Property Tax: Costly & Confusing

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In his seminal work The Wealth of Nations, economist Adam Smith, defined the principles of good taxation as "*fairness, certainty, convenience and efficiency*". Although he defined those principles in 1776, there is general agreement that they should still be the core of any sound taxation system. So why is our property tax system in Atlantic Canada so unfair, complicated, opaque, inconvenient and inefficient… apart from the fact that we have *four* provincial jurisdictions administrating an aggregate population and land area half that of most other provinces? In part it is because there are two components to the system, the *property assessment* and the *tax (or mill) rate* and this affords ample opportunity for meddling and buck passing. The basis for the *property assessment* in each province is mandated by the respective provincial government. Broadly speaking it is based on Market Value, the price you would get if you sold your property in the open market at a specified "*Base Date*". The *tax rate* is set by the municipality, though in some provinces part of the property taxes are rebated to the province and they will dictate their part of the tax rate. Each municipality determines its budget requirements and divides it by their aggregate property assessments to arrive at the tax rate. The tax paid by each property owner is the product of their property assessment multiplied by the mill rate. Quite simple really and it broadly meets Adam Smith's criteria. But that is before the meddling!

Property Assessment

Property assessments are computed by the province… apart from the City of St. John's in Newfoundland which undertakes its own. In Prince Edward Island and New Brunswick assessments are undertaken by the PEI Department of Finance and Service New Brunswick respectively. In Nova Scotia the responsibility has been delegated by the province to the government owned (and grandiloquently named) Property Valuation Services Corporation (PVSC). In Newfoundland, other than the City of St. John's, the government owned Municipal Assessment Agency Inc. undertakes the property assessments.

Although Market Value is the common basis for property assessment in each Canadian province, different Base Dates apply with each assessment authority. For the 2023 assessment year, New Brunswick and Prince Edward Island utilise a base date of January 1st 2023, Nova Scotia settles for January 1st 2022, as does Newfoundland (excluding the City of St. John's). The City of St. John's used January 1st 2020 for the 2023 assessment year *but they have just published* *their 2024 assessments (the Appeal Period runs to August 18th 2023) with a base date of January 1st 2022. Since the City of St. John's only updates its assessments every two years, 2024 will be the first year that the assessments can reflect the impact of the Covid pandemic. Prince Edward Island have also just published their 2023 assessment roll (the Appeal Period runs to August 3rd 2023) and since the base date is January 1st 2023 the assessments can reflect the impact of Hurricane Fiona both from a business and damage perspective.*

Assessment Averaging

Although Assessment Averaging is used in Ontario and Saskatchewan, Atlantic Canada has been mercifully spared. Now however, with impeccable timing, and after ten years of deliberation, Halifax Regional Municipality (HRM) has *"directed its staff to implement a rolling three-year Assessment Averaging Program for commercial properties to help increase predictability in property taxes for commercial property owners and businesses… for business owners with properties experiencing sudden spikes in assessed values"* thus closing the stable door after the horse has bolted. Commercial property values, on which the assessment is based, are no longer facing large increases. Commercial property value increases were a result of the low interest rates, not excess occupier demand, and interest rates are now rising again so most property values are no longer increasing. Some such as retail and office are falling: the former because Covid escalated the move to on-line shopping, the latter because the Halifax downtown office market was overbuilt pre-pandemic and is suffering now from "working from home (wfh)". The phase-in applies in designated Commercial Development Districts and includes the Halifax Central Business District (CBD), where commercial values are now falling, as well as the Burnside Industrial Park, where industrial prices were increasing but are now stablising. Those industrial property increases were driven by occupier demand, some of it due to the disruption of supply chains and the movement to on-line shopping. HRM's program will further complicate the Property Tax regime, attract *"startup costs of $150,000 to $250,000 with ongoing costs of $50,000 to $100,000 per year",* keep many civil servants employed (probably wfh) and increase the commercial tax rate by 3%. Fortunately, HRM's web site now warns that the *"program will not be coming into place for the 2023/2024 fiscal year as the Minister of Municipal Affairs and Housing (MAH) has declined to sign the By-law"*, still hope then, that HRM will avoid scoring another own goal.

