Assessment. The latter can be utilised to adjust assessments downwards. Assessment Departments are sometimes economical with the truth, insisting that properties are assessed at their market value when in fact the correct figure may be 30% lower. Unless you are able to calculate the General Level of Assessment it may be impossible to mount a successful appeal even though your property carries a tax burden 43% higher than its contemporaries! In a word (well several words) Action Alert! is a mother lode of tax saving information.

Action Alerts! are archived on your Client Area so you can benefit from previous issues no matter when we first registered you on our web site.

To access previous issues of Action Alert! visit our web site ***www.turnerdrake.com*** and follow the links (client area → action alert).

BROKERAGE DIVISION

PROPERTY INVESTORS CLUB™

Our Property Investors Club was launched on Friday 13th. (February 1989): not the most auspicious of dates but we weren't superstitious then. Somewhat wiser now, we no longer walk under ladders, break mirrors, whistle aboard ships … and we *always* turn our money over when there is a full moon. Anything to avoid a re-occurrence of the 1989 market meltdown.

Our timing may have been off but the concept was not, and advances in technology no longer place us at the mercy of the mail. Thanks to Tim Berners-Lee we now have the World Wide Web; and courtesy of Marc Andreessen a way of navigating it. And we have e-mail! Goodbye Canada Post! It's time again to re-launch our Property Investors Club™ (PIC™) … drum roll please … thank you. This time we played it safe, PIC day was Tuesday 29th. January 2001.

PIC™ is designed for time stressed investors and potential investors who want to keep their finger on the pulse of the industrial, commercial and investment (I.C.I.) real estate market in the Halifax Regional Municipality (H.R.M.). It includes investors who wish to purchase property to occupy themselves.

PIC™ is not a mutual fund; we do not "pool" members' equity for the purpose of acquiring property, though later we will provide an electronic forum on our web site **www.turnerdrake.com** where members can exchange ideas and, if they wish, collaborate. For the moment however each PIC™ member is a potential investor who operates independently of the other members.

Most I.C.I. property priced over $2.0 million is listed with the dozen or so *commercial* brokers, few of whom belong to the Multiple Listing Service™ … while most property priced below $1.0 million is listed with *residential* brokers who utilise the M.L.S.™ as their main marketing tool. We are in the unique position of being in both camps, a commercial broker who is a member of the MLS™, and of course we have our own listings too. We are thus a single source of information on I.C.I. properties for sale in H.R.M.

We scrutinize the I.C.I. properties that are for sale in H.R.M. with a threshold value of $0.5 million, select the most promising and present their key characteristics in our PIC of the Pack tabular format for easy review. This bulletin is e-mailed to each PIC member, every two weeks.

Our Property Investors Club is free, there are no joining or membership fees and members can unsubscribe at any time. No salesman will call, no legs will be broken. It really is a great way to monitor the I.C.I. market in metro. If you are an investor and would like to join the 100 or so members of PIC say so in your e-mail to Verna (**vturner@turnerdrake.com**) or Mark (**moffman@turnerdrake.com**).

For information on properties we have for sale or lease visit our web site ***www.turnerdrake.com*** and follow the links (corporate site → products → brokerage).