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# ON THE LEVEL.



Turner Drake

Most taxes are voluntary: they rely on the co-operation and integrity of the taxpayer. Personal Income Tax, Corporation Tax, Capital Gains Tax, HST/GST, Deed Transfer Tax, are prime examples. They place the onus for determining their quantum firmly on the shoulders of the taxpayer. The State retains the jurisdiction to challenge the taxpayer's self assessment and may impose a penalty if the latter proves inadequate whether by incompetence or dishonesty. This is in sharp contrast to the property taxation system, which depends on the State, usually the province, occasionally the municipality, to determine the assessment. Here the onus to "get it right" rests on the shoulders of the taxing authority ... and it is left to the taxpayer to mount a challenge when the former proves inadequate. Unfortunately there is no countervailing compensation when the State fails to make the grade: in fact the taxpayer wears the cost of the State's incompetence because they cannot recover their overpayment of taxes from previous years. To rub salt into the wound, some Assessors are overtly hostile to the

taxpayer's challenge to their property assessment and fail to recognise that the appeal process itself is an integral part of "getting it right". Perhaps Assessors should suffer the same retribution as taxpayers ... punitive financial penalties or jail time unless they "get it right". Oh happy days!

Of course, the argument could, and is, raised by Provincial Assessors that they lack the resources to do the job. If such really is the case, the provinces should abandon the charade and move to taxpayer self assessment of property taxes. Logic dictates that this should be done in any event: it would eliminate much of its adversarial flavour and remove the temptation for politicians to distort it by "assessment caps" or similar meddling. If they are unwilling to cede responsibility for assessment to the taxpayer Assessment Departments should put up or shut up ... and recognise that the appeal process must be open, transparent and inexpensive; and devote their efforts to ensuring that these objectives are achieved.

## **Nova Scotia: Uniform or Uninformed?**

Many provincial Assessment Acts, including the Nova Scotia legislation mandate a "uniformity provision". Although the basis for the assessed

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value is the market value of the property on a "base date" (January 1st two years preceding the assessment year in Nova Scotia) the Act requires that "taxation must fall in a uniform manner". Provincial case law has established that this uniformity provision must be applied across, rather than within, asset classes in the municipality. So *all* commercial property has to be assessed uniformly ... office buildings cannot be compared solely with other office properties, but must be compared with every commercial assessment in the municipality. This "General Level of Assessment" is calculated by dividing the sum of the assessments, for those properties that have sold within six months of the base date, by the aggregate of their sale prices. If this aggregate assessment to sale price ratio is 80%, then all properties must be assessed at 80% of their market value. If the property is assessed at a higher rate than 80%, the owner and occupiers will pay too much in taxes. The Provincial Assessment Department, Service Nova Scotia (SNS), calculates the General Level of Assessment, for each municipality, every year. Since sale prices are not public knowledge in Nova Scotia, private taxpayers are unable to calculate the General Level of Assessment because the relevant data is not available to them. They must instead rely on Service Nova Scotia's calculations. It follows therefore that there is a heavy responsibility on SNS to "get it right" ... since if they fail to fulfil this responsibility *half of the commercial properties will shoulder too high a tax load, and half will pay too little in property and business occupancy taxes.* In 2001, Homco Realty Fund (20) Limited, the owners of a major downtown Halifax office building, challenged Service Nova Scotia's calculation of the General Level of Assessment for commercial properties in the Halifax Regional Municipality (HRM). The objective of Homco's concern was 1741 Brunswick Street, a building situated rather appropriately, opposite Halifax's Town Clock, an edifice that has held Haligonians accountable since 1803. (This was not the first time one of Richard Homburg's companies had attempted to hold the authorities to account. On an earlier occasion he tried to ensure that HRM enforce its own unsightly premises

by-law by taking them to court, albeit without success).

