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Newsletter

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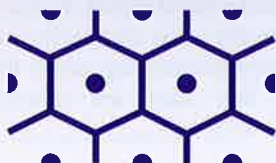

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OH LORD! BENCHED AGAIN!

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On July 19th 2004 the New Brunswick Court of Queens Bench heard an appeal by Service New Brunswick, the provincial assessment authority, from a decision by the Assessment and Planning Appeal Board which had lambasted SNB's methodology of including the 15% H.S.T. (a "pass through" tax similar to the G.S.T.) in its calculation of assessed value as *"an affront to common sense"*. The Judge agreed with the Board and in dismissing Service New Brunswick's appeal reiterated that *"It would be an affront to common sense that the cost of an item could be increased by the amount of a local tax which is rebated to the payer, with an offset of one with the other"*. Service New Brunswick's Director of Assessment, Mr. William Morrison, was in court to hear the decision, which also awarded costs to the Respondent. This case was an appeal of the latest, in a series of scathing decisions by the normally reticent Board, which has called into question the judgement, competence and experience of SNB's assessment staff (Newsletter Vol. 2 No. 76).

In June 2001 a Board decision *(Baxter Foods Limited versus Director of Assessment)* dismissed SNB's argument that the functional inadequacies of an old dairy plant should be ignored because their assessor "was only doing a bricks and mortar appraisal". The Board, whilst noting that the assessor had "prepared an excellent and thorough Building Valuation Report" also decreed that "functional and economic" depreciation *had* to be reflected in the assessed value.

In a November 2001 decision, *(NB Publishing Co. versus Director of Assessment)* the Board plainly thought it ludicrous that facts, known before the assessment date, were ignored by the Assessor in arriving at the assessed value. In tones of mounting incredulity the Board observed that *"it was the assessor's position, and obviously that of the Respondent (Service New Brunswick) that no matter what you found out what was to happen after January 1st of any particular taxation year, you must ignore it! He believes 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*

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2nd, 1998 and, even if you knew this event would happen in November of 1997".

The assessment appeal involved a multi-storey printing plant, still being utilised for this purpose, but with the widely published decision having already been made to move the process to Moncton.

A December 2001 Board decision *(Small Fry Snack Foods Inc. versus Director of Assessment)* was even more forthright noting that Service New Brunswick's *"Exhibit D-13, which was presented as some sort of valuation report, is woefully deficient in virtually every respect. Because it lacks a signature, the Board does not even know who is the author"* and *"It must be stated this document (it is difficult to call it a report) was full of misinformation, partial information and error".* Whilst the only witness called by Service New Brunswick was a senior level assessor with 25 years experience, *"her experience with industrial properties like that of the Appellant was limited".*

The December 2003 Board decision referred to earlier *(Food City Limited versus Director of Assessment)* involved the use, by Service New Brunswick, of the Boeckh costing system to calculate the assessed value. This is a well established technique for ascertaining the value of "specialised property"; real estate that is often built by the occupier to fulfill a specific function such as a saw mill, oil refinery ... and in this case a large food distribution warehouse and supermarket. Even though SNB had utilised the Boeckh costing system since time immemorial they had not realised that the costs were inclusive of the H.S.T., a "pass through" tax similar to the G.S.T., but levied at 15% instead of 7%. The Board decision observed that *"This rather startling revelation came to light when two local agents of the Respondent (Service New Brunswick) advised the Board they were unaware of this".* Once they discovered that their costing figures **included** H.S.T., SNB did a flip flop and decided that this was the way to go. Since property owners engaged exclusively in commercial activities are entitled to full Input Tax Credits for the H.S.T. they incur, the tax is a "wash". The Board was plainly outraged by SNB's tactics and said so ... the Court of Queens Bench concurred.

Quo Vadis?