General Level of Assessment

Perish the thought, but in order to make life easier for themselves and discourage appeals, an unscrupulous assessment authority could be tempted to assess all property below its Market Value. On first blush this might appear to be a win situation for the property owner as well, since their property would be underassessed, but in fact every property would be in the same boat. And since the degree of underassessment would not be uniform, some properties would bear an inequitable share of the tax load. Worse, owners of the latter property would have no grounds for appeal. Recognising the danger, every province in Canada, *apart from New Brunswick*, includes a "uniformity" provision in their Assessment Act. This provides that all property has to be assessed in a uniform manner, the intent being that like properties will bear similar assessments and hence tax loads. Unfortunately, this is not applied in a uniform manner in each province. Nova Scotia, for example, utilises a "General Level of Assessment" calculation based on municipality and taxation class (residential or commercial). So if, in aggregate, commercial assessments are 80% of their Market Value, then it will be possible to successfully appeal any assessment that is higher than that level, even if the property is assessed at less than its Market Value. The General Level used to be calculated by totaling the assessments for every property that sold within six months either side of the Base Date, divided by the aggregate of their sale prices. This methodology derives from a decades old court case which should be challenged since it is biased in favour of the higher priced properties. A single property worth $10 million has the same weight as 10 properties that sold for $1 million each. If the Assessment/Sale Price Ratio for the more valuable property was 100%, and that for the lower valued properties 50%, the General Level would be computed as 75%, even though 91% of the properties in this example were at the 50% level. A less crude approach would be to calculate the General Level on a per unit (ft.2, room, apartment unit) basis and to compare within property types. Unfortunately, the inequity was further compounded when PVSC, apparently for administrative convenience, changed their application of the methodology to include only properties that had sold *within the twelve-month period prior to the Base Date (instead of six months either side of it).* When values are increasing this results in an inflated General Level and vice versa. And since properties are lumped together by taxation class (residential or commercial) an apartment building will be treated differently to an office property even though both are investment type real estate.

The calculation of the General Level falls on the assessment authority, and its validity rests on their integrity. There is substantive evidence that PVSC's predecessor, the NS Assessment Department, "cooked the books" by excluding property sales from their analysis that lowered the General Level. These "outliers" comprised sales to *pension funds* and *national purchasers* such as REITS (on the grounds that they were lamentedly lacking in sophistication and consequently paid far too much for property), and properties valued using discounted cash flow (on the grounds that… well, just because). In 2005 the Department's General Level calculation methodology was considered by the Nova Scotia Utility and Review Board (Homco Realty Fund [20] Limited), in a case involving a major office building. The Board ruled against the Department noting "*this problem is further aggravated by the Director's attempt to (in the Board's view) artificially protect the Director's claimed general level of assessment by excluding sales of such large transactions"* and "*while the Director not surprisingly appears to be content with a claimed general level of assessment which is close to 100%, one of the ways the Director achieves this result is to automatically exclude sales which would otherwise lower it"* and "*the Director appears ready to disqualify any sale involving a REIT or pension fund without further inquiry as to the market circumstances of the sale"*. The Assessment Department promptly appealed the decision to the Nova Scotia Court of Appeal (CA 246980) and lost again. A huge waste of taxpayers' money, including that of our client. So, does the Assessment Department's successor, the PVSC, continue this practice of excluding "outliers"? We decided to test the accuracy of their General Level.

