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Newsletter

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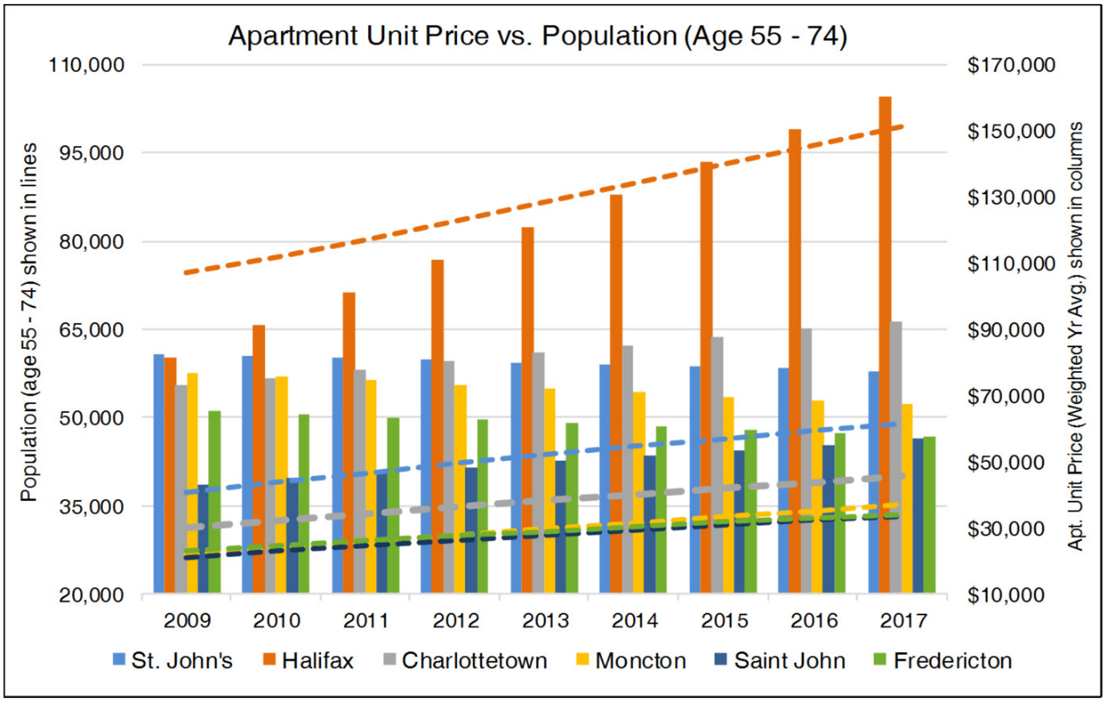
A GOLDEN AGE



Source: TDP CompuVal® Knowledge Base, Economic Intelligence Unit; Stats Canada.

Property markets throughout the Region are on a roll! Scarcely a week goes by without news of another investor new to Atlantic Canada, determined to join the party. In earlier times the ocean's rich bounty drew entrepreneurs here: fish, fowl, Spanish treasure, buccaneering, rum running, oil and gas, all had their place in the sun. Some linger still: plundering promises substantial reward. Property booms here however are rarely propelled by Regional activity, rather they are the result of events elsewhere, and so end badly. Although the relatively recent property market boom in St. John's was triggered by the success of the Province's offshore oil and gas activity, the exploration was itself a function of soaring energy prices on the world stage. Following the collapse of oil prices, the City of St. John's was left with a surfeit of office space. The local economy continues to follow the fortunes of oil prices elsewhere. The Atlantic Region's first post war property boom was fueled by a surplus of money seeking a home, coupled with a dearth of investment opportunity elsewhere. Launched in the late seventies, it peaked in the late eighties, crashed and burned in the early 1990's, at which point some property had a negative value. The feeding frenzy which fed that property boom was amplified by national and international players: property companies, institutional investors (pension plans, life insurance companies) and limited partnerships (the predecessor of today's Real Estate Investment Trust). This incremental demand, added to that of local investors, drove up property prices, values that had hitherto been determined by purchasers knowledgeable of local conditions and risk. The ex parte investors acquired properties based on their knowledge of opportunities elsewhere and critically under estimated the risk involved and therefore the commensurate return required, to operate property in this Region. When the Thai baht collapsed, the result of the failure of that country's banks, the contagion spread rapidly around the world. When it reached our shores in August 1990 the financial institutions headed for the hills and withdrew credit. The ex parte investors experienced an epiphany and unloaded their property investments with the same alacrity exhibited a few years earlier in purchasing them. They dumped properties into a market bereft of mortgage availability. Those of us then active in providing real estate advice experienced an emotion akin to that of a priest who discovers there is no God. We are now in the second post war property boom: it is eerily and disturbingly similar to the first. The brunt of the 1990's crisis was borne by the Region's locally based investors; few survived. Time to take stock!