Service New Brunswick re-assessed all heavy industrial property in 2003. The Board decision in the Food City case noted that Service New Brunswick's Manager of Valuation, gave evidence and was unaware that his Boeckh costings included H.S.T. He was also in charge of the heavy industrial property re-assessment. The latter was completed using a Heavy Industrial Manual which *excluded* H.S.T. and the Boeckh Manual which *included* the 15% tax. In addition many other types of owner occupied property such as supermarkets, warehouses, fabrication shops, dairies, fish plants, meat packing plants, gasoline service stations, theatres, restaurants, wharves, etc. were assessed using the Boeckh costing manual. No doubt the merry men (and women) of the heavy industrial assessment team are scurrying around lowering those assessments as we speak. We must expect nothing less. SNB's mission statement, (still) clearly enunciated on its web site, is *"customer service, customer consultation and customer satisfaction".* Hopefully they are doing it on their own time too: the cost of the appraisal work in New Brunswick is charged back to the taxpayer as part of their property tax bill ...

Service New Brunswick has now appealed the Court of Queen's Bench decision to the NB Court of Appeal.

Standing On Guard For Thee

Winning an assessment appeal can too often be a pyrrhic victory. The New Brunswick Assessment and Planning Appeal Board rarely awards costs, and those granted by the Court of Queens Bench are unlikely to cover all of your actual expenses. So how can you prevent such an occurrence, faced with Service New Brunswick, an obdurate opponent apparently unabashed by this steady stream of court criticism? Try holding the assessor to account: most are members of the New Brunswick Association of Real Estate Appraisers, a private club that, in 1995, was granted a monopoly on appraising in the province on condition that it would *"govern its members ... in order to serve and protect the public interest".* (New Brunswick, and shortly thereafter Nova Scotia, are the only provinces to vest this type of power in a private group). You can confirm that the assessor is a member by visiting NBAREA's web site **www.nbarea.org/getmembers.asp**. NBAREA's by-laws do not allow its members to appraise property unless they have a specified minimum level of education, experience and competence. Presumably NBAREA, "in order to serve and protect the public interest", will act promptly to prevent an assessor from conducting an assignment unless he/she is qualified to do so ... particularly if there is a prior court decision that questions his/her judgement, competence or experience on a similar assignment.

*For more information on property tax visit our web site **www.turnerdrake.com** and follow the links (products → property tax → appeals). For information on the NBAREA visit their web site at **www.nbarea.org.***

COUNSELLING DIVISION

Avoid the H.S.T.

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Confusion about the application of the G.S.T./H.S.T. abounds. The clumsy prose of the Excise Tax Act does little to alleviate the situation: prolonged study of the text is liable to reduce the reader to a gibbering imbecile. H.S.T. is little understood outside the Atlantic Region; we find that initially some clients decline to pay it, apparently labouring under the misimpression that they are exempt

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because they are based elsewhere. (The Alberta based office of a nationwide accounting firm recently insisted to us that they were entitled to reduce their H.S.T. payment by the "Provincial Sales Tax portion"). The location of the property rather than the owner, dictates whether it, and any services performed for it, attract H.S.T. or G.S.T. (the two are mutually exclusive).

In the Sira Enterprises case, (Newsletter Vol. 2 No. 73), the Tax Court rejected Canada Customs and Revenue Agency's position that fair market value should be based on the sales of other, established properties. In our view, their decision makes clear that "fair Market Value" has to reflect reality. It is the Market Value of the property in its *unleased state* (apart from one unit) and this cannot be ascertained by comparing it with the sales of other properties that have an established market presence, stable cash flow and an operating history, *unless* these factors are also taken into account. Potentially, there are three methods for computing Market Value: in appraisal terminology these are known as the Cost, Direct Sales Comparison, and Income Approaches. The Cost Approach, essentially an exercise to determine what it would cost to purchase the site and construct the building, is not predicated on the property being occupied. The Income Approach is an exercise in converting rental income into a capital value and does presume that the building is occupied. Likewise, the Direct Sales Comparison Approach usually assumes some level of occupancy since investment properties are rarely offered for sale when they are vacant. Thus the application of the Income and Direct Sales Comparison Approaches would require a deduction for the cost of lease-up (marketing and time value of money) and risk (entrepreneurial profit) . . . as well as the cost of any work unfinished at the "first occupancy date", e.g. paving, landscaping, etc. necessary to achieve rent up of the units at market rent. At first blush the Cost Approach appears to be the more reliable indicator of fair Market Value. However it too has to be adjusted downwards if the expectations of the developer fall short of reality. This often occurs because developers usually start to assemble land for their project two years or more before completion. It is not unusual for several developers to have the same bright idea at the same time . . . and to bring their projects on stream together, flooding the market. Rental expectations are not met and the market value of the property is below its construction cost. Since the inception of most projects, by definition, are timed to begin at the peak of the five year economic cycle, many projects reach completion at the onset of the subsequent recession. This happened in Dartmouth, Nova Scotia, in 1990, when the subsequent oversupply of apartment units coincided with the recession . . .and the market value of the buildings on completion was just half their construction cost. *There is no evidence that CCRA accepts the implications of the Sira Enterprises decision, or the precedents on which it is based.*