The Homco Realty Fund (20) Limited General Level of Assessment appeal was heard by the Nova Scotia Utility and Review Board (NSUARB). Their 118 page decision, rendered on 28th February 2005, allowed Homco's appeal and determined that SNS' "*general level of assessment is wrong*" and calculated it at 91.7% (SNS had insisted it was 98.4%). The Utility Board's weighty decision, as befitted six days of hearings over a five month period in 2003 and 2004, is thoughtful and carefully reasoned. It is available on NSUARB's web site. The case was adjudicated by a seasoned three person panel. Homco Realty Fund was represented by Michael J. O'Hara L.L.B. aided by Giselle Kakamousias, the Manager of our Property Tax Division. She was charged with the task of undertaking a review of SNS's calculations and sales data. Service Nova Scotia, happily unconstrained by the same financial imperatives as the taxpayer, devoted *two* lawyers to the case, Randall R. Duplak, QC and Kirby E. Grant L.L.B.; *and even flew in an expert from Phoenix, Arizona specially for the case.*

Unfortunately after sitting their Phoenix fella through the entire first three day session of Homco's testimony, Service Nova Scotia declared themselves so impoverished they were unable to fly him back again to give his *own* testimony at the second three day session ... a great shame; perhaps they ran out of Air Miles ... Nonetheless SNS were not expertless: their Assessor Mr. M. Musycsyn had prepared a report and rendered testimony.

Homco Realty Fund included, as the main plank of its appeal, the fact that its assessment represented 97% of its market value (the property had been sold shortly after the base date). Other comparable sales were assessed at assessment/sale price ratios of between 55% and 82%. The sole valuation issue before the hearing was that of uniformity of assessment, and the kernel of the disagreement between the taxpayer and SNS lay in the inclusion, or exclusion, of certain sales in the

General Level of Assessment calculation. SNS also argued that the General Level of Assessment calculation methodology favoured by case law was incorrect and should be abandoned and replaced by SNS' "mass appraisal approach", mathematical Mumbo-jumbo rightly rejected as such by the Board and the Court of Appeal in previous cases but apparently still worshipped by the Assessment Department. The Board again declined to be seduced by this whiff of brimstone, recklessly believing perhaps, that they and the Court of Appeal were still correct and tartly pointing out to Provincial government lawyers Duplak, QC and Grant L.L.B. that there had been no legislative changes since the Court of Appeal last rendered its decision on the matter. SNS also attempted to escalate the appeal to the Supreme Court by arguing that the Utility Board lacked the jurisdiction to hear the case. The Board disagreed.

Service Nova Scotia excluded all properties from its General Level of Assessment calculation whose sale price was determined using discounted cash flow. Since all major investment type properties are valued on this basis, all were excluded from the calculation! The Board determined that SNS' decision to exclude these sales was based on (1) *administrative convenience*, and (2) *a misinterpretation of a previous court decision (City of Halifax and Revenue Hotels Limited v. Director of Assessment 1988, NSMB-122-85-A).* The Board observed that as a result of the foregoing "*the assessments of many large and expensive commercial properties in the HRM have been set at values lower than they should have been*". (The corollary of course, is that the other properties have had to pick up this substantial tax shortfall). Service Nova Scotia's Mr. Musycsyn excluded the sale price of the subject property, 1741 Brunswick Street, even though it sold close to the base date, as evidence of its market value! He also excluded the sale of Purdy's Wharf, HRM's trophy office complex and acknowledged that he would have done so even if it had not been sold on a discounted cash flow basis because it was an "*outlier*" i.e. it was so under-assessed its inclusion in his data would have substantially reduced his General Level of Assessment calculation! The Board

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referred to this practice as a "systemic error" and observed that "this problem is further aggravated by the Director's attempt to (in the Board's view) artificially protect the Director's claimed general level of assessment by excluding sales of such large transactions" and "while the Director not surprisingly appears to be content with a claimed general level of assessment which is close to 100%, one of the ways the Director achieves this result is to automatically exclude sales which would otherwise lower it". On another occasion Service Nova Scotia's Mr. Musycsyn excluded a purchase by the Hospitals of Ontario Pension Plan partly on the grounds that the purchaser was "a pension plan" and a "national purchaser", causing the Board to observe "the Director appears ready to disqualify any sale involving a REIT or pension fund without further inquiry as to the market circumstances of the sale". Mr. Musycsyn's rationale apparently was that REITS and other "national" purchasers were lamentably lacking in sophistication and consequently paid far too much for property ... so these sales had to be excluded from his analysis!