We analysed a sample of the PVSC's computed 2023 General Level of Assessment for Commercial property, located in 49 municipalities. Their General Level ranged from 91% to 100%. *However, in 34 (69%) of those municipalities PVSC simply adopted a General Level of 100% on the grounds that there were "fewer than 11 sales"*, and hence insufficient sales data, to reliably calculate it. We did not discover the same sales limitation, but in any event PVSC could have overcome it by extending the sales period. To be consistent with PVSC we adopted their methodology of using sales that occurred during the twelve months prior to the January 1st 2022 Base Date and found that:

- PVSC "chase sales", i.e. when a property sells they amend the assessment to reflect the sale price. Based on our analysis the degree to which this occurs appears to depend on the Municipality and presumably the assessor. Most assessments increased after the property sold, some almost tripled and the practice of chasing sales appears to be most pronounced in the Halifax Regional Municipality (HRM)
- Because PVSC "chase sales" their General Level of Assessment calculation is meaningless. For example, the 2023 General Level is based on the 2023 assessments (for those properties that sold in the calendar year 2021) compared with their sale prices in 2021. But PVSC have *already* adjusted the 2023 assessments to reflect the sale price in 2021. The exercise is method bound. It is analogous to a meteorologist forecasting the yesterday's weather, today… and then boasting about its accuracy.
- Although PVSC claim to "follow internationally accepted standards for mass appraisal from the International Association of Assessing Officers (IAAO)" on their web site, "chasing sales" is frowned on by the IAAO and most assessing jurisdictions. Defined as "the practice of making any substantive change in the value of a recently sold property, while not also reviewing and applying the same criteria to properties that have not sold" it penalizes properties that have been sold.
- Our own calculations of the General Level are lower than PVSC's even though we both utilise the same time frame, suggesting that they must be treating some sales as outliers.

We currently have two cases involving this practice of chasing sales before the Nova Scotia Assessment Appeal Tribunal awaiting a ruling. Of course, in New Brunswick, property owners are further penalized because there is no Uniformity provision in their Assessment Act.

Transparency

Whilst assessment authorities are disclosing a little more information than was the case in the past, they often do so reluctantly. Transparency is the sine qua non of any taxation system, it goes to its heart; fairness, certainty, convenience, efficiency. After four decades and a new century it astounds us that we are still fighting this battle. This is not a contest; the objective should be to disclose and consider all of the facts to arrive at the correct conclusion. Many assessment authorities now collect financial information such as rental income and expenses on commercial, industrial and apartment properties even though the properties themselves are not under appeal, at considerable cost to the property owner: failure to comply with these Income and Expense "requests" usually results in the forfeiture of any right of appeal even if, as is often the case, the assessor ignores the data in arriving at the assessed value. Presumably the purpose of this data gathering is to help achieve consistency and make life easier for the assessors by relieving them of the necessity to maintain contact with the market. And PVSC do an impressive job analyzing this data. They then utilise the information to construct benchmark rental and operating expense rates for different property types often segregated by building age and location. The difficulty however is that there is always a range of rental and operating expenses which is dependent, not just on property type, age or location but also the financial strengths of landlord and tenant, suite and building sizes, amenities, physical condition, aesthetic appeal, bay size, construction quality, and so on. These factors are ignored in arriving at individual assessments and while this can be excused because of the nature of the mass appraisal process it is a different matter if the assessment is appealed. It is then incumbent on the assessor to focus on the property, something they frequently forget to do. Since it is up to the property owner to prove that the assessment is incorrect, assessors obfuscate, often attempting to support their assessment with skimpy two-page appraisal reports based on average benchmarks, even at Review Board level. If the property owner does not have professional representation it can be difficult to combat this nonsense. However, owners *are* entitled to know how their property was assessed and that means scrutinising the assessor's calculations and knowledge of the property. This is important, *the assessor may never have inspected the property, even if the assessment is being reviewed*. If the property is rent generating or otherwise capable of being valued based on its income potential (apartment building, office, industrial, retail) the assessor's calculations of its rental income, operating expenses and capitalization rate (rate of return) should be property specific. We are currently conducting an appeal where PVSC are refusing to provide these calculations and identify the comparable properties on which their capitalization rate calculation is based, claiming the information is "confidential" …even though we have offered fall on our sword before disclosing it to our client (or anybody else). PVSC are adamant. They massed their troops (Senior Legal Counsel, Senior Commercial Assessor, Commercial Assessor) at the Nova Scotia Assessment Appeal Tribunal (NSAAT) hearing… we fielded Giselle Kakamousias our VP Property Tax; an appropriate balance of forces... The NSAAT ruