VALUATION CASE STUDY
HST HANG UPS

The Challenge

As soon as the first unit is occupied the Excise Tax Act requires the apartment developer pay HST/GST on the property's Fair Market Value. But what is Fair Market Value? Is it synonymous with the Market Value … or is it the aggregate of land and building cost? Non-residential property is excluded from this "self supply" calculation: does this include parking as well as commercial space? The developer turned to Turner Drake for advice.

Turner Drake's Approach

The Excise Tax Act provides a circular definition of "Fair Market Value" stating that it *"means the fair market value of the property or service without reference to any tax excluded by section 154 from the consideration of supply"*. Canada Revenue Agency and Tax Court of Canada judgements have added little to the foregoing definition, other than confusion. Generally Fair Market Value appears to be synonymous with Market Value i.e. "the most probable price which the property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus". One of the three methods of calculating Market Value is the Cost Approach which aggregates the land value with building cost (less obsolescence). This was germane because the construction cost had run well over budget due to unforeseen expenditures, particularly for demolition, site excavation and sub-grade work. Comparison of actual costs with those that would have been expected given normal circumstances, determined that they ran into many millions of dollars. In valuation terms this represented incurable functional obsolescence caused by super adequacy and was a legitimate deduction from the building's reproduction cost provided that it did not produce an offsetting incremental increase in value. We therefore valued the property using the Income Approach and determined that the underground parking contributed approximately 5% of the total Net Operating Income (and hence value) to the building compared with the 28% construction cost ratio of the sub-grade work. For competitive reasons, the property's rental structure could not be increased to offset the unforeseen increase in construction costs so we determined they should be treated as functional obsolescence in the Market Value calculation. The Excise Tax Act required that the residential and non-residential components be treated as separate properties. The parkade generated all of its revenue from the occupants of the apartments so fell within the residential component. The 14,000 ft.^{2} commercial space did not do so and therefore had to be excluded from the self-supply calculation. Since it was not a separate legal entity it was our view that it had to be included in the value of property in its entirety and then "apportioned out" on the basis of its contribution to total net operating income, in order to isolate the Fair Market Value of the residential component.

Winning Results

Turner Drake furnished the developer with a comprehensive Valuation Report with a detailed logic path to the Fair Market Value conclusion anchored by market data, for deployment in their negotiations with Canada Revenue Agency.

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