Non-Profit Housing

How should you arrive at fair Market Value if the apartment building is erected on the expectation that it will lose money. The *Charleswood Legion Non-profit Housing Inc., Transcona Place Inc. and Her Majesty the Queen 97-45-GST-1; 97-355-GST-1* cases involving non-profit and not-for-profit housing considered this very question. The appellants had erected two apartment buildings, each to be occupied by two classes of tenant: life tenants who paid a substantial deposit refundable on termination plus their share of the operating costs; and "designated unit" tenants who paid what they could afford. The 60 unit apartment building was erected in Charleswood, Winnipeg at a cost excluding land of $5.2 million (the land was sold to the developer, a related party for $1; it was actually worth $400,000). The 30 unit apartment building was erected at a cost of $2.9 million including land, in Transcona about 12 kilometres from Winnipeg city centre. Both buildings generated insufficient income to cover their operating costs and debt service so the Manitoba Housing and Renewal Corporation (MHRC), using Provincial and Federal government funds, agreed to meet the shortfall, including the principal and interest payments on the mortgage, for 35 years. MHRC also secured an option to purchase each property for $1 plus its cost less any mortgage principal paid down. This option could only be exercised if the owners breached their obligation to provide non-profit housing. At the end of 35 years the assets were to be distributed to a corporation whose main purpose was to be the provision of rental housing to "households with core needs". The Royal Canadian Legion was a sponsor in both properties.

The appellant's appraiser concluded that neither property had any value until the 35 year agreement to provide non-profit housing expired. He valued the Charleston property at $14,000 and the Transcona property at $8,800. However, apparently seized with the doubt that grips us all during the morning's wee hours, he also reported that his values for the projects had they not been non-profit, would have been $2.8 million (Charleston) and $1.6 million (Transcona). CCRA responded by polling their various offices across the land to determine the approach that should be used. Three offices responded, each with a different answer, so head office was consulted. Their solution, which differed from any of the others, was to ignore the non-profit agreement with MHRC and treat them as though they were normal investment properties. CCRA therefore adopted the appellant's figures of $2.8 million (Charleston) and $1.6 million (Transcona). The Tax Court decision disagreed with just about everybody and, in our humble opinion, got it just about right.

The judge firmly rejected both the appellant and CCRA's rationale. He made it clear that he thought CCRA were lacking in logic, adopting $2.8 million for the Charleston property, given that its construction cost was $5.2 million, and that the land was worth $400,000. The Court decided that *"the fair market value of the two subject properties should not exceed their cost (Charleston $5.6 million; Transcona $2.9 million) and should not be lower than the amount of the mortgage loans used to finance their acquisition (Charleston $3.9 million; Transcona $2.2 million)".* However since the Court had no power to increase CCRA's appraised values, the latter were adopted.

