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TURNER DRAKE & PARTNERS

Real Estate Counsellors, Brokers & Valuers

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Newsletter

INVESTMENT PROPERTY: SHIFTING SANDS

"Those who do not remember the past are condemned to repeat it"

- George Santayana

Shifting Sands

Income producing real estate matured into an alternative investment vehicle to the stock market in the United Kingdom in the 1960s. Continental Europe came of age during the 1980s. The trend gained traction in North American during the late 1970s and early 1980s. Then came the market meltdown, which occurred in Canada in 1990. This traumatic event resulted in the exit, voluntarily or by bankruptcy, of individual investors (limited partnerships, property companies), pension funds, life insurance companies, banks and trust companies. They abandoned the property market with the same fervour they had exhibited in embracing it a decade earlier. During the 1990s real estate was greeted with the type of enthusiasm normally reserved for the black plague. Then the twenty first century dawned, and everything changed (again!). Real estate became the vehicle of choice, and investors rushed back into the property market. Late last year however Banquo's ghost appeared at the feast: a chill wind started to blow as credit dried up. Property investors cast nervous looks over their shoulder at their Wunderkind. Are they correct: will we once again face market meltdown hysterics? We have been active participants in this three decade drama. In this article we explore the events which precipitated the 1990 property crash, we review its aftermath and examine the explosion of investment activity which greated the new century. We then draw upon this experience to forecast the future. Hang on tight, the last thirty years have been a wild ride, an exotic cocktail of hope, frustration, despair, anticipation, excitement and dread. Join us on our magic carpet as we ride the winds of change through the dying days of one century into the dawn of another.

The Past Past

Following Ronald Reagan's election to the Presidency of the United States in 1980, that country embarked upon tax cuts and financial deregulation, policies designed to stimulate the economy by unleashing the country's entrepreneurial drive. Gross domestic product

(Continued on page 2)

IN THIS ISSUE

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(Continued from page 1)

grew by $3,013.6 billion during that decade versus $1,751.0 billion for the decade earlier. Much of that money was invested in real estate, particularly home ownership, following the deregulation of the Savings and Loan industry in 1982. Unfortunately lax, or non-existent underwriting standards, incompetence and fraud became the order of the day. More than 1,000 Savings and Loans Associations subsequently failed in what economist John Kenneth Galbraith called "the largest and costliest venture in public misfeasance, malfeasance and larceny of all time". Between 1986 and 1991, the number of new homes constructed dropped from 1.8 million to 1.0 million, the lowest rate since World War II. Faced with the collapse of its financial system the United States' government formed Resolution Trust in 1989 to take over the worst loans. In total the crisis cost America $160 billion, of which $124.6 billion was paid by their taxpayers. The financial crisis and the construction slowdown contributed to the 1990 recession.

American exuberance during the 1980s spilled over the border into Canada. Here the Trust Companies embarked on a program of expansion into residential real estate, often purchasing residential real estate brokers to provide a conduit for their loans. It was a marriage made in heaven, their real estate sales brokerage company reaped the commission on the houses they sold, and had ready access to mortgage funds to facilitate their sales. Their parent had a captive market for its loans. Nor did the Trust Companies confine their activities to residential mortgages: they enthusiastically competed with the banks and life companies to place commercial mortgages. In one infamous case, a property company called Cadillac Fairview sold 11,000 rental units in Toronto to Greymac Credit Corporation for $270 million: they immediately flipped them to Kilderkin Investments Ltd. for $312.50 million...who promptly "resold" them to 50 numbered companies for $500 million. $152 million of financing was provided by a triumvate of trust companies: Crown, Seaway and Greymac (there was an existing first mortgage of $110 million when Cadillac Fairview sold the property and they supplied a vendor take back mortgage of $113 million). The owner of the trust companies and the mortgagors involved in the $152 million flip financing were related parties. Ironically the alarm was raised by the tenants, afraid their rents were going to increase; rather than by the trust companies' depositors. The Provincial and Federal Governments stepped in to protect the depositors. By the Fall of 1987 our Newsletter was resignedly reporting that "yet another Trust Company has gone bankrupt", and by the end of the decade trust companies that had been household names for decades had failed financially or had been absorbed by the major banks: the trust company industry as an independent entity had effectively disappeared. The stage was set for the 1990 property collapse.