Service Nova Scotia has appealed the Utility Board's decision.

For information on the *Homco Realty Fund (20) Limited* case visit the Nova Scotia Utility and Review Board web site [www.nsuarb.ca](http://www.nsuarb.ca) (New Release → Re: *Homco Realty Fund [20] Limited*).

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## PROPERTY TAX DIVISION

### The New Paradigm



Jupiterimages

Over assessed? Your chances of getting relief diminish by the hour. In many provinces now, Assessors have been relegated to a clerical role. Increasingly they lack the authority, and frequently the training and knowledge to do anything but accept the result generated by their computer model. The real decision is made by "head office" and even the most conscientious Assessor can do little but operate within the very narrow limits imposed from "above". This was the norm in Ontario, but the practice has now spread to New Brunswick and Nova Scotia. You can, it is true, appeal if your property is over-assessed. In most instances however the provincial assessment authority will confirm the assessment; leaving you with Hobson's Choice, accept a figure you think is wrong or shoulder the cost of a Court or Board Hearing. Assessors will not come to the negotiating table prior to the Hearing unless they face the daunting prospect of facing an opponent with a strong track record in Court. This is unfortunate because property owners can no longer expect relief if they are over-assessed, unless they retain professional assistance.

We foresaw the present situation which is why in July 2001, we launched our PAMST<sup>TM</sup> Property Tax Manager program. Over 100 firms and individuals have now enrolled their property, worth ± \$1.0 billion, in the program. Some owners are individuals with a single property, others are household names with multiple property portfolios. The program is flexible and cost effective ... so successful in fact that some companies have insisted we enrol their properties located outside Atlantic Canada. So why have clients enrolled properties located in nine provinces in the program? We believe it is because our program achieves the highest initial tax savings ... and then maintains them in the future. Our studies show that PAMST<sup>TM</sup> protected properties bear a lower initial tax burden than their cohort ... and register lower assessment increases in future years. These tax savings fall straight to your bottom line ... monies that would otherwise be squandered by politicians and civil servants, can instead be deployed in your business to increase profits and jobs, thus bolstering the economy.

If you relish paying taxes, pass on PAMST<sup>TM</sup> : keep up the good work we need you.

For more information on property tax visit our web site [www.turnerdrake.com](http://www.turnerdrake.com) and follow the links (products → property tax → appeals). If you are a client you can access Action Alert! bulletins through your personal Client Area.

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## VALUATION DIVISION

### Fire Insurance



Media Bank

In 1688, Edward Lloyd opened a coffee house in Tower Street, London so that clients could exchange shipping news and share the risk inherent in marine trading: thus was insurance born.

Perhaps because of that informal beginning, insurance has always had a "handshake" air about it ... the insured usually assuming that they have more coverage than really exists. Only in the cold light of dawn following the fire, does reality raise its head. And although only 2% of fires result in total loss, the real damage often occurs from smoke and water, often rendering it difficult to establish the state of the building prior to the fire. In our experience, insurers are very cautious now about paying out claims and will almost always check that

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the property was not under-insured ... even on a partial claim, by commissioning an appraisal after the fire unless the insured has a recent appraisal (preferably kept off site) from a reputable company.