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For more information on Tax Court of Canada decisions visit their web site at ***decision.tcc-cci.gc.ca/en/index.html****.*

EGG HEAD (DOUBLE YOLK)

Bruce Scallion, B.Comm., AACI   André Pouliot, B.Comm., AACI

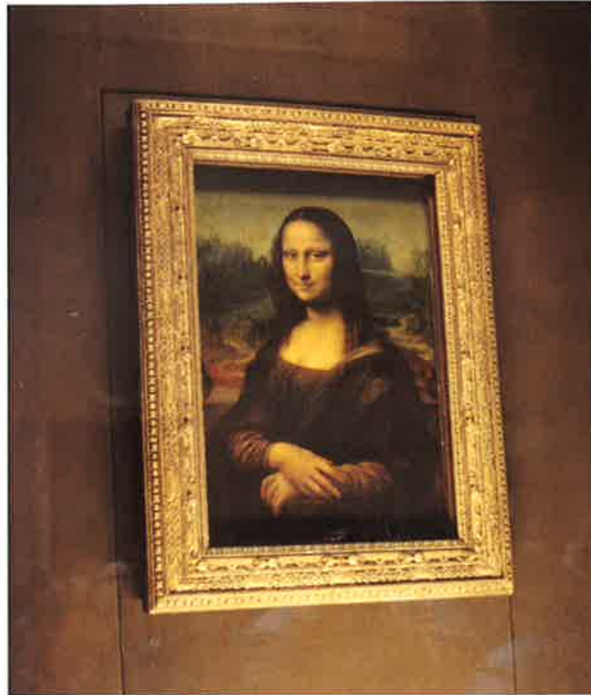
Congratulations to Bruce Scallion and André Pouliot on attaining their AACI (Accredited Appraiser Canadian Institute) designation from the Appraisal Institute of Canada. Both joined us with freshly minted Commerce degrees from Saint Mary's University; Bruce in 1996, André in 1998. Bruce is a Senior Consultant in our Valuation Division and lives with his wife and (almost new) son in a cape cod home they built overlooking St. Margaret's Bay. André is a Senior Consultant in our Property Tax Division and this year has been putting his French to good use in New Brunswick. He tied the knot in July: he and his wife have just fuelled the housing boom with a purchase in Halifax's Clayton Park. Both Bruce and André have successfully completed the University of British Columbia's five year Diploma in Urban Land Economics course and are in the final stages of the Bachelor of Business in Real Estate degree.

LASERCAD™ DIVISION

BOMA 96: A Reason to Smile

The revised method of measuring office buildings, known as BOMA 96, can increase office property values by between 5% to 25% by including building common areas (e.g. lobbies, HVAC rooms, etc.) in the definition of "rentable area" according to a June 2004 investigation by the Globe and Mail. The Globe article cites examples drawn from Toronto (where lavish lobbies loiter). In Atlantic Canada, the gain in value is likely to max out at a more prosaic 8% according to the lads in our Lasercad™ Space Measurement Division … nothing to be sneezed at nevertheless.

Tenants are frequently surprised to find that the area of space on which they pay rent is rather larger than the area they actually occupy. Initially most prefer not to



Leonardo da Vinci

know, eyes glaze, mouths stretch into yawns, the subject generally raises less interest than a eunuch in a harem … until times get tough. Under the "old" method of measurement BOMA 80, the "usable area", the space occupied by the tenant, was grossed up by the common areas on the tenant floor, e.g. public washrooms, corridors, etc. to compute the "rentable area", the space on which the rent was calculated. The rentable area was typically 15% greater than the usable area. The "new" method of measurement BOMA 96, includes the floor common area plus the building common areas such as lobbies and mechanical rooms. It has the benefit of logic and the happy result, to the landlord, that the rentable area is now typically 20% to 25% greater than the usable area.

Many landlords argue that the optimum time to convert from BOMA 80 to BOMA 96 is in a strong rental market. They rationalise that tenants will only accept the change when space is scarce. In reality tenants usually have little appreciation of the difference between "usable" and "rentable" area, much less the subtleties of BOMA 80 versus BOMA 96 … and since rent/ft.^{2} of rentable area is the commonly used benchmark, a landlord using BOMA 80 is at a competitive disadvantage to a competitor using BOMA 96 because his rent will appear higher, even if it is not. In short, the argument favours procrastination rather than logic. The optimum time to convert to the new system of measurement is at the first available opportunity, viz. at the commencement of a new lease term, either on lease renewal, or tenant roll-over. Until new leases have been consummated for every space in the building, you will have to live with two definitions of "leasable area". Eventually however you will secure

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your place in that part of heaven reserved for astute landlords.