We pinpoint May 1990 as the start of the real estate recession in Atlantic Canada, based on the reduction in sales volume and prices in the residential property market. (We've tracked this activity continuously since 1978). In reality however the commercial property markets started to feel the pinch in 1989 as credit dried up. This however was a worldwide phenomenon whose triggering event lay far offshore in Thailand. The baht, the country's currency, collapsed as a result of over exuberant property loans by its banks; the contagion spread to Japan, whose banks had exhibited similar malaise, and then around the world. Professors Richard Herring and Susan Wachter of the Wharton School, University of Pennsylvania produced a research paper in 1998 on the Asian Twin Financial Crisis. In it they noted that "one striking feature of the current Asian financial crisis is that the most seriously affected countries *first* experienced a collapse in property prices and a consequent weakening of their banking systems *before* experiencing an exchange rate crisis". (The dependence of the national economy on the banking system is acute in emerging nations since their banks hold over 80% of the total assets; or in present day Japan where they hold 79%, according to the good professors).

The Wharton study looked at real estate busts and bank crises in Sweden, the United States, Australia, Japan and Thailand. It found that while they can occur independently of each other, a collapse in property values is due to (1) a sharp fall in demand, or (2) a rapid rise in supply or (3) both of the foregoing. The study's authors found that the prime culprit was a rapid rise in supply fuelled by easy credit from the banking system, which continued long after rising vacancy rates should have signalled an over expansion.

The commercial property market collapse in Atlantic Canada in 1990 was no minor event. Hotels/Motels throughout the Region plunged in value, on average, by 50%. Industrial properties lost between 25% to 75% (average 44%) of their value if they were situated in Burnside, the region's largest park, located in Dartmouth, Nova Scotia. In Nova Scotia, the further one moved away from the Halifax/Dartmouth area, the greater the drop in value. Industrial properties located in places such as Amherst lost between 50% and 80% of their value. The office sector in Halifax Central Business District was devastated, losing about 55% of its value. The apartment market dropped 5% to 10% on Halifax Peninsula, 50% in Dartmouth's Highfield Park, and 30% to 50% elsewhere in Metro. Retail, shuddering under the twin impact of the recession and the growth in "big box" merchandising, also suffered badly. Some Shopping Centres fell in value by 35% (Neighbourhood) to 55% (Community). All this in a Region where, for at least thirty years, (and probably since the Great Depression) property prices had steadily increased, year after year. The banks ran for cover, investors felt betrayed, we questioned whether there was a God... and saved property owners millions of dollars in successful tax appeals.

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

PROPERTY TAX DIVISION

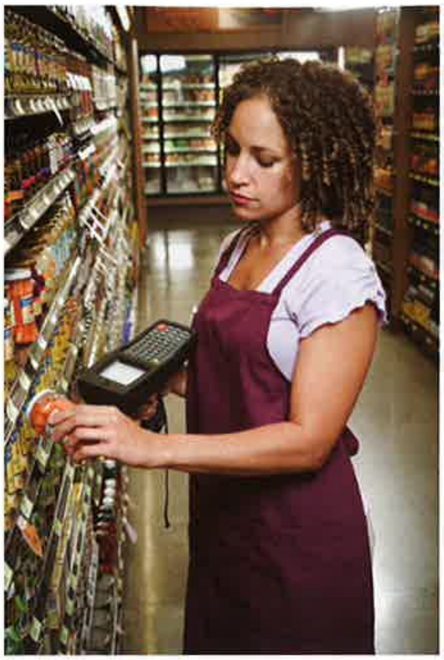
Opportunity Beckons

The 1990 recession was a time of great opportunity for property owners in Atlantic Canada: for the first time since World War II they were able to reverse their hitherto inexorable rise in property taxes. In many cases our Property Tax Division was able to halve our clients' tax load: a benefit that lingers these

(Continued on page 3)

(Continued from page 2)
eighteen years hence because timid Provincial assessment authorities have been loath to lock horns with us again. In this article we explore the property tax map across the Atlantic Region and suggest strategies you can employ to lower your tax load and curtail government excess.