IN THIS ISSUE

Banking on the Boom

Investment activity is mixed but by and large apartments are the favoured regional investment, appealing to a wide spectrum of buyers, from local to international investors.

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This is partly due to the fact that the buildings come in a broad range of sizes, management requirement and expertise, as well as price. They are also less risky than other property types. Suite sizes are smaller than other investment opportunities so the loss of a single tenant is less catastrophic. But it is also due to the fact that other property type investments are struggling. Office and Industrial properties in particular, are having a hard time: there is a surplus of space in every one of the six Census Metropolitan Areas and Census Areas we survey. Our Economic Intelligence Unit surveys the entire universe of office and industrial properties available for rent in buildings 5,000 ft.^{2} and larger. Our June 2018 study covered office space in every metropolitan area together with industrial space in HRM. The remaining data is taken from our December 2017 survey. As the table shows, vacancy is well above the equilibrium 5% for both property types in all areas.

CMA-CA	Office		Industrial	
	Vacancy	Trend	Vacancy	Trend
St. John's	21.00%	Rising	11.34%	Falling
HRM	15.44%	Rising	11.84%	Falling
Charlottetown	13.05%	Falling	10.63%	Falling
Moncton	12.10%	Falling	22.66%	Rising
Saint John	18.95%	Falling	11.88%	Falling
Fredericton	9.70%	Falling	18.97%	Rising

Source: TDP Economic Intelligence Unit

The high office vacancy in St. John's is due to the collapse of oil prices following an over enthusiastic expansion of supply predicated on the assumption that such would not occur. Sadly it did, but oil prices are rising again and the vacancy rate will eventually fall. The high office vacancy in the Halifax Regional Municipality (HRM) is due, in large part, to an over expansion of supply triggered by government grants, apparently based on the conviction that this was necessary to transform Halifax's Central Business District into a New York style financial centre. At the time the decision was taken it was believed that the financiers were camped off the harbour's mouth waiting for their rooms to be prepared. Unfortunately they have yet to materialise; lost in the fog bank perhaps?

Industrial demand is driven by changing materials handling technology. Over the past forty years building ceiling heights have increased decade over decade substituting cubic capacity for floor area. Building structures have a physical life of between 40 and 50 years. They are not subject to the same economic pressures from increasing land values if they are located in an industrial park so there is less incentive to redevelop than would be the case if they were located in a more urban environment such as the Central Business District or on a heavily trafficked highway. Functional obsolescence due to the desirability for higher ceiling heights does not impose the same redevelopment time sensitive pressure either as increased land value. Functionally obsolete industrial buildings therefore tend to hang around, bloating supply and increasing the vacancy rate. During the past 17 years Fredericton has never achieved supply/ demand equilibrium; St. John's, HRM and Saint John last reached it in 2005, Charlottetown in 2010 and Moncton in 2011. Now that we have a declining working age population, high vacancy rates are destined to become a fixture of the industrial landscape … new buildings will capture the demand.

Over the past three years there has been a strong demand for hotels in St. John's and the Halifax Regional Municipality confounding Airbnb enthusiasts. We suspect that demand might have peaked now, but in any event hotels are a specialist investment. Shopping centres too may be past their prime as an investment given the competition from on line shopping unless they are a Retail (Big Box) Park, a Regional Centre that still commands the heights in its market, a Neighbourhood Centre or Strip Mall servicing a neighbourhood or busy highway. Community Shopping Centres are a fading force; most have attempted to respond by reverting back to strip centres from enclosed malls.