Fire insurance rates in Atlantic Canada have risen by about 150% since 2001, the year of the perfect storm. The terrorist attack on the New York World Trade Centre on 11th September hit the reinsurance market hard and all of us are now paying the price. At the same time the stock market's mediocre performance has robbed insurance companies of their reinvestment income. Most property owners pay between \$2.50 to \$7.50 per annum, per \$1,000 of insured building value for coverage on the building, equipment and rental loss. Each \$100,000 of "over-insurance" therefore carries a cost of between \$250 to \$750 annually ... and it is quite usual for commercial properties to be over-insured, sometimes by 50%, because of the cumulative effect of conservatism ("better to err on the side of safety"), yearly indexing, the fact that the most popular software programs for calculating building costs include the 15% H.S.T., and because insurance coverage pre September 11<sup>th</sup> was quite cheap.

### Replacement Cost New

This is the current cost of reconstructing the building on the same site with materials of like kind and quality for like occupancy without deduction for depreciation. More simply put, it is the current cost of replacing the present building with a new one, and is the basis for most fire insurance coverage. However there is no point in including the H.S.T./G.S.T. in your replacement cost insurance for a commercial building because it is a "pass through" tax and your insurer will not pay for something that you will get back from the Federal Government. On the other hand if you are insuring an apartment building, or home, you must include the tax in your replacement cost estimate because you will not get a refund from Ottawa. If you are insuring a church however, 50% of the H.S.T./G.S.T. is non-refundable and has to be included in the replacement cost estimate.

Foundations below the level of the lowest floor, buried pipes, cost of excavations, and the proportion of the architect's fees applicable thereto generally comprise 3% to 5% of the building value. There is little point including them in your replacement cost unless your policy contemplates compensating you for them. Most policies however are silent on the issue and by default include them in the insurable value. It is a good idea in any event, to include them in your coverage if your replacement building is not to be of identical design, or in the same location as the structure destroyed by the fire. Your policy may allow you to locate your replacement building on an adjacent site.

If you suffer major damage, a likely event because of

smoke and water, if not the fire itself, your insurer will almost certainly check that you are adequately insured. The co-insurance clause in your policy is designed to discourage under insurance by ensuring that you bear part of the risk if you are underinsured, even if you suffer only a partial loss. For example, if your property has a replacement cost of \$1.0 million, but is only insured for \$0.7 million, the total amount paid out by your insurance company on a policy with an 80% co-insurance clause, assuming a \$0.5 million loss, would be as follows:

$$\frac{\$700,000}{80\% \times \$1,000,000} \times \$500,000 = \$437,500$$

If you own a heritage building, you may be particularly vulnerable to the co-insurance provision because the building materials may no longer be available locally ... may even have to be shipped from abroad. So if the building's walls are constructed of granite, ironstone, sandstone ... or the floor and roof timbers are of massive construction, it may be cost prohibitive or physically impossible to re-construct the property with the same materials. In these circumstances it may be wise to secure an endorsement to your insurance policy clarifying that materials that are capable of performing the same function will be deemed to be of "like kind and quality" if the original materials are not readily and economically available.

If your building was erected before 1990 it is very likely that changes in the building code, by-laws, etc. will preclude you replacing the fire damaged structure as presently constructed. For example, the by-law may require a sprinkler system in an apartment building. Your insurer will only compensate you on a Replacement Cost New basis if you replace the building. If you do not do so, you will only be compensated on an Actual Cash Value basis. If you want to ensure that your insurance will fully fund a replacement building, you need to carry sufficient insurance ... and obtain an endorsement acknowledging that your policy covers you for the upgraded replacement building.

### Actual Cash Value

Due to changes in the municipal zoning by-law it may be legally impossible to rebuild a fire damaged structure, e.g. because the existing use no longer conforms with the use now permitted on the lot. Since you are unable to rebuild, your insurance company will only compensate you on an Actual Cash Value basis *even though* you may be insured on a Replacement Cost New basis.