Reduce Risk

The value of any income generating property is inversely related to risk: the higher the risk associated with the income stream the greater the rate at which it will be discounted by a prospective purchaser. It follows therefore that any action taken by the property manager to reduce risk will impact favourably on value. Increasingly we live in an age of transparency: the onus of proof has shifted to the seller. "Caveat emptor" may not be dead, but it is no longer much of a defence. It behoves landlords to ensure that the rentable area on which the lease rent is calculated, is correct. Although BOMA (80 or 96) is the standard method of measurement for office buildings, other standards prevail for shopping centres, industrial or residential space. The same amount of usable retail space will yield different rentable areas if it is located in an office building, or a shopping centre. Our Lasercad™ Division utilise the Urban Land Institute's method of measurement for retail space in shopping centres, the SIOR standard for industrial buildings, and the CREA methodology of space measurement for residential space. Our laser measuring equipment is accurate to within 3 mm and we work to a closing error of 2% or less … and we stoutly resist the temptation to calculate the areas solely by running a bubble around the CAD plans because an incorrectly drawn plan will yield an incorrect area. Instead we reconcile it with an area calculated manually from the dimensions we collect during our field survey. We believe that we are the only company in Canada offering space measurement services that is governed by a quality system registered to the ISO 9001:2000 standard.

Instant Access

Each time we complete an assignment, a copy of the completed drawing is posted to the client's secure area of our web site, available to be accessed 24/7. (We host our own web site and back-up the tapes in the small hours, each morning). There is no charge for this service.

For more information on our Lasercad™ Space Measurement service visit our web site at ***www.turnerdrake.com*** *and follow the links (corporate site → products → lasercad™) or call Mark Turner at 1-800-567-3033 (429-1811 in H.R.M.). Lasercad™ is available throughout Atlantic Canada.*

BROKERAGE DIVISION

Sales - Nothing to Sigh About!

We pride ourselves on having built a better mousetrap:

Turner Drake

it enabled us to sell 80% of our listings during the dog days when the industry norm was 20%. However the property markets are so hot now, we could probably sell your mother in law too if she occupied the right type of real estate.

We concentrate on investment, commercial, industrial (I.C.I.) property in a price range of $0.25 million to $10.0 million, located within a 100 kilometre radius of Halifax Regional Municipality (H.R.M.). We are one of the few commercial brokers in H.R.M. with access to the Nova Scotia Association of Realtor's Multiple Listing Service (MLS™).

Purchasers have an appetite for virtually every type of ICI real estate. It's as though the market collapse of 1990 never happened: it is expunged from memory. In a sense it is rather frightening how quickly people forget. Is it about to happen again? We think not; but some markets are overheated and may have peaked.

Residential land - demand is very strong in areas which are not adversely impacted by H.R.M.'s Interim Growth Management Strategy. The latter has curtailed supply in some areas by allowing new development only along existing public and private roads. New roads are permitted in the Central/Eastern Growth Area, (principally the area east of the present urban conurbation) but they are limited, and development

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along new roads is restricted to 8 lots per year. H.R.M. will replace the Interim Growth Management Strategy with a new Regional Development Plan late in 2005. Demand for raw land is a function of the demand for new housing … which in turn is contingent on GDP growth and low interest rates. Depend on Dodge!

Apartments - demand is still strong, particularly for ≥ 50 unit buildings due to the activities of Killam Properties Limited and private investors. Real estate investment trusts (Reits) are still looking for larger buildings. Halifax Peninsula is the preferred location. We believe that this market has peaked. Rents have not risen substantially over the past five years, often not keeping pace with inflation. Virtually all of the increase in capital value has occurred because investors have been willing to sacrifice yield. It is a good time to sell.

Offices - there is a strong demand for office buildings suitable for owner-occupation (≤ 6,000 ft.^{2}) particularly on Halifax Peninsula. Prices there have increased at a compound rate of about 10% per year for the past seven years and show no signs of slowing down. This same increase has not been reflected in rental rates. Prices will continue to increase so long as the economy grows. This market is not so dependent as the apartment market, on the Bank of Canada maintaining its low interest rates.