Apartments: Investment of Choice

Given the foregoing it is little wonder that apartments appeal to the greatest range of purchasers and that for many, are their retirement nest egg. They promise to grow their investor's initial equity investment by mortgage principle pay down and capital appreciation, as well as providing some return on the investment itself … and they minimise income tax, a major consideration given this country's punitive tax regime which finds its apogee here in Atlantic Canada.

The ability to tax shelter a cash throw off (the revenue remaining after deducting operating expenses and debt service from gross income) and the mortgage (principle) paydown, by utilising the capital cost allowance (CCA) is attractive to owners attempting to build their retirement nest egg. However CCA will decline every year post purchase since it represents the depreciation allowed on the building and other improvements based on their acquisition price. Canada Revenue Agency will also claw it back when the property is sold. However income tax payable on capital gain, the increase in value of the property since purchase, realisable on sale, will only be taxed at 50%. This capital gains tax liability together with capital cost allowance recapture can be deferred by postponing the property sale and remotgaging instead, to release capital. Property appreciation therefore is key: real estate that falls in value appeals only to masochists, stability in value to socialists, increasing in value to realists. If you fall within the last camp, where should you have entrusted your hard earned dollars and what guideposts can you utilize for the future? We are about to tell you: but first …

The Magic of Appreciation …

… and Financial Leverage. Imagine the following scenarios. You remortgage the family home, pledge your first born, promise your daughter's (or son's) hand in marriage, sell the dog, prevail on your parents, lie to your bank and acquire a relatively new apartment property for $3.0 million. That sum will buy you a 15 unit building in Halifax's South End; double that number of units in less refined locations elsewhere. You persuade your bank to provide a mortgage for 70% of the purchase price for a 10 year term, 25 year amortization, at 4% per annum. Life looks good: you settle down to a decade of bed bugs, cockroaches, failed furnaces, leaks and things that go bump in the night. Over the next ten years your property does one of two things: it does not increase in value (the socialist within you is satisfied) or its value

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increases by a modest 3% per year. How will your initial $900,000 equity grow over the next ten years and what will it be worth in today's dollars assuming annual inflation of 2% …

	At Date of Purchase	After 10 Years	
		No Increase	3% Annual Increase
Market Value	$ 3,000,000	$ 3,000,000	$ 4,031,749
Mortgage Balance	$ 2,100,000	$ 1,496,728	$ 1,496,728
Equity	$ 900,000	$ 1,503,272	$ 2,535,021
		$ 900,000	$ 900,000
Equity Increase (2018 $)		$ 603,272	$ 1,635,021
Deflated @ 2% pa.		x 0.82	x 0.82
Equity Increase (2018 $)		$ 494,893	$ 1,341,287

A caveat: Canada Revenue Agency will treat your mortgage principle pay down plus any cash throw off, as taxable income to the degree that it is not sheltered by your capital cost allowance. Still, on a gross income basis you are better off ten years' hence to the tune of an extra $1,031,749 ($846,394 expressed in today's dollars), if the property appreciates in value.

Quo Vadis?

We have analysed the sale prices of apartment properties in all six major metropolitan areas in Atlantic Canada for the time span January 1st 2009 to September 25th 2018, utilising our proprietary CompuVal® Knowledge Base. Each sale was analysed on a "unit basis" i.e. the price was divided by the number of apartments in the building. CompuVal® then calculated the weighted average price each year and ran a regression line through them to produce a "predicted" average unit price. The result is displayed in the bar chart on Page 1. Over the past nine years apartment prices have, on average declined slightly in St. John's, somewhat in Moncton and Fredericton, increased moderately in Charlottetown and Saint John, and substantially in Halifax Regional Municipality. Unfortunately the past is … well passed, so where do you purchase in the future? Our Economic Intelligence Unit (EIU) married our CompuVal® analysis with demographic data from Statistics Canada to produce the answer.

The demand driver for rental apartments is population growth or decline. Our EIU investigated the two demographics that are the largest users of rental accommodation, the 20 to 29 year olds and the "empty nester" 55 to 74 age bracket. The younger age group explains about 80% of the price differential in apartment building prices in Halifax and Charlottetown, presumably reflecting the influence of their respective universities' populations, but had little to moderate influence elsewhere. The empty nester cohort on the other hand had a greater influence on apartment prices. It consistently explained most of the price differential in each of the six municipalities. The 55 to 74 age cohort is represented by the dash lines in the graph on Page 1.