Actual Cash Value (ACV) is defined as "Replacement Cost New (RCN) less depreciation". Unfortunately there are three types of depreciation: physical,

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functional and external. Deduction of all three from Replacement Cost New produces Market Value ... which can also be computed by ascertaining the market value of the property and deducting therefrom the value of the land: the residual is the Market Value of the building. Court decisions on Actual Cash Value are ambivalent and appear to be case specific rather than enlightening, flip flopping between "Replacement Cost New less Physical Depreciation", and "Market Value". In general however the Court decisions appear to be guided by a reluctance to select the definition which will impose financial hardship on the insured. Increasingly too, insurance companies appear to be plumbing for the "Replacement Cost New less Physical Depreciation" formula, but it would be unwise to book your world cruise until the claim is settled. You can shorten the odds by ensuring that your building is valued on the basis of Replacement Cost New less Physical Depreciation *when you place your insurance*. This should foreclose any attempt by your insurer to opt for the Market Value standard in the event of a claim.

### Building Costs

The three most common methods of calculating Replacement Cost New are (1) to guess, (2) get somebody to guess for you, and (3) use last year's guess and add 2%. All are cost effective provided that you do not guess high ... or have a fire. For those of more scientific bent, we suggest accompanying the exercise with a silent plea to the Almighty. We, on the other hand, rush around with laser measuring equipment, hard hats, work boots and serious expressions recording everything that does not move. We then feed this building data (and the occasional civil servant) into our costing system. Since we are not only serious but suspicious too, we periodically test our system against local construction costs for calibration purposes, and to verify its accuracy. Once we have your building's specifications in our system, we can run annual updates, very inexpensively ... unless you have altered it of course, in which event we rush around with laser measuring equipment, hard hats, work boots, etc. etc.

Our fire insurance valuations are conducted in accordance with our ISO 9001:2000 registered quality management system. We are the only firm undertaking this type of work that is so registered in Atlantic Canada. We have systems in place to ensure that we produce work of a consistent, high quality ... and systems in place to ensure that we do not deviate from the systems in place ... and audits in place to ensure that we do not cheat. We really are very serious people, seriously.

### PAMST<sup>TM</sup>

If your property is enrolled in our PAMST<sup>TM</sup> Property

Tax Manager program we will have the building specifications and measurements in our Compuval<sup>TM</sup> database. We pass the benefit to you in the form of a 10% fee discount.

For more information on Fire Insurance visit our web site [www.turnerdrake.com](http://www.turnerdrake.com) and follow the links (corporate site → products → counselling → fire insurance) or call Patti Farewell at 1-800-567-3033 (429-1811 in HRM), and ask for our Fire Insurance brochure.

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### NOW, WHICH KNOT WAS IT?



Congratulations to our Nigel Turner for raising \$1,025 for the Easter Seals campaign. He and sixty four other participants raised a total of \$85,000 by rappelling down the side of 1801 Hollis Street, a twenty two storey office building in Halifax's Central Business District, on 3rd June 2005.

This is the third year that CREIT, the building's owners, have organised the event which this year will take place in seven cities countrywide. Halifax kicked off the program this year; Winnipeg and Toronto will follow in August; Calgary, Moncton, Victoria and Vancouver participate in September.

Participants and sponsors can register online at [www.thedropzone.ca](http://www.thedropzone.ca).

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### ANOTHER MARATHON!

Congratulations to Giselle Kakamousias, the Manager of our Property Tax Division on the successful completion of yet another marathon, admission into the prestigious Royal Institution of Chartered Surveyors (RICS).

Founded 136 years ago, the RICS is the world's premier organisation of property professionals, with 110,000 members practicing in 120 countries. The RICS has accredited 400 degree level courses

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Giselle Kakamousias, B.Comm., MRICS, AACI

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worldwide including, in North America, degrees at Clemson, Columbia, Cornell, University of Florida, Georgia Institute of Technology, Georgia State, MIT, Texas A & M, UNB and the University of West Indies.