The rental market for investment grade office buildings (A and B space) in H.R.M. is soft and it has still not attained the price levels achieved before the property market collapse in 1990. There is still an overhang of sublet space available in Halifax CBD, partly as a result of the decline in offshore oil/gas activity. Halifax CBD too is suffering from neglect and lack of political leadership. It is dirty, graffiti and wild postering abound. Even at the height of the afternoon, squatters camp out in doorways. During the past decade Halifax CBD has seen its rental price premium erode substantially, as office renters migrate to the suburbs and the industrial/office parks. No longer the best place to invest; Halifax CBD is slowly declining.

Retail - strong demand at all levels. This too is dependent on continued GDP growth. Retail is very location dependent and some shopping centres have never recovered from the H.R.M. subsidised retail node in Bayers Lake Industrial Park which initiated the "big box" development explosion there. Retail patterns will change too if a similar development is successfully launched in Dartmouth. Generally speaking however there is strong demand across the retail spectrum, from small strip malls to major retail developments.

Industrial - very strong demand both for owner occupation and investment. The favoured location continues to be Dartmouth's Burnside Industrial Park. Vacancy rates are low and should continue that way since speculative building is constrained by the memory of the 1990 property crash. Industrial developers appear to have longer memories …

Multiple Listing Service™ (MLS™) are trademarks of the Canadian Real Estate Association.

*For more information on our Brokerage Division visit our web site at **www.turnerdrake.com** and follow the links (products → brokerage).*

VALUATION DIVISION

Increase Wealth: Count Toes ...

Today, more and more investors factor capital growth into their investment decision. This is in marked contrast to the climate that prevailed following the real estate market collapse in 1990. In that chilly aftermath, purchasers of income producing property eschewed all thought of capital appreciation and focussed exclusively on the investment's immediate cash producing ability. "Discounted cash flow", once the holy grail, was condemned as the wicked wanderings of reckless minds. What a difference ten years makes! Purchasers, especially those enamoured of apartment properties focus on the future, the present is passé . So how can you gauge whether the value will increase … or decrease … and given competing investments, how do you chose between them? It's really a matter of counting your toes.

Forecasting the Future

First, some definitions: *(1) Effective Gross Income (EGI):* in the case of an apartment building this would be the aggregate of the rents, parking revenue, washer and dryer income, etc. that is actually received by the landlord. *(2) Total Operating Expense (TOE):* this comprises all of the landlord's expenses, other than mortgage payments, necessary to operate the property. *(3) Operating Expense Ratio OER = TOE ÷ EGI.*

So long as investor's perception of risk remains unchanged the Market Value will: (1) increase when $^a/_b$ > OER; (2) remain unchanged when $^a/_b$ = OER; (3) decrease when $^a/_b$ < OER.

a = Expected growth in EGI.
b = Expected growth in TOE.

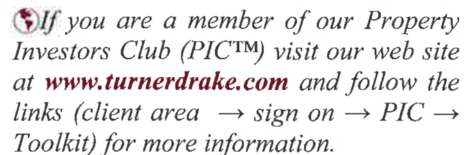
Example:

You are considering the purchase of an apartment building with a gross income last year of $1,001,411 and total operating expenses of $399,717. CMHC continues to encourage new construction through high ratio mortgage insurance even though vacancy rates are rising. You anticipate that annual rental growth for the foreseeable future will be limited to 2%, even though operating costs continue to increase at 4% per year. Will the Market Value increase or decrease in the future?

$$\text{OER} = \frac{\$\ 399{,}717}{\$1{,}001{,}411} = 0.40$$

$$\frac{\text{Expected growth in EGI} = 2\%}{\text{Expected growth in TOE} = 4\%} = 0.50$$

Therefore the Market Value will *increase* in the future.


*If you are a member of our Property Investors Club (PIC™) visit our web site at **www.turnerdrake.com** and follow the links (client area → sign on → PIC → Toolkit) for more information.*