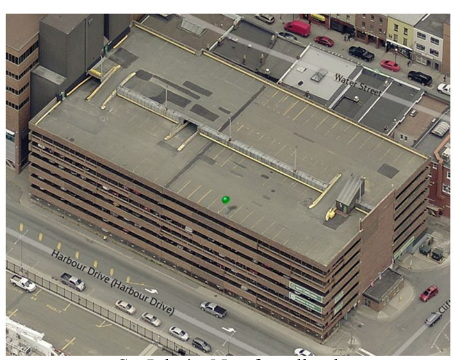
The Conclusion

If you are going to purchase an apartment building choose a location with a growing empty nester (55 to 75 age cohort) population. A younger demographic (20 to 29 age cohort) is a bonus if it is growing but is location specific proximate to a university, hospital or similar institution.

*Ashley Urquhart, our Senior Manager Brokerage Division is straining at the bit to assist you buy or sell apartment properties in the Maritime Provinces. Nigel Turner, our Vice President, Valuation Division values apartment properties across Atlantic Canada. Alex Baird Allen's Economic Intelligence Unit team will assist with site selection anywhere in Canada. All can be reached at tdp@turnerdrake.com or by phone at 1-800-567-3033 (this is **not** a call centre). Check us out at www.turnerdrake.com, we're a good looking lot ... well, some of us.*

PROPERTY TAX DIVISION

Taxing Times Newfoundland



St. John's, Newfoundland
(Assessment Review Court Decision: $118,100 in tax savings)

If you own property in Newfoundland and Labrador (excluding St. John's) you should have just received your *proposed* Assessment Notice: seize the day and reduce your taxes for the next **three** years (St. John's marches to a slightly different drummer; real estate owners in St. John's should expect to see their notice by November 30th). You have thirty days to file an appeal from the date you received your Notice.

The upcoming re-assessment marks the first year of the new triennial assessment cycle. Before we get into that however, some dates to confuse you: the *current* assessment cycle (2016 -2018) is based on the market value of your property as of January 1st, 2014 (the 'base date'). This was a time when oil still sold for over $100 per barrel and the Canadian dollar traded nearly at par with its American counterpart. Broadly speaking the *current* assessment cycle encapsulates the market conditions for the three years prior to the January 2014 base date (2011, 2012, and 2013).

Since then a lot has changed. The *proposed* 2019 assessments are based on the market value of your property as of January 1st, 2017, and again, capture the experience of the three years prior to the base date. What were those experiences? On January 1st, 2017, West Texas Intermediate traded for just above $50 per barrel, having dipped to less than $30 during that three-year period. The Canadian dollar was worth roughly 75 cents American.

But what of your assessment? If you own property in Newfoundland, this should concern you. In January 2014, the real estate market was *booming*. Rental rates in St. John's for example were the strongest of any market in Atlantic Canada and vacancy rates were low. Fast forward to the start of 2017: the drop in oil price has caused rental rates to stagnate and vacancy to skyrocket.

But what of your *current* assessment?! When you received your 2016 assessment notice in the fall of 2015, things were looking grim, economically speaking. You paid your tax bill in a very different economy than what that assessment was based on! The pain it inflicted wasn't reflected in your (then) new assessment; you dealt with empty spaces and flat-lining rents while your

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tax bill climbed. If you've weathered the storm, relief could be in sight. The *proposed* 2019 assessments are supposed to be based on your property's market value as of January 2017 so if your assessment is higher than its market value, you are over-assessed. However the Assessment Act also mandates that your property has to be assessed in a *uniform* manner: so if your assessment is greater than that of *comparable* properties, you should also appeal. Use similar wording to the following: "The assessment is excessive, unfair, not uniform with other assessments and any other grounds that may appear. Praise the Lord and pass the ammunition".