Giselle is the third member of our professional staff to be admitted to the RICS.

For more information on the RICS, visit their web site at [www.rics.org](http://www.rics.org) and RICS Canada at [www.rics.org/Canada](http://www.rics.org/Canada).

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## BROKERAGE DIVISION

**Oh Hell. Sell!**



Jupiterimages

Our Brokerage Division assists property owners sell or lease their industrial, commercial and investment (ICI) real estate. Our primary area of operations is Nova Scotia, specifically HRM and its

environs within a radius of 100 kilometres. Increasingly however we are asked to provide our ICI brokerage services in New Brunswick and Prince Edward Island.

We also represent firms and individuals who wish to acquire ICI real estate or relocate to new premises. Since the fee for doing so is usually recouped from the vendor or landlord we have structured our contractual relationship so that these fees are paid instead to our client, the purchaser or tenant ... and they in turn pay us out of the proceeds. We have done so to prevent any conflict of interest, perceived or real ... but it also has the happy result that the purchaser/tenant retains part of what would normally be the brokerage commission. We cannot claim that this type of contractual arrangement is unique, although we are not aware of its existence elsewhere.

### A Bubble?

Property markets are awash with money: there is a surfeit of purchasers and a lack of vendors. Both are driven by the same imperatives, a lack of investment opportunity in the stock market and cheap money. These two factors appear to render real estate an attractive investment vehicle. How times change! When property markets collapsed worldwide in the late 1980s, following the failure of the Thai Batt (*Newsletters Vol. 2 Nos. 65, 66, 67*), investment real estate ranked in popularity with the black plague. Now it has replaced the IT sector as the investor's darling. Those that forget their history are destined to repeat it. Is the bubble about to burst?

Our continuing poll of property owners discloses strong demand to purchase more real estate, and a reluctance to sell. The most compelling argument fuelling the "not sell" rationale is the lack of investment opportunity in the stock and money markets. Yet sale prices are driven by purchasers willing to accept little or no return on their equity investment out of current income. There is little rental growth, at least in the Halifax Regional Municipality (HRM) for most market sectors ... and there are major forces in play which have, and will increase operating costs. Fire insurance

rates in Atlantic Canada have risen by 150% since 2001 (*see our Fire Insurance article in this issue of Newsletter*). Electrical costs have already risen by 6.1% this year (in April) and the Nova Scotia Power Corporation has now applied for a further 15% increase for residential customers, and increases of a similar magnitude for other users, to cover its soaring cost of fuel oil, coal and coke. The major investment properties in HRM can expect their assessments to increase substantially (60% in some cases) when Service Nova Scotia again loses its appeal of the Homco case (*see our "On The Level" article in this issue of Newsletter*). HRM's Mayor, Peter Kelly seething earlier this year (*Newsletter Vol. 2 No. 78*) at the Province's Bill #74, which he alleged would cost the Municipality \$600,000 annually in lost taxes, as a result of the break it afforded Imperial's Dartmouth Oil Refinery, is unlikely to be thrilled with the tax revenue sacrificed to date by Service Nova Scotia's (SNS) incompetence and will expect the situation to be rectified without further delay. (*SNS continues to assess Purdy's Wharf, the municipality's trophy office complex at \$73 million, and defiantly ignoring the recent Utility Board decision, proposes to assess it at just \$78 million next year ... O & Y REIT has just sold their 47.5% interest to their co-owner in the property Great West Life, for a reported \$63 million. HRM loses \$2.3 million per annum in property taxes from this property alone*). It is likely therefore that net return on equity will continue to decline in future years and investors will continue, as they have during the past five years, to rely on capital growth to provide the major portion of their return on investment. By any definition that is a bubble. In our view that particular party is almost over. Time to sell!

(To be continued in the next issue of Newsletter ...)

For more information on our Brokerage Division visit our website [www.turnerdrake.com](http://www.turnerdrake.com) and follow the links.

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