Nova Scotia



© Fotosearch
($501,000/annum in tax savings)

Before they engage our services, prospective clients often utilise their own staff or engage a national tax consulting firm to minimise their property tax load, a strategy that frequently fails to germinate on the bureaucratic barrens of Atlantic Canada. Our Property Tax Division however have carefully cultivated their negotiating skills here among the wastes of provincial parochialism, civil service secrecy, arrogance and indifference. So when a national retailer retained us to tackle their property tax burden in Nova Scotia, we rose to the challenge. The client had utilized its own property tax staff to minimise their property tax load. They had worked hard, aggressively contesting and securing reductions in assessments. Could we secure additional tax savings? We went to work.

At the outset we contacted Service Nova Scotia, the provincial assessment authority, and requested that they assign a single commercial assessor to the project. We then embarked on a detailed inspection of every single property in the province wide portfolio. Property sales on which assessments are based, are not in the public domain in the Province and the assessment authority refuses to provide detailed assessment information on comparable properties. Secrecy and a "circle the wagons" mentality is all pervasive. Service Nova Scotia did however provide us with their calculations on the subject properties. We checked these calculations with the results of our site inspections to identify errors and omissions. We also attended the Registry of Deeds office in each locality to obtain the legal descriptions, including easements and other encumbrances on title. The site boundaries and easements were then mapped onto satellite and aerial photographs to identify impediments on title, access and circulation difficulties.

Our Compuval™ databases contain sales, assessment, physical, fiscal and photographic data on 39,000 Atlantic Canadian commercial property transactions, carefully compiled over the past thirty years. The information is geo-coded for easy reference and allows us to quickly compare assessments on a cross sectional and longitudinal (time series) basis. Using these databases we were able to benchmark our client's portfolio against a control group comprising two major competing chains.

During two weeks of negotiations with Service Nova Scotia, we successfully concluded appeals on all of the properties and produced incremental tax savings of $501,000/annum for our client. Although Service Nova Scotia re-assesses each commercial property in the province every year we anticipate that these tax savings will continue for the foreseeable future.

Property Taxes Again Leap Ahead

Commercial property taxes have leapt ahead of inflation again this year. This is partly a response to the shift of the Business Occupancy Tax from occupiers to owners during the phase out period (5 years for most properties). However municipal budgets are burgeoning: Halifax Regional Municipality (HRM) is expected to collect 6% more in property taxes from commercial property owners during the next 12 months, according to its recently struck budget. The waters have been further clouded by the propensity of the provincial government to strike deals with some large industrial property owners, outside the normal appeal process, to "cap" their property tax contributions. The remaining taxpayers have to pick up the resultant tax shortfall.

This year the provincial government instituted an "inflation cap" on residential assessments. We understand that the tax revenue lost is not meant to be recouped from the commercial property tax base, but if such is the case its impact will be to increase the tax burden on apartment buildings and homes that change ownership. Since it is the young who are more mobile, it is they who will bear much of the burden since their property will be effectively "re-assessed" for tax purposes each time it is sold. (If you are domiciled outside Nova Scotia you may perforce regard a policy which penalizes young homeowners as byzantine and bizarre, particularly in a province that is already losing its working age population at an alarming rate: presumably you live in a more enlighted tax jurisdiction). It would be prudent to assume that some of the tax revenue lost as a result of the "cap", will be recouped from commercial property owners.

The 2008 appeal period closed on February 11th so unless your property is enrolled in our PAMS™ Property Tax Manager program, or you have already filed an appeal, you are too late to curtail your 2008 property tax increase. However we hope to get a head start on your 2009 property taxes. Nine years ago the then Minister and Deputy Minister responsible for property assessment met with senior members of our Property Tax Division and agreed to publish a "pre-roll" in June each year, disclosing the following year's assessments. This mutually beneficial arrangement allowed us, and other taxpayers, to establish their assessments prior to the official assessment roll in December. Last year the provincial assessment department Service Nova Scotia (SNS) was transmogrifying into the Property Valuation Service Corporation (PVSC), a "not for profit" corporation owned by the municipalities. Since they were fully engaged learning to say "PVSC" instead of "SNS", and implementing a new computer system, their "pre-roll" was a