Confused? Call our Newfoundland Tax Manager, Gregory Kerry, at 709-722-1811 (St. John's) or 1-800-567-3033 (toll free, this is ***not*** *a call centre). He should be able to determine whether you have valid grounds for appeal by asking a few questions about your property and its assessment: all at no cost to you. Do it !*

LASERCAD DIVISION

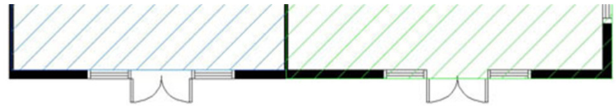
Quelle Différence: Retail or Office!

The Building Owners and Managers Association (BOMA) publishes measurement standards for office, industrial, retail, and mixed use spaces. These measurement standards provide guidelines for measuring the area occupied by each tenant within a building and, when appropriate, allocating common spaces.

BOMA states that if a building contains a single occupancy type comprising 51% or more of the total building area, the corresponding standard should be used. In other words, the building owner does not have the right to simply choose the standard that best serves their interests. Given the ubiquity of commercial buildings that can be used for both office and retail uses, particularly in suburban and rural areas, it is critical to understand the differences between these standards.

Boundary Condition

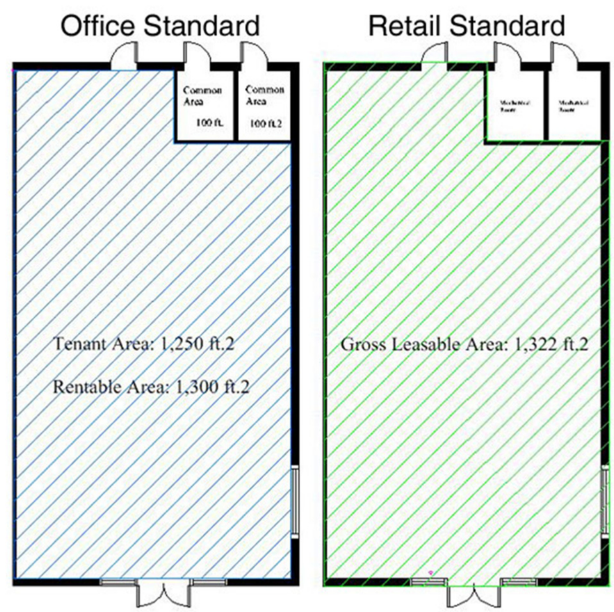
Where does my measure line extend to? One of the most important differences between the Retail and Office Standards is how the measure line differs for exterior enclosures. The Gross Leasable Area of a retail building is measured to the *outside face* of the exterior walls. Under the Office Standard the measure line for the exterior enclosure is the dominant portion of the *inside finished surface*. The dominant portion is the finished surface that comprises over 50% of the vertical height, measured from floor to ceiling (not exceeding 8 ft.). This difference can be significant. The illustration below shows how a unit measured to the Retail Standard (right) captures more area than a unit measured to the Office Standard (left) based on this condition:



Allocation of Common Area

Under the Office Standard, building owners can allocate to each tenant their proportionate share of common area. This process of "grossing-up" the tenant's space means each unit has two areas: a *Tenant Area* (the space physically occupied by the tenant), as well as a *Rentable Area* (the Tenant Area plus a proportionate share of common space). In a retail building this is not the case, as this Standard does not allow for the grossing up of common areas. Under the Retail Standard, Gross Leasable Area is simply the area designed for the exclusive use of an occupant with no share of common area.

Consider a hypothetical office unit with a Tenant Area of 1,250 ft.^{2} located within a building that contains three additional units of the same size and 200 ft.^{2} of common area. Each unit comprises ¼ of the total Tenant Area, and is allocated 25% of the common area (25% x 200 ft.^{2} = 50 ft.^{2}) making the Rentable Area of the unit 1,300 ft.^{2} (blue overlay on left side graphic below). If this were a retail building the Gross Leasable Area would be 1,322 ft.^{2} as this unit would simply be measured to the exterior face of all exterior walls, and would exclude any allocation of building common areas (green overlay on right side graphic below).



These are just two of the many differences between the Retail and Office Standards. With a total of six BOMA Measurement Standards it is critical to verify that the correct standard has been applied to your building, and that your space has been certified to verify its accuracy.

Mitchell Jones splits his time between our Lasercad® and Valuation Divisions. For further information feel free to reach out to him, or any one of our space measurement experts at (902)429-1811 or toll free at 1-800-567-3033 (this is ***not*** *a call centre).*

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PLANNING DIVISION

The Dangers of Knowing the Price of Everything and the Value of Nothing

(Image via Wikimedia Commons)

"I think we're confusing heritage with nostalgia"
"Not every old building is a heritage building"
"I respect the past, but we are not living in it"
"I drive by that building every day and I think it's an eyesore"

Just a few quotes from the latest proposal to demolish an iconic century-old building and make room for progress. What cabal of money-grubbing developers would, without a hint of shame, so plainly offer their own decades-long neglect of a historic building as justification for its demolition? Why, a good number of Halifax's own elected councillors of course!

Having proved their bonafides with a unanimous approval of a new Heritage Conservation District the month prior, councillors, in fresh receipt of a building condition report for one of their own registered buildings, wasted no time debasing themselves with all manner of excuses as to why the Halifax Forum deserves the dynamite treatment. "A modern building for a modern city" offered one, espousing a viewpoint decidedly more mid-century modern, than modern-day. Bravely willing to take costless (to them) actions in fulfilling their duty to the public realm, it seems once the chips are down some find it quite easy to shift from clucking tongues to copping out.

The intrepid, if outgunned, heritage planning staff managed to get an admonishing squeak into the staff report, "as the building owner, it is incumbent upon the Municipality to exhibit stewardship in this area by investing in the Forum's heritage preservation". Atlas shrugged.

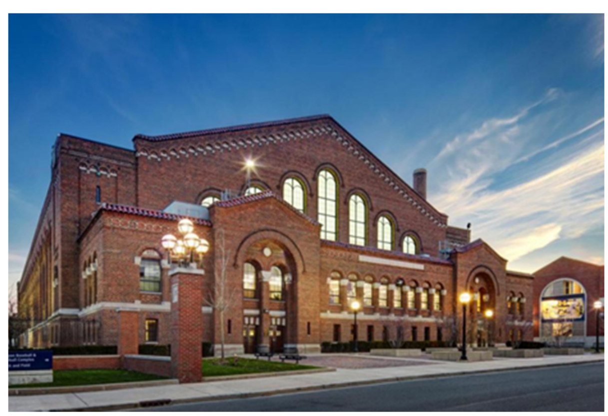
Unfortunately for the top minds on council, that pesky Heritage Property Act does apply after all. Combined with a few other staff reports, they will at least have to pay some further lip service to the issue before they can vote to do what they've so clearly already decided. A forthcoming Heritage Impact Statement will further spell out the historic and architectural merit of the building and provide conservation guidance, however the future of the Forum has much broader implications.

The North End is changing. Market forces and planning policy are driving new development to the area. Within a scant few blocks of the Forum a bevy of development projects mean more than 2,000 new residents will soon call the area home. All of this is to say nothing of the further density that will be driven to the area under the incoming (…hopefully) Centre Plan, wherein it is designated as the largest "Growth Centre" in the urban core.

All of this can be good. All of this can be bad. For more than a decade now the municipality has been making the case for more urban densification and its role in the social and economic health of the city; infrastructure efficiency, public health, climate impact mitigation, traffic management, the higher quality of services and amenities it can justify. Yet all of this high-minded ambition hits the ground somewhere. Achieving these goals is a long, incremental process, and along the way will be many points where the public gets to evaluate actual outcomes. Will HRM's performance stall the progress, or add to its momentum?

The Halifax Forum is a heritage arena, unique in the city for its history and form. It is one of the largest heritage buildings left, enabling a broad range of adaptive reuse options compared to the typical Georgian and Victorian stock. It is also unique in its use. Unlike most heritage buildings, which are often private, it continues to play an active role in the life of the North End neighbourhood. It is therefore a pillar of the community's identity, visually and socially. This is a building known and loved by far more than architectural aficionados; previous rumblings of its demolition have elicited swift public outcry.

