Turner Drake & Partners

Real Estate Counsellors, Brokers & Valuers

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Newsletter

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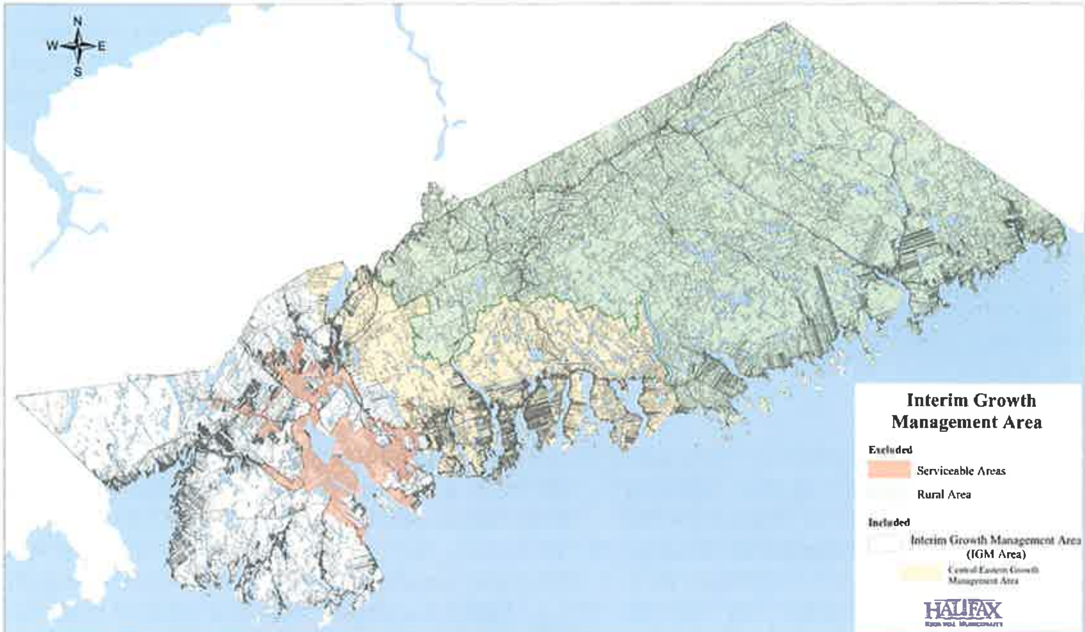
H.R.M. STRUGGLES WITH SUCCESS



On January 22nd 2004, the Halifax Regional Municipality (HRM) froze new residential development in most unserviced areas of the municipality for a period of 90 days. Only the rural area lying about two hours driving time away from the Halifax CBD along the Eastern Shore (shown coloured green on the plan) escaped the moratorium. HRM restricted their lot approval to a single permit for any newly subdivided area of land, approved after January 22nd 2004. This rather drastic action was precipitated by their growing concern at the explosive growth of unserviced subdivisions, which in turn were fuelled by the current housing boom. The geography in much of HRM is not particularly tolerant of on-site services. The igneous and metamorphic bedrock provides limited groundwater resources and the presence of minerals/elements such as arsenic, uranium and radionuclides have resulted in pressure on the municipality, from home owners, to rectify their drinking water problem by extending municipal water services. Ground saturation from a multiplicity of septic systems and excessive road maintenance costs convinced HRM that it had to take action now, rather than wait until the new Regional Development Plan was completed in September 2005. Cunning developers had thwarted the purpose of controls imposed under the existing Development Plan in the Hammonds Plains area by taking pre-emptive action during the consultative process; hence HRM's decision to bushwhack them with their January 22nd announcement.

IN THIS ISSUE

During the post January 22nd moratorium HRM worked feverishly to fashion an Interim Growth Management Strategy to contain development until the new Regional Development Plan could be implemented. The moratorium expired on April 20th 2004 and was replaced by the Interim Growth Management Strategy which itself went through a number of iterations before crystallizing into a form that was broadly acceptable to HRM and the development community.

The Interim Growth Management Strategy applies to the areas shown coloured white and brown on the map, i.e. the areas of HRM that do not have access to municipal water and sewer services, and lie within the urban metropolis commuter belt. Some areas already have growth controls (Dartmouth, Hammond's Plains/ Upper Sackville/Beaver Bank, Bedford, Halifax, Eastern Passage/Cow Bay) and these continue to be in force and in effect under the Interim Growth Management Strategy.