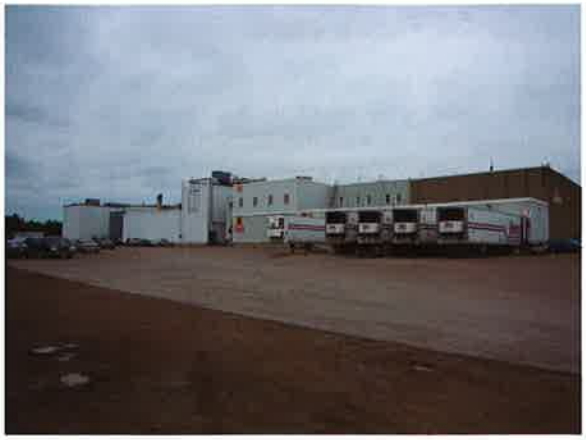
(Continued on page 4)

(Continued from page 3)

casualty. This year we have high hopes that the PVSC (motto: "A Truly Valued Nova Scotia") will not drop the ball.

Please call our Nova Scotia Tax Team: Giselle or Mark if you require assistance, at 1-800-567-3033 (429-1811 in HRM).

New Brunswick



Saint John, New Brunswick
($250,000 in tax savings)

The 30 day appeal period in New Brunswick ended on April 2nd. If your property is enrolled in our PAMS™ Property Tax Manager program we will have filed an appeal if the opportunity exists to reduce your property taxes. If you have filed an appeal yourself, the purported basis for your Year 2008 property assessment is the market value of your property on January 1st 2008. Unfortunately there is no "unformity" provision in the NB Assessment Act requiring that smiliar properties bear similar assessments. This is an unusual and major flaw in the Act. It is possible that you may encounter an enlightened assessor (they exist) who places more weight on equity of assessment than strict application of the letter of the law. If you are not so fortunate then you have little recourse when your realty assessment is lower than your property's market value, even though your property may be assessed at a higher figure than comparable real estate.

The high Canadian dollar has hit many manufacturers hard. If you have been forced to mothball your plant because of market conditions, Service New Brunswick will reduce your assessment by 50%. You should not accept their reduced assessment without consulting our NB tax team: it may still be too high. If your business has been effected by the strong dollar, but your plant still continues to operate, you have strong grounds for an assessment appeal. If your property is "purpose built", e.g. a saw mill, Service New Brunswick will have computed your assessment using a "cost to replace" method. In our experience SNB's major source of error lies in their calculations of depreciation: *Physical*, *Functional* and *External*. They often take a stab at the first, miss the second and ignore the third!

Please call our New Brunswick Tax Team: André or Rick if you require assistance at 1-800-567-3033.

Ombudsman's Report

On February 28th 2008, the provinical Ombudsman issued a report entitled "Residential Property Assessment Appeal Process in New Brunswick: Levelling the Playing Field". Although the report was confined to residential property the Ombudsman's observations and conclusions have applicability to all types of real estate and echo our comments in previous issues of Newsletter. The Report highlights the furstration brought on by lack of transparency surrounding the property assessment appeal process, the arbitrary powers of property assessors using methods that are complex, and legislative provisions and policies that offer little in the way of evidence disclosure. With respect to high assessment increases, the Ombudsman observers *"In our view, the best way to deal with such situations is to emphasise that property owners have the right to appeal assessments and to see that Service New Brunswick undertakes changes to the appeal process to make it more fair, effective, timely and transparent".* Amongst other things the Report makes the following recommendations which have in our view, equal applicability to commercial assessment:

(1) The burden of proving the accuracy of the assessment should be placed on Service New Brunswick, instead of the taxpayer.

(1) The Appeal Board should publish its assessment decisions annually and make them available to the public.