So what message might Council's treatment of the Forum send? Will it shine as an example of how existing neighbourhoods can densify and change while retaining and enhancing the elements they already love? Or is development only for the benefit of newcomers, a spectre to be opposed like the barbarians at the gate? Will the municipality show how the enlightened treatment of built heritage adds value to the overall quality of place in a way that exceeds the potential of new development alone? Or will its pound-foolishness produce only lingering regret, and a list of self-serving excuses to be eagerly wielded by similarly unscrupulous property owners?



Restored 1928 arena in Michigan: Rosetti Architecture

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New HRM municipal rink: Hello Halifax

Neil Lovitt is the Senior Manager of our Planning and Economic Intelligence Unit Divisions. For more information on those Divisions visit our corporate web site www.turnerdrake.com → Corporate Site →Planning or →Economic Intelligence Unit.

VALUATION DIVISION

Which Value?

It is a common misconception that a piece of real estate has a single value. This is simply not true. Determining which value is appropriate, likely has the biggest impact on property value.

The Royal Institution of Chartered Surveyors' Global Valuation Standards, specify *six types of real estate value* (Market, Rental, Equitable, Investment, Synergistic, and Liquidation). The Appraisal Institute (of America) has identified *ten distinct, and valid, property valuation bases* in common use in North America. Legislation, case law, and the purpose of the real estate assignment, result in many variations of these property valuation bases. Any conversation about valuing your property has to start therefore with an understanding of the purpose of the valuation assignment or you can end up with a conclusion which is worthless at best, or seriously misleading at worst.

Let's discuss the two most common types of value.

Market Value (Highest and Best Use) is typically quoted and understood by many (including appraisers) to be the only type of value. It is the highest price you would get for your property on a specific date, if it was offered for sale, properly marketed, and exposed for a sufficient period of time to alert and allow all potential purchasers to submit offers. It assumes that both seller and buyer are knowledgeable of property values, that neither are under pressure to sell or buy, are typically motivated, and are each acting in their best interest. It assumes a cash purchase, or typical mortgage financing, in Canadian dollars. It also anticipates that the purchaser will be able to put the property to its "Highest and Best" use, which may for example, include redevelopment, if this will create a higher value than the existing use of the property.

But beware, *Market Value is **not** the price you could expect to get if the purchaser (1) was an adjoining owner, (2) was undertaking a land assembly, (3) was a relative or business associate, (4) knew something that the vendor should have known but did not, (5) did not know something known to the vendor of which the purchaser should have been aware, (6) wanted a "vendor take back" mortgage, (7) intended to lease back the property to the vendor, (8) enjoyed a negotiating advantage because, for example, the vendor was in dire financial straits, ... and so on.*

We were recently contacted by an existing client looking to secure financing for their property located in a Central Business District. Their property was improved with an older, single storey commercial building. The underlying land was worth considerably more than the building and property under its current use. After discussing the purpose of the assignment with the client and their bank, it became clear that the bank was interested in more than just the **Market Value (Highest and Best Use)** of the property in this instance. The bank's goal was to determine if the income generated by the property, under its current use, was sufficient to keep the lights on and pay the existing mortgage. However, the bank also wanted to know what they could expect to sell the property for if they ended up taking possession of it and selling it on the open market. Effectively, the bank had two different goals which gave rise to two different values.

We completed a thorough analysis of the property and provided the owner, and their bank with two values (1) Market Value (Highest and Best Use), which in this case was for redevelopment of the property, and (2) Market Value (Value in Use) as it currently exists without regard to redevelopment potential. Market Value (Value in Use) is similar to Market Value (Highest and Best Use) but is based on the assumption that your property could only be utilised for its existing purpose.

Difference in Value

In this instance the difference in value was significant: $1.5 million (Market Value - Value in Use) versus $2.3 million (Market Value – Highest and Best Use). Both values were included and supported in the report, allowing the bank to make an informed decision on their lending.

Looking for explanations on the different types of values listed above? Visit our Valuation and Advisory Services site https://www.turnerdrake.org→WhichValue for more information on the various types of values.

*Nigel Turner, Vice President of our Valuation Division, can be reached through any of our offices in Halifax, St. John's, Charlottetown, Saint John and Toronto or by calling 1-800-567-3033 Ext. 330 (this is **not** a call center).*

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