The Interim Growth Management Strategy prohibits new roads (public or private); more than 3 flag lots per parcel of land that existed prior to January 22nd 2004 (unless they were shown on Preliminary, Tentative and Final

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subdivision applications) and eliminates the "final endorsement" stage under the Subdivision By-law. So, you can now only create new lots on existing public and private roads. All Tentative and Final subdivision applications on file with HRM prior to January 22nd 2004 are allowed to proceed. Concept subdivision applications filed before January 22nd 2004 can also proceed but are restricted to 25 new lots per year. All flag lots shown on Preliminary, Tentative and Final subdivision applications can also proceed. Approved development agreements and completed applications in process prior to January 22nd 2004 can proceed as well.

The Central/Eastern Growth Management Area, shown coloured brown on the map, is subject to the Interim Growth Management Strategy outlined above *however new public roads are permitted* provided that they intersect or extend only from existing public roads … so long as they do not intersect Trunks #2 or #7, Routes #207, #318 or #357. Development along these new roads is restricted to 8 lots per year. (The Central/Eastern Growth Management Area comprises a portion of Musquodoboit Valley-Dutch Settlement, Eastern Shore [West], Lake Echo/Porters Lake/Chezzetcook [Planning Districts 8 & 9], all of Lawrencetown, The Prestons and Lake Major Planning Area, a portion of Planning Districts 14 & 17 [Waverley], and Enfield except between Grand Lake and Dartmouth/Bedford boundary).

Quo Vadis Property Values?

What impact does this have on property values in HRM? Irrespective of whether your property is located inside or outside the Interim Growth Management Strategy area, its value will be impacted … particularly if the controls are extended into the new Regional Development Plan.

HRM argues that there is already an ample supply of unserviced lots available under the Interim Growth Management Strategy (IGMS) and consequently lot prices will not increase because of the Strategy. The development community disputes HRM's lot inventory figures. In a sense, this is a dispute about semantics. Some sort of development controls are inevitable and will find their way into the new Regional Development Plan. During the short term, before the Plan is implemented, the IGMS will drive down the value of land, the development of which is now constrained by the planning controls. The value of land suitable for development ultimately depends on demand for its end use, e.g. residential, commercial or industrial. Since aggregate demand is not impacted by the IGMS, the value "lost" by property constrained by the planning controls should in theory have shifted to the unaffected property, so the latter should have gone up in value by a commensurate amount. In actuality however a degree of uncertainty has been introduced by the IGMS, and in particular the prospect of a new Regional Development Plan which will not be implemented until late 2005. Because of this timing issue, the lands unaffected by the IGMS will not benefit fully from this shift in value unless, and until, they continue to enjoy development privileges under the new Regional Development Plan. The bottom line is that the moratorium freezing new development has changed the water on the beans. It set in motion a process which prohibits or restricts development on some property, and that in turn diminishes its value. Other property will increase in value as a consequence.

Valued … and Valueless

The arbitrary redistribution of property rights (and values) through the planning process should be of great concern to all of us, not just those unfortunate owners who are adversely effected. The sanctity of private ownership, like the rule of law, is part of the bedrock which underlies all successful market economies. It is a critical part of the conversion process for any country proceeding from feudalism or communism, to an open economy. Most of our individual wealth resides in the property we own and it is a major source of capital. In our experience its importance, and role in the economy, is not well recognised by our public sector: they generally treat private property rights in a cavalier manner, nuisances that make their job more difficult. The Canadian Real Estate Association attempted and failed to get protection of property rights embodied in the Canadian Charter of Rights and Freedoms. It is therefore left to each property owner to defend the bundle of property rights that in total represent "ownership", against attempts by government to remove them stick by stick, without compensation. The most blatant attempts to abrogate private property rights occur when public authorities need to acquire real estate for public purposes. "Purchase at the lowest price" is too often the mantra employed … whilst the politicians stumble through the process, usually bewildered by the virulence of the owner's reaction to the confiscation of their property. Confiscation of property rights resulting from new planning controls is even more insidious because the expropriation occurs without offsetting compensation. As a result public opposition often thwarts what are often necessary changes to land use that benefit the community at large. We need to think "outside the box" and implement a procedure that compensates owners whose properties suffer a value loss as the result of new, but necessary planning controls. This could change the planning process from one in which each property owner resists changes which adversely impact their property value, to a less adversarial exercise focussed on maximising benefit to the entire community.

*If you need counselling advice on valuation related matters in HRM or elsewhere, give Mike Turner or Lee Weatherby a call at 1-800-567-3033 (429-1811 in HRM) or visit our web site **www.turnerdrake.com** and follow the links (corporate site → products → counselling).*

PROPERTY TAX DIVISION

Nova Scotia

This year the Province has enacted three pieces of legislation which will further assist in distorting the assessment process. Their impact will be to shift more of the tax burden onto business owners, particularly those situated in the

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Source: Turner Drake & Partners Compuval™ Database.

business parks … and onto the less wealthy, and generally younger, property owners in residential subdivisions. A curious policy for a small province with a shrinking and aging population, that weekly watches its well educated youth depart because they find it difficult to secure jobs locally.

Property taxes are the product of the mill rate, set by the municipality, and the assessed value computed by provincial civil servants employed by Service Nova Scotia. The assessed value is based on the market value of the property, two years prior to the assessment year. For example, assessments for 2005 are based on the property's market value on 1st January 2003.

Bill #80 is intended to address rapidly rising residential assessments, which in turn are the outcome of increasing property values. During the 1990s only three countries in the developed world; Canada, Germany and Japan, missed out on the housing boom (Newsletter Vol. 2 No. 72). The 1990s were not good years for Canadians: most saw their incomes shrink in real terms in the first half of the decade and only grudgingly expand in the latter half. However as real incomes started to increase, property price increases gathered pace (see HRM Residential Price Index graph). These price increases started to feed back into the assessments of residential and waterfront land. Reacting to complaints from home owners, especially those located along the province's much sought after South Shore, the government has moved to "cap" assessment increases on residential properties (single family homes and apartment buildings with no more than 3 units) and taxable resource property (i.e. woodland) so long as half the interest therein (or more) is owned by a provincial resident. Brothers and sisters of former provincial resident owners also qualify as do family trusts or farmer's co-operatives with head offices in the province so long as at least half their shares are held by provincial residents. The legislation casually discriminates against everybody else.

The capping will commence in 2005 and applies to the 2005-06, 2006-07 and 2007-08 municipal taxation years. It is necessary to apply before 30th November of each preceding year, submitting proof of residence (facsimile of a Nova Scotia Health Card flashed by a kilted resident wearing provincial tartan). Bill #80 and the attendant regulations are couched in the usual gibberish but we believe the intent is as follows:

Year #	Calendar Assessment Year	Capped Increase over Previous Year	2005 Assessed Value
1	2001	0%	
2	2002	15%	Year 1 x 1.60
3	2003	15%	Year 2 x 1.39
4	2004	10%	Year 3 x 1.21
5	2005	10%	Year 4 x 1.10

Presumably the 60% increases will be applied against the 2001 Base Year (Year 1) assessment, and all subsequent year assessments will be ignored for computational purposes unless the assessment has been increased for reasons other than physical improvements to the property. The increase allowed will be capped at the rate allowed for that particular year, and then increased again in subsequent years by applying the legislated increases. If there have been physical improvements to the property post 2001 which have resulted in an increase in the assessment, that increase will be treated separately and the annual allowable legislated increases will be applied to it. The resulting 2005 assessment must not exceed the property's market value at the base date (1st January 2003). The 2001 Base Year assessments are themselves supposed to be based on the market value of the property on 1st January 1999, i.e. before property experienced the large increases in value (see HRM Residential Price Increase graph). Because of "appraisal lag", much of the most valuable property was under-assessed as of this date. Bill #40 does not mandate how demolitions are to be assessed: nominal assessments are possible. Oh happy days!