Prince Edward Island

On May 16th the Provincial Assessment Department mailed out their Year 2008 Assessment Notices. The PEI Real Property Assessment Act provides that commercial property has to be assessed at its market value on January 1st of the assessment year. Commercial property includes apartment buildings, with the exception of a single unit if it is owner occupied. The Year 2008 asssessment of an owner occupied residence is based on its January 1st 2002 assessed value indexed up by the PEI Consumer Price Index to January 1st 2007. The tax burden therefore falls increasingly on commercial property. The problem is further exacerbated because of the Provincial Assessment Department's lackadaisical efforts in maintaining assessments at market value. Whilst the Real Property Assessment Act mandates market value as the basis for commercial property assessment, Section 28(2) requires that any appeal to the Commission must *"demonstrate uniformity of assessment in relation to other assessments".* There would therefore appear to be an implicit assumption that the market value criteria is inadequate of itself...the

(Continued on page 5)

(Continued from page 4)

assessment has to be uniform with other assessments. You should therefore apply the following decision rules in respect to your commercial assessment.
Your property is over-assessed if:

(1) The Assessed Value > Market Value as at January 1st 2008

or (2) The Assessed Value > Assessed Value of Similar Properties.

You have 90 days from the date of your Assessment Notice in which to appeal. We suggest that you utilise the following wording as your grounds for appeal:

"The assessment is excessive, unfair, not uniform with other assessments, and any other grounds that may appear. Praise the Lord and pass the ammunition".

Our Compuval™ transaction and assessment databases for the Island allow us to compare assessments with market values; assessments with assessments of similar properties; and assessments with prior assessments of your property and similar properties. We can thus undertake cross sectional and longitudinal (time series) analysis, slicing and dicing the data so that we can view it from different angles. The data is geocoded so we can compare the locations of the various properties using maps, aerial photographs and satellite imagery.

If you would like to discuss your property with us before you file an appeal, or if you would like us to file your appeal, please call our Prince Edward Island Tax Team, Nigel or Mark at 1-800-567-3033.

Newfoundland

St. John's Newfoundland
($181,500 in tax savings)

Our Newfoundland tax team saved this St. John's retailer $181,500 over two assessment cycles spanning 2004-2009. Rather than accept the first Court decision which yielded tax savings of $48,000 for the 2004-2006 assessment cycle, they doggedly pursued a second appeal at the first available opportunity and saved our client an additional $85,500 for the 2007-2009 assessment cycle.

Only the strong survive in Newfoundland, and nowhere is that more true than in retailing. This is an intensely competitive marketplace and our client had managed to survive and prosper by "sweating the details". Property taxes are a fixed expense; every dollar saved is a dollar earned. It was critical that their property tax burden be no higher than their competitors. They turned to us for help.

We started by comparing the property tax assessment on a ft.^{2} basis, with all of their other stores. Having established that it was the highest of any store, we obtained a copy of the assessment records. Since the Assessment Authority uses market value as the basis of its assessments, we compiled sale prices for big box properties in the Atlantic Region and analysed them on a ft.^{2} basis. (Property sales information is confidential in the Maritimes so we have painstakingly created our own database from various sources, some legal). Having established that the property was over-assessed, we created a rental database for large retail stores in Greater St. John's. Using a logarithmic regression model, a statistical curve fitting and forecasting technique, we processed the data to establish the property's rental value, which we then capitalised into a market (assessed) value. We then represented our client in Court for the 2004-2006 assessment cycle.

Although the assessment was not increased for the 2007-2009 assessment cycle, we again filed an appeal. Using the prior Court case to identify further weaknessess in the Assessor's case, we expanded and refined our analysis of retail rents. Using two logarithmic regression models we established the rental differential between big box "finished" retail e.g. Wal-Mart, and "unfinished" retail such as our client property. The matter was again adjudicated by the Court.

The first Court decision reduced the assessment from $8.0 million to $7.5 million for the 2004-2006 assessment cycle. The second Court decision further reduced the assessment, from $7.5 million to $6.5 million for the 2007-2009 assessment cycle.

Year 2010 Re-Assessment

Next year is the last year of the tri-annual assessment cycle. The City of St. John's compiles its own assessments and has already sent out its Year 2009 Assessment Notices. They should have remained unchanged from the previous year unless you have made changes to your property. The City is also gathering information for its Year 2010 re-assessment. If you own property in St. John's you should have already received an Information Request for the calender year 2007 property income and expenses. (The Base Date for the Year 2010 re-assessment is January 1st 2008). Although these Information Requests were

(Continued on page 6)

(Continued from page 5)

due to be filed by April 30th 2008, the Assessment Department is pragmatic: it is not too late to file. We recommend however that our Newfoundland tax team review them first. Assessments outside the City of St. John's are the responsibility of the Municipal Assessment Agency Inc. They usually issue their Assessment Notices in October.

