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BRIDGING THE GAP

Turner Drake

A Canadian's home is his castle … fortunate then that most are blissfully unaware of the precarious nature of their "ownership", held as it is at the whim of the Crown. At any time the Federal or Provincial Governments, or any body designated by them, may decide to exercise that whim and regain ownership. Sometimes they will compensate the property owner: often-times they will not, though usually this occurs when they abrogate only part of the bundle of property rights that, in total, constitute property ownership. The latter often occurs when the Government imposes planning controls, rezones the property, or moves the serviceable boundary … as hapless owners in the Halifax Regional Municipality are now finding out to their cost. Property ownership today is dynamic; protection of property rights is *not* embodied in the Canadian Charter of Rights and Freedoms so it is necessary for owners to aggressively defend the rights they do have by virtue of statute or common law. Vigilance should be the order of the day! Yet most property owners are passive, anxious to co-operate, willing to subjugate their own interests to the common good, quietly confident that they will be treated fairly by any government department needing their property for a new road or redevelopment scheme. In our experience, this confidence is rarely warranted. With the possible exception of the Federal Government, most acquiring authorities conduct their activities based on a strategy of minimising their own inconvenience and cost. No more so is this in evidence, than in New Brunswick. There, the Department of Transportation disports itself in a manner that is often opaque, frequently misleading and at times, threatening. Pity the poor property owner! It is our job to bridge that gap. We currently have two teams working for private property owners in the province, both led by Chartered Surveyors (Fellows of the RICS) and accredited appraisers. Lee Weatherby, a veteran with twenty nine years experience of expropriations, and an outstanding expert witness, is working for owners affected by the twinning of the Trans Canada Highway between Grand Falls and Edmundston. He is assisted by colleague Charlie Dunn. That team is also working for owners affected by the

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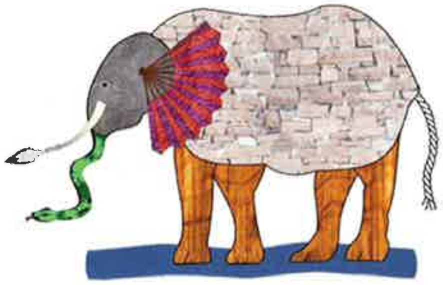
Gunningsville Bridge project in Riverview. Mike Turner assisted by colleague Nigel Turner, is advising owners impacted by the Woodstock to Perth Andover section of the Trans Canada Highway realignment. Mike too is an expropriations veteran and an experienced expert witness.

Beware of Strangers Bearing Gifts

When the acquiring authority first approaches you to open negotiations for the purchase of part, or all, of your property, rarely will they mention the word "expropriation". They may not be motivated solely by a desire to spare your feelings. The Federal and Provincial Expropriation Acts may be draconian in their powers, but they do have many redeeming features. They establish the legal framework within which the acquiring authority is obligated to act … and that framework is designed to protect *your* rights. The Acts usually stipulate too that the expropriated party is entitled to the protection and support afforded by proper legal, real estate and other professional advice. Unfortunately, the cost of that advice is not borne by the acquiring authority *unless* your property is expropriated. Nor are you legally entitled to the other protection afforded by the Act *until* your property is expropriated. Previously, we had advised property owners that they should proceed to negotiate so long as the acquiring authority committed itself, in writing, to afford the property owner all the rights and privileges conferred by the Expropriation Act. Based on our experience with the New Brunswick Department of Transportation, we no longer believe this to be sound advice. It is our opinion that property owners should not rely on such assurance, and should instead refuse to negotiate until their property has been formally expropriated … only then will they enjoy the security afforded by our court system. Property owners have a natural tendency to assume that the acquiring authority will act in their best interest … or at the very least treat them fairly. This sometimes happens, but in our experience it is the exception, rather than the rule. It would be wise not to take any promise by any acquiring authority at face value ... even if it is in writing. Nor should you assume that the person negotiating with you is knowledgeable in real estate or your business … or that any appraisal which accompanies their offer of compensation bears any relationship to your loss. It is common practice for the acquiring authority to commission a "baseline" appraisal, particularly in rural areas. The NBDOT does so, as do other bodies such as the gas pipeline companies. The purpose of a baseline appraisal is to establish the "average" land value along the route of the new highway or pipeline. These appraisals ignore depreciation in property value due to, for example, "injurious affection", *usually the most substantive part of any claim.* Yet the acquiring authority may utilise their baseline appraisal figure to demonstrate the "reasonableness" of their offer, which will usually be in excess of their "average" land value and often be in excess of its market value where only part of the property is being acquired. The gloves usually come off if the property owner requests that the acquiring authority commission a "property specific" appraisal to address the actual loss suffered by that particular property. We are told that the usual response to such a request is a warning that it may result in lower compensation than that already offered. If the property owner persists, the acquiring authority will then commission an appraisal from a private company. *However it is NBDOT's practice to place constraints on the assignment, and thus preclude the private appraisal firm from considering all of the items which are properly compensable under the Expropriation Act.*

Different Perspectives: Different Conclusions



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In our view NBDOT's policy of restricting their appraisal reports to a consideration of only part of the loss, is at best misleading, and may result in an erroneous conclusion for the loss that was calculated. The New Brunswick Act, sharing as it does a common heritage with the other Provincial and Federal Expropriation Acts, provides compensation for losses suffered under any or all of the following headings:

(a) the *market value* of the land.
(b) damages attributable to *disturbance.*
(c) damages for *injurious affection.*
(d) any *special economic advantage.*

NBDOT instructs their appraisers to consider only Item (a) and part of Item (c) i.e. *"the market value of the takings and any loss in market value to the remaining lands".* Most, though not all, of the appraisal reports are careful to spell out this constraint. However many property owners, lacking expertise in expropriation law and valuation, fail to appreciate that other losses have been ignored. Worse, the constraint may colour the appraiser's conclusions since the losses are interrelated … somewhat akin to the individual conclusions reached by the six blind men given access to different parts of the same elephant … This is not to imply that the private sector appraisers are biased but rather to suggest that NBDOT's policy is misguided and frequently misleading.

We recommend therefore that you carefully check that any appraisal report tendered by NBDOT addresses all heads of claim. If, as is likely, it does not, insist that they provide you with a new appraisal report under the terms of reference contemplated by the Expropriation Act. They have a statutory obligation to do so.

Market Value

If they only want part of your property, NBDOT will probably over-state the value of the land they are taking, hoping that you will accept their offer, and perhaps overlook, or fail to appreciate, that you have suffered other losses. They may indicate that a property specific appraisal will indicate a lower figure for the land (as indeed it might) and thus attempt to dissuade you from insisting on it. However if you have suffered other losses, chances are they will far outweigh their over-appraisal of your land. Make clear to NBDOT that their appraisal has to include *all* heads of claim. We suggest

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you commit this concern to paper and make it clear that NBDOT have a statutory obligation to provide a complete assessment of your losses resulting from the expropriation.

Disturbance

This is payable to occupiers, be they owners or tenants, and covers removal and relocation costs, both residential and business. However in the case of a business relocation, the losses cannot be assessed until the business has relocated and been in operation for nine months, or until two years has elapsed since the expropriation, whichever occurs first. If the business cannot be relocated because, for example, the owner is too old to start afresh, or no suitable property is available, compensation will be based on the total extinguishment of the business. The purpose of this head of claim is to compensate the occupier for any loss which arises by virtue of the forced sale and would include, for example, expropriation of part of a farm. *The appraisal reports commissioned by NBDOT exclude consideration of disturbance loss.*

Injurious Affection

Injurious affection occurs when part of the land is expropriated and includes (1) the reduction in value of the remaining property and, (2) personal and business losses resulting from the construction on, and use of, the property acquired.

The reduction in value to the property remaining after the expropriation is usually substantial, far outweighing the loss of the land itself. A new road severing an established farm will severely disrupt the economic unit: farm buildings will no longer be as accessible, land adjacent to the highway may be susceptible to salt damage, drainage patterns may be disrupted, fields may no longer be of optimum shape or size, woods roads may have to be relocated, pasture land lost to the highway may have to be replaced by cultivated land, productive land will be lost permanently to the additional headlands, and so on.

The business loss too can be extensive. The loss of productive land will cause injurious affection to the fixed assets such as potato and grain storage, outbuildings, and farm machinery, because it will render part of them surplus. Whilst the actual loss will vary by farm unit, it is apparent from our research that an investment of between \$1,250 to \$2,000 per acre is usual. *The appraisal reports commissioned by NBDOT exclude consideration of personal and business damages despite the fact that they are codified in the Expropriation Act and are well recognised in case law (Berry et al v. The Queen. Land Compensation Board, Alberta, March 8, 1979).*

Special Economic Advantage

The Expropriation Act provides that owner occupiers may be compensated for losses that are not reflected in the market value of the land. In order to be compensable, Special Economic Advantage must be (a) special, (b) economic and (c) arise out of use and occupation. The 1957 Supreme Court of Canada decision *"Gagetown Lumber Co. v. R."* is the leading case and illustrates it well. The Crown expropriated timber limits owned by an established logging company which had a mill located in the vicinity. The Court decided that the timber had greater value to the owner because they owned the nearby mill. A similar situation pertains with land that has been farmed by the owner occupier for a number of years. Because the land has been worked by the same family for a length of time, sometimes generations, they are intimately aware of its characteristics and can work it to the best advantage. Land forming part of the existing farm unit is therefore more valuable to the present owner occupiers than similar quality land available for purchase, because they are familiar with it. This is known as the "endowment effect". *The appraisal reports commissioned by NBDOT exclude consideration of Special Economic Advantage despite the fact that it is codified in the Expropriation Act and is well recognised in case law.*

*For more information on Expropriation visit our web site **www.turnerdrake.com** and follow the links (corporate site → products → counselling → expropriation).*

PROPERTY TAX DIVISION

Service New Brunswick Looses it, Again … and Again, and Again!

Fotosearch

Great news for property owners in New Brunswick and Nova Scotia. On June 30th 2005, the Court of Appeal of New Brunswick ruled that the 15% HST should **not** be included in the assessed value for property tax purposes. This was an appeal of a 2004 Court of Queens Bench decision *(Newsletter Vol. 2 No 77 Oh Lord! Benched Again!)* which had ruled too that HST should be excluded from the assessed value. That in turn was an appeal from an Assessment and Planning Review Board decision that, you guessed it, HST should not be included in the assessed value. Service New Brunswick, the Provincial assessment authority, was the appellant in the Court of Queens Bench and Court of Appeal cases and costs were awarded against them each time. In all three cases, the Court took the unusual step of emphasising that the inclusion of the HST in the assessment was "an affront to common sense". (HST like GST, is a "pass through" tax). Are the Courts trying to convey some sort of message here? This is just the latest in a series of scathing Court decisions that have lambasted Service New Brunswick. Can we now expect their Director of Assessment Mr. William Morrison, and their Manager of Valuation Mr. Gerald Carroll, to do the honourable thing and fall on their swords? We hope so: or should we expect instead that Service New Brunswick will obfuscate? Instead of rising to the occasion by correcting their erroneous assessments will they attempt to circumvent the Court of Appeal decision and refuse to reduce assessments that include HST, on the grounds that they are still below the market value benchmark mandated by the Assessment Act? Surely not! Some

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properties will then continue to carry the burden of the HST in their assessment (effectively a "tax on tax") whilst others will not …

Could Service New Brunswick get away with such a sleight of hand? Probably: most properties in the province were assessed by guess and by golly, the so called "mass appraisal" approach. Not so heavy manufacturing properties however! They were appraised on an individual basis, many by a private firm under a proposal call which required that each property be appraised in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP). These appraisals were thorough, every brick and stick was counted and recorded in meticulous detail in reports that typically ran to 1,000 pages each! Service New Brunswick were so confident of the integrity and accuracy of the results, they provided one copy to each property owner, an action we applauded as "a commendable display of transparency" *(Newsletter Vol. 2 No. 74)*. The assessments thus derived did in some, perhaps all cases, include HST. It will be easy therefore to correct these assessments to reflect the Court of Appeal decision. Less easy for SNB to pretend that these assessments were non-compliant with the Assessment Act because SNB's contractor had appraised them below their market value.

Commonsense being notable by its absence in Nova Scotia too, the assessment authority there, Service Nova Scotia (SNS), continues to insist that HST must be included in the assessed value … but only for some properties. Despite the New Brunswick decisions, and a ruling of the Nova Scotia Regional Assessment Appeal Board, SNS continue to include the HST and have signalled their intent to have the matter heard by the Supreme Court of Nova Scotia.

Taxmaster Turmoil

In our experience property owners are prepared to tolerate taxes provided that, (1) the tax burden is not too excessive, and (2) it is distributed equitably: tax avoidance is rarely the motivator for an assessment appeal. The private sector's good humoured acceptance of its responsibility to shoulder its proper share of the municipal tax load implies, and is dependant upon, a similar level of integrity by the public sector since the latter are charged, for the moment anyway, with determining how the tax burden is distributed. Manoeuvres such as Service Nova Scotia's attempt to "cook the books" *(On The Level, Newsletter Vol. 2 No. 80)* strip the process of all credibility and should in our view, result in the forfeiture of their role as the assessment authority. Similarly the reluctance of Service New Brunswick to accept the Court of Appeal ruling that HST must be excluded from the assessed value deserves careful scrutiny (a senior SNB civil servant advised us this month that the Court was "wrong" and implied that only magnanimity had prevented them proceeding to the Supreme Court of Canada on the issue … despite the fact that three levels of appeal had concluded SNB's inclusion of HST was an "affront to common sense"). If Service New Brunswick attempts to circumvent the Court of Appeal decision by refusing to remove the HST, and instead re-assesses the property at a "market value" absent the HST, but which by happy coincidence equates to the prior value including HST, they too must surely forfeit all credibility in the eyes of provincial taxpayers. Time will tell … we'll keep you posted.

For more information on Property Tax visit our web site ***www.turnerdrake.com*** *and follow the links (products → property tax → appeals). If you are a client we can keep you informed of the changing property tax landscape, and critical dates, through our free Action Alert! email service. Action Alert! bulletins can also be accessed through your personal Client Area.*

COUNSELLING DIVISION

In Demand, We Supply

JupiterImages

Real estate development in Atlantic Canada has been characterised by booms and busts: short explosive bursts of supply fuelled by easy access to finance, frequently followed by falling prices as an oversaturated market struggles to absorb the new space. So what! This is characteristic of real estate development virtually everywhere. Ah, but the situation is exacerbated in this region because our markets are "thin" and unforgiving of miscalculation. In larger urban centres, population and economic growth rapidly absorb excess supply; the markets find equilibrium faster. The Halifax Central Business District (CBD) office market is a chilling example. There is a strong correlation between growth in real G.D.P. (i.e. G.D.P. expressed in constant dollars) and demand for office space. In fact 87% of the change in office demand can be explained by the change in real G.D.P. *(Newsletter Vol. 2 No. 49 Temples to a Dying Deity?)*. Office supply in the Halifax CBD exploded through the 1980s; the inventory increased from 2.67 million $ft.^2$ (1981) to 4.80 million $ft.^2$ (1991), a 2.13 million $ft.^2$ increase in supply during a period when demand increased by just 1.75 million $ft.^2$. New supply came to a virtual halt in 1990, following the onset in 1989 of a four year economic recession *(Newsletter Vol. 2 No. 72 When Time Stood Still)*. Although there has been only one recession since, in 2002, and that was short lived, the

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office market has never been able to shake this surplus space "overhang". Some buildings have been converted to residential use, there has been no significant new building, yet market rents still fall short of their 1989 peak. Why? We have had good G.D.P. growth since the start of the new millennium. Part of the explanation lies in changing work habits; cell phones, computers, email and fax machines make it easier to work from home. Space requirements per employee have also declined, and information technology has supplanted face to face contact making mobility more important and rendering suburban locations, especially in industrial parks, more attractive and siphoning off demand that would otherwise be captured by the CBD. A thin market has become even thinner. No need for the Atkins diet here!

We have watched too, with some sense of déjà vu the scene unfolding before us with condominium apartment construction. During the 1980s Atlantic Canada, especially Halifax Regional Municipality (HRM) as it is now, welcomed a cornucopia of condominium construction. Alas those hopes were wrecked too on the shores of the 1989 recession. In small towns in Atlantic Canada the first albeit modestly sized condominium project was often a roaring success; the follow up project a dismal failure. Even in the largest urban area, the City of Halifax, the first projects quickly skimmed off the demand leaving little for those that followed. The subsequent recession dealt the body blow. After falling back steeply in the early 1990s, prices started to recover in 1995, and escalate in 2000. They were unfazed by the 2002 recession. However, because condominium purchase financing is often backstopped by CMHC a.k.a. the Canadian government, their supply is not subject to the same financial discipline and fiscal constraint as other types of real estate. Whilst demand may be caused by low interest rates and the influx of the baby boomers into the empty nester market, that situation will change drastically when these demand generators have run their course.

It is with these and similar weighty matters in mind that we have decided to sharpen the focus of our Counselling Division's market analysis (supply and demand) survey service. Our new Economic Intelligence Unit (EIU) blends Economic Base Analysis with Empirical Research.

Economic Base Analysis

We utilise data mining software and advanced statistical techniques to explore, sift through and uncover trends in economic, psychographic and industry specific data … and then use this information to build econometric forecasting models. Successful model building is a blend of statistical and real estate expertise. It is an interactive process in which each model is designed, built and tested for accuracy and reliability against known outcomes. Then it is tweaked again and again to produce the best fit. After the model is deployed as a forecasting tool, the outcomes are measured against real estate industry norms to ensure that they are reasonable.

Empirical Research

A thorough market analysis requires that we "kick the bricks" by measuring the success or failure of other competing developments. It allows us to test how the type, scale and mix of development suggested by the Economic Base Analysis will perform under current market conditions by comparing the subject property with other competing properties, recently completed.

Market Feasibility

If you are contemplating erecting a building and would like a critical analysis of the type, size, amenities, pricing and market absorption for the finished space … one call does it all.

*For more information on Market Surveys visit our web site **www.turnerdrake.com** and follow the links (products → counselling → market surveys) or phone Patti at 1-800-567-3033 (429-1811 in HRM) and ask her to send you our Urban Market Econometrics brochure.*

BROKERAGE DIVISION

Oh Hell. Sell! (Continued from last Newsletter)

Last year, investors in the United States, pumped $7.0 billion (USD) into Real Estate Investment Trusts (REITs), nearly double the amount they committed in 2003. Opportunities are now so scarce there, even small investors who prefer to purchase real estate directly, are looking for opportunities here in Atlantic Canada, swelling the army of local entrepreneurs actively seeking to purchase property. Canadian REITs, and pension plans including foreign funds are scrambling to invest in the region's real estate. It has the same aura as the feeding frenzy of the 1980s. That was followed by the market meltdown in 1990 and the exit of many pension funds from real estate. Yet this time it is different; right? As the leading edge of the baby boomers reaches retirement age, this generation with its longer life expectancy and active life style, needs to put their investments to work for the long term. And they are rich! In America 60% of the economy's investment assets are now controlled by the over 60s. Our Canadian Pension Plan (CPP), its apron strings severed from direct government control, has started to pour funds into real estate. In July 2005 it invested $1 billion (Cdn.) into eleven office buildings, a portfolio it jointly owns with Oxford Properties, the real estate arm of the Ontario Municipal Employees

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Retirement System (OMERS). In July it was part of a consortium led by Brookfield Properties, to purchase the 25 office building portfolio owned by O & Y Properties and O & Y REIT. CPP provided 50% of the equity for the $2 billion (Cdn.) offer. (As at March 31st, the CPP reserve fund had assets of $81.3 billion).

Investor demand is driven by the requirement for consistent annuity type returns, capital growth, portfolio diversification, tax shelter (in some cases) … and the lack of attractive investment opportunities in the stock and money markets. Most real estate markets in Atlantic Canada are not experiencing strong rental growth: property prices have surged because purchasers are accepting lower yields. The latter are now at historic lows. Interest rates are now increasing, the consequence of buoyant economies here and in the United States. Have prices peaked? We believe so in many markets. Inflation is low and rental increases are struggling to match climbing operating costs, primarily insurance, real estate taxes, fuel oil and electricity. In determining which markets have peaked and which have life left in them, it is instructive to view each from the viewpoint of their main purchaser demand: *owner occupiers, local investors* or *national/international investors.* Although all three are bound by the common thread of low interest rates … which in turn is a function of the (mainly) Chinese appetite for U.S. Treasury bonds … they are otherwise driven by divergent imperatives.

Owner occupier demand for real estate is dictated by the performance of their respective business enterprise which is usually industry specific and is reliant on the buoyancy of the economy. (There are exceptions, some industries perform best during a faltering economy, for example liquidators, but they represent but a small portion of overall demand). A key determinant of the present buoyant economy is low inflation and that in large part is concomitant on cheap imports from the emerging economics of China, India and Brazil according to a recent analysis by The Economist. They in turn are threatened by a rising tide of protectionist sentiment, especially in the USA, as Canadian softwood producers have recently discovered to their cost! The performance of owner occupied type real estate rests therefore with the expansion of the emergent economies, especially China … and is threatened by trade barriers raised by the European Community and especially the United States, and the rising price of oil.

Local Investors run the gamut, from individuals owning a single rental property, usually an apartment house, to regional companies. Many of the latter were wiped out during the 1990 market meltdown, but we have witnessed a resurgence of local companies during the past ten years and they again form an important part of the investment scene in Atlantic Canada albeit in a much reduced role than formerly. They are innovative, flexible and attuned to local conditions. They provide the majority of market demand for rental properties in the under $3.0 million price range.

National/international investors include "home grown" companies such as Killam Properties Inc. and Summit Reit; but this sector is usually dominated by investors domiciled outside Atlantic Canada, often opportunistic purchasers who moved in to pick up the pieces in the early 1990s after the market meltdown, usually at prices discounted by 50% to 70% from their 1989 peak. (Industrials lost 44% of their value; hotels 50%; CBD offices 55%; apartments 5% to 10% on Halifax Peninsula, 30% to 50% elsewhere in HRM; Neighbourhood shopping centres 35%, Community shopping centres 55%). Led by outside investors, prices started to recover in hotels/motels (1995), apartments (1997), industrials (1997/1998), offices (1998) and retail (1999). Local investors were decimated by the market meltdown; this was after all a province where property prices had steadily increased year after year for at least thirty years. However they have now regrouped and battle it out with the national/international investors for property priced between $3.0 to $5.0 million. The latter however dominate the over $5.0 million market.

The following analysis applies to the Halifax Regional Municipality (HRM) and is directed to property owners who do not intend to hold their property for more than 10 to 15 more years.

Apartment Buildings fall into two main markets based on "size", and several sub-markets dictated by "location". Broadly speaking demand for ≥ 50 unit buildings is driven by *national/international* investors: private companies such as Toronto based TransGlobe which in June purchased the 600 unit Bell family portfolio in North End Dartmouth, and which reportedly is now acquiring the 500 plus unit Causeway Bay Towers on Halifax Peninsula; public companies such as Killam Properties Inc.; and the Real Estate Investment Trusts (REITs).

Properties < 50 units tend to be the domain of *local* investors, primarily individuals or groups of individuals. However *national/international* investors also compete for these properties if they are proximate to their existing holdings.

Demand is strong in both "size" markets, and in all "locational" sub-markets apart from Spryfield. In our view the current prices leave no upside potential. Rent increases struggle to match the inflation rate and fail to recoup increases in insurance, property tax, fuel oil and electrical costs. Capital values have been increasing only because mortgage interest costs are low and demand has forced down yields (all cash yields for modern property in Peninsula South, HRM's premier rental location, are now down to 7.9%). Vacancy rates are rising (2005 > 3.0%, 2004 2.9%, 2003 2.3%). In our opinion the apartment market has peaked and prices will decline concomitant with increases in mortgage rates, or an improving stock market. Apartment buildings located in neighbourhoods where development sites are available are at greatest risk because CMHC, a government agency, backstops the financing of new construction through mortgage insurance. Supply of new product increased in the past even as vacancy rates increased, because financing was still available. **Sell!**

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

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