Bill #74 is even more drastic since it sets aside the market value basis that underpins virtually all assessments in the province. It essentially removes the assessment of Oil Refineries and Liquified Gas Plants from the purview of Service Nova Scotia's professional staff and codifies it instead into regulations. Since at present there are no Liquified Gas Plants in the province, the impact of the legislation is confined to the Dartmouth Imperial Oil Refinery and that property is specifically identified in Bill #74. Halifax Regional Municipality (HRM) have condemned the move as ham fisted (pun intended); Mayor Kelly protesting that *"municipalities are prohibited by the province from making tax agreements with businesses and industries; and therefore, the province should not be permitted to adjust the Assessment Rolls to put more money into the hands of commercial ventures at the expense of local property taxpayers. 'It's just not the homeowner … it's one business being subsidized at the expense of the other'".* HRM compute their immediate loss in tax revenue resulting from the legislation at $600,000/annum.

Bill #93 is confined to the assessment of gas distribution systems. It too changes the basis of the assessment from market value, as envisaged by the Assessment Act, and substitutes a formula based on gross distribution revenues and pipeline costs. These revenues and costs *exclude* G.S.T. … Service Nova Scotia meanwhile insist that all other property assessments *include* H.S.T. The formula provides for a heavy write-down of the pipeline cost (and assessment) starting at 65% in the first year, 50% in year two and 20% in the third year; "normal" depreciation accrues thereafter up to a maximum of 50% of the original cost. The pipeline costs are indexed, presumably to allow for inflationary increases, *but only for pipeline installed*

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after 1st January 2009.

Taxing Times

On January 10th, Service Nova Scotia a.k.a. the Provincial Assessment Department, mailed out its 2005 Assessment Notices. Additional Notices will follow in February for properties effected by the "capping" legislation referred to earlier. In order to make up for the revenue lost due to the "capping", property owners can expect their tax rates to rise when the municipalities set their "mill rates" in late Spring. Nova Scotia property owners can therefore expect a double whammy in 2005. Because of the "capping" legislation Service Nova Scotia did not publish a "pre-roll", i.e. disclose their proposed 2005 assessments in June 2004: a departure from previous practice. Many property owners were therefore unable to negotiate their 2005 assessments prior to publication in January 2005. In addition they should now expect increasing tax rates as the municipalities struggle to recoup revenue lost due to the capping of certain assessments. The Provincial government has redistributed the tax load: small business and the generally younger residential property owners now carry an increased burden.

It is apparent too that the Business Occupancy Tax, a levy imposed on occupiers of commercial property, is to be eliminated. The legislation will probably be introduced in 2005: and it appears likely that it will be phased in over a three year period. Service Nova Scotia's October 2004 bulletin indicates that this tax normally contributes 40% of municipal tax revenues. The monies lost will be recouped by increasing the realty tax; so there will be large increases in the commercial tax rate. Service Nova Scotia predict that the average commercial property's tax load will "remain the same or decrease slightly"; however tax redistribution will be uneven. The finance and insurance sector (3% of businesses) will experience a decrease in their tax load whilst the automobile dealers and tourist related properties such as restaurants and camp grounds (11% of businesses) will pay more in taxes. The owners of vacant, or partially vacant, commercial property will also be penalised … landlords look out!

New Brunswick

Heavy lifting? Don't call us! *"Anyone having problems with assessors should direct them* (their complaints) *to Service New Brunswick and not the Association".* This was the alarmed response by the New Brunswick Association of Real Estate Appraisers (NBAREA) to our article "Oh Lord! Benched Again!" (Newsletter Vol. 2 No. 77). That article dealt with the July 19th 2004 appeal by Service New Brunswick to the New Brunswick Court of Queens Bench, 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 the assessed value as *"an affront to common sense".* The Court of Queens Bench had agreed with the Board and in dismissing Service New Brunswick's appeal and awarding costs to the Respondent had 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".* Our article noted that the case was an appeal of the latest, in a series of scathing decisions by the normally reticent Board which had called into question the judgement, competence and experience of SNB's assessment staff. In one case the Board in commenting on the evidence tended by Service New Brunswick noted that *"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."* Our article noted that winning an assessment appeal can too often be a pyrrhic victory because the Board rarely awards costs and those granted by the Court of Queens Bench are unlikely to cover all of your actual expenses. Because the SNB employees giving expert testimony were Appraisal Institute of Canada members we suggested recourse to the NBAREA, since their enabling legislation required they govern the professional conduct of their members, the better to serve and protect the public interest. (The NBAREA is the legislated continuation of the Appraisal Institute of Canada in New Brunswick).

The NBAREA advise us that such is not the case. They

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insist they *are unable to hold their members to account for their professional conduct if they are employed by Service New Brunswick as assessors. They cite Section 29 of the N.B. Association of Real Estate Appraisers Act as the reason their hands are tied and wish to make it clear that it was a policy decision of the government at that time and had nothing to do with a lack of will on their part to govern their members' activities, the better to serve and protect the public interest.* They have asked that we publish a disclaimer to that effect. [In fairness to "the government at that time" (the Liberals led by Frank McKenna) we feel obliged to point out that NBAREA/AIC's enabling legislation was not a government bill, but a private members bill the Appraisal Institute themselves had promoted!].

We have to admit to being very surprised at the NBAREA/AIC's interpretation of its enabling legislation. We had understood Section 29 as meaning that SNB assessors could not be coerced into joining NBAREA; not that they were unaccountable for their professional conduct if they chose voluntarily to belong. In the past the New Brunswick Assessment and Planning Appeal Board have made it clear that they place great weight on an expert witness being a member of a professional association because the latter governs their professional conduct. In virtually every case in which we have been involved the SNB assessor has claimed membership of the Appraisal Institute of Canada (AIC) as part of their professional credentials without any qualification as to their absence of accountability. Indeed the reports they tendered suggested quite the reverse. Perhaps they too were confused. Happily the NBAREA/AIC will no doubt have addressed that problem now and SNB assessors, who are members of the Appraisal Institute of Canada, will no longer tender verbal or written evidence without the necessary clarification. Presumably their ensuing evidence will no longer be treated as expert testimony and accorded any weight by the Board/Court: to that degree anyway property owners should be able to reduce their litigation costs.

Hopefully too the Association will now change its By-Laws as they are currently presented on its web site. At present they state that *"the Association adopts and undertakes to enforce the Code of Ethics and Rules of Professional Conduct and Standards of Professional Practice in force from time to time with the (Appraisal) Institute (of Canada)."* There is no warning that the foregoing fails to apply to the 61 SNB assessors who comprise 30% of its membership: hence our confusion; we trust readers were not unduly inconvenienced by the (apparently) incorrect advice contained in our prior Newsletter.

*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**.*

VALUATION DIVISION

A Matter of Choice

Turner Drake Ekard Renrut

After the property markets crashed worldwide in the late 1980s (Newsletter Vol. 2 No. 65 - *The Pre-Millennium Meltdown. Will it Happen Again?*) Canadians greeted investment opportunities in real estate with all the enthusiasm they now reserve for SARS. They plowed their funds instead into the stock market: information technology companies were king. This decade, chastened by the accounting scandals at Enron, WorldCom, et al, and the fall from grace of high flyers such as Nortel Networks, attention has again refocused on real estate. Whilst Real Estate Investment Trusts (Reits) are the vehicle of choice for most small investors, we find that an increasing number of individuals prefer to purchase the bricks and mortar. Apartment buildings are their preferred choice: this type of property offers a multiplicity of investment opportunities which cover the spectrum in terms of risk and equity involvement. Investors are constrained by the amount of equity they have available to invest, their tolerance of risk, and the property's proximity to their place of residence if they wish to self manage it. An investor will therefore select properties for consideration that meet their criteria of affordability, location … and whether the property's rent/operating expense profile falls within the investor's comfort range. Within this selected group, the investor will choose the property that maximises his/her expected return. In our experience most purchasers base this calculation on the forthcoming year's cash flow: in practice this is usually the gross income, net operating income (gross income less operating expenses) or before tax cash flow (NOI less debt service). Basing a purchase decision on a single year "snapshot" can be misleading: it is worthwhile taking a longer term view.

The advantages of looking further ahead can be illustrated by considering two properties, both available for purchase at $500,000 with mortgage financing for 65% of the sale price at 7% (compounded semi-annually) on a 5 year term, with a 25 year amortization period. Each property therefore requires an equity

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investment of $175,000 (Purchase Price - Mortgage).

Property A is located in Sackville, a suburb of Halifax. This is the more risky investment since there is still land available on which to erect competing buildings. There is also a greater risk of vacancy because the tenants can purchase affordable homes in the area if mortgage rates decline. Next year's net operating income is expected to be $55,000.

Property B is located in Halifax's South End on Halifax Peninsula, close to employment centres such as the Central Business District, the hospitals and universities. There is no land available on which to erect competing buildings without redeveloping existing properties. Vacancy rates have historically been low. Next year's net operating income is expected to be $40,000.

Based on the foregoing information, the investment purchase criteria looks as follows:

	Year 1			
	Property A		Property B	
Type of Cash Flow	Amount	% Return	Amount	% Return
Net Operating Income	$55,000	11%	$40,000	8%
Before Tax Cash Flow	$27,684	16%	$12,684	7%

If the investor is indifferent which property to purchase it means that he/she is quantifying the additional risk of the Sackville property, over the South End, at 38% (based on net operating income) or 129% (based on Before Tax Cash Flow). Most investors would consider this "spread" adequate to compensate them for the additional risk of investing in the Sackville location versus the South End property. Unfortunately a long term view which considers the investment over the anticipated holding period, will paint a much different picture *even if the vacancy does not change and both properties experience the same rate of rental growth.* This will occur because, (1) there is a strong demand for apartment buildings and the rates of return investors are prepared to accept is falling … and they are falling faster in areas where supply is constrained, and (2) the cash throw off, i.e. the surplus cash available after paying the debt service, can rarely be re-invested at the same rate as that generated by the property.

Year	Item	Property A	Property B
0	Initial Equity	($175,000)	($175,000)
1	Equity Dividend	$ 27,684	$ 12,684
2	Equity Dividend	$ 28,784	$ 13,484
3	Equity Dividend	$ 29,906	$ 14,300
4	Equity Dividend	$ 31,050	$ 15,132
5	Equity Dividend	$ 32,218	$ 15,981
5	Sale Proceeds	$256,105	$335,005
	Internal Rate of Return	22.74%	20.24%
	Modified IRR	18.92%	18.65%

If the vacancy rates of both properties do not change and their rents increase at the same rate (2% per annum), the internal rate of return generated by each investment on the original equity investment will be virtually the same (Sackville 18.9%, South End 18.7%). We have assumed that each property will be sold at the end of 5 years at a price based on the then net operating income (Sackville 11%, South End 7%) versus the original acquisition prices of 11% (Sackville) and 8% (South End). We have also assumed that the monies remaining after paying the mortgage will be re-invested in Guaranteed Investment Certificates yielding 3.5% per annum.

This picture will change if the investor wishes to hold the property for a different time period. Such properties are often purchased for retirement income so a ten year holding period is not unusual. All other conditions remaining the same, the modified internal rate of return would change to 15.5% for Property A (Sackville) and 13.7% for Property B (South End). This is a risk premium of 13% for the Sackville property over its counterpart in the South End.

Is this premium adequate to compensate an investor for the increased risk inherent in the suburban (Sackville) property over its central city (South End) counterpart? That is a personal decision which will depend on the investor's appetite for risk. The real point is that the true risk premium is only 13%, not 129%.

*We are blessed with a wealth of young, trained minds who are available to undertake this type of analysis for you, quite inexpensively. To access them, please call Lee Weatherby or Mike Turner in our Counselling Division at 429-1811 (HRM) or toll free 1-800-567-5033. You can also visit our web site at **www.turnerdrake.com** and follow the links (products → valuation).*

WE RUN MARATHONS TOO!

George Kakamousias

Not all of us; just Giselle Kakamousias the Manager of our Property Tax Division. In October 2004 she completed the 42 kilometre Valley Harvest Marathon which started and finished in downtown Kentville, a market town gently nestled in the apple orchards of Nova Scotia's Annapolis Valley. Cheered on by her husband, two young daughters, proud parents, sister, niece, godmother and other friends, Giselle placed 22nd in the 46 women competing. There were a total of 596 participants in the full and half marathon events, the proceeds of which went to local charities.

Giselle trained for the marathon by running around Bedford Basin, Halifax's massive inner harbour and the assembly point for another great effort, the World War II convoys. Giselle keeps in shape by consuming sushi, salads and provincial tax assessors. She looks forward to repeating the process in 2005 … the marathon too.

Please notify us by mail, fax or telephone if you would like to be removed from or added to our mailing list.