If you have any questions or would like us to review your Information Request before filing, call our Newfoundland Tax Team, Rick or André at 1-800-567-3033.

COUNSELLING DIVISION

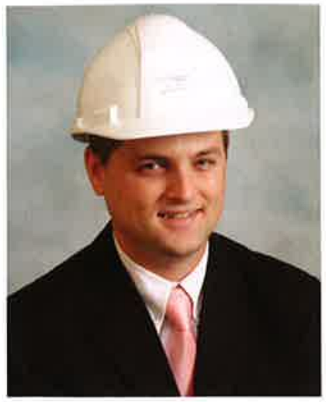
His Other Car…

Lee Weatherby FRICS, AACI

Legal counsel and clients, fortunate enough to witness Lee's expert testimony in Court are invariably impressed by his unruffled demeanour, no matter how blistering the cross examination. His precise, measured, logical analysis of complex issues render him invaluable in matters involving litigation and as a colleague and friend for the past 21 years. However his quick wit and dry humour, often masked by a propensity to think before he speaks, hint at a Mr. Hyde in our Dr. Jekyll. So it was no great surprise to us that this aficionado of Alice Cooper, the Rolling Stones and the darker side of rock, should casually hop a plane across the Atlantic to race Ferraris and Porsches on the very track that almost saw the untimely demise of BBC Top Gear presenter Richard Hammond. Happily no such fate befell Lee (yet), though we gather the Ferrari is a savage beast that will warrant his attention again in the future. We notice moreover that his most recent trip to the hallowed land was to Lindisfarne, the Holy Isle...perhaps he wanted to make peace with his Maker before chancing his arm again...or perchance he now prefers monks and mead.

LASERCAD DIVISION

Measuring Up



Mark Turner B.Comm., AACI

BOMA, North America's de facto setter of standards for measuring office space made a major stride in eliminating confusion a couple of years ago, when it effectively adopted the Society of Industrial and Office Realtors (SIOR) methodology for measuring industrial space. Together with the International Council of Shopping Centres (ICSC) it is now tackling retail space, and who better to sit on the joint BOMA/ICSC international committee than Mark, our Lasercad™ Division Vice President. Shopping Centres are usually measured to the Urban Land Institute (ULI) standard. However a conflict can arise between the ULI and BOMA standards when the shopping centre contains office space. Which standard should apply? Happily the BOMA/ICSC retail measurement committee is exercising their minds on that very subject.

Should you be driven by an excess of zeal, lack of love life, or other matters too dark to contemplate, you can learn more by visiting the BOMA/ICSC committee's blog at www.planimetronblogs.com.

Our Lasercad™ Division provides space measurement services on office, industrial, retail and residential space throughout Atlantic Canada. Visit our web site www.turnerdrake.com and follow the links (corporate site → products → Lasercad) or call Mark at 1-800-567-3033 (429-1811 in HRM) Ext. 325.

BROKERAGE DIVISION

Top Gun!

Russ Allen

ING Real Estate Canada, HRM's largest industrial landlord, have again named Russ as their "top achiever" for 2007. This is the second year running that Russ, our Brokerage Division Vice President, has won the award, leasing more of ING's portfolio than any other agent. Runners up for the award were Janice Mitchell (Colliers), Darlene Bennet (Cushman & Wakefield), Jim MacInlay (JJ Barnicke), Mike Brown (Cushman & Wakefield), Joe Chisholm (Market Experts), Bill MacAvoy (CBRE) and John Fennell (Greenwood Lane).

During the last quarter of 2007, Russ represented either the tenant or landlord in four out of the five largest industrial leasing assignments in HRM, as listed by CBRE in their Market Report (CBRE didn't actually mention that fact, but we thought you would want to know…)

Our Brokerage Division is a member of NAI Global, the world's leading managed network of commercial real estate firms. NAI Global's managed network, entrepreneurial structure and best in the class technology helps clients everywhere in the world tap into 8,000 experts in 375 offices across 55 countries. Visit our web site www.naihalifax.com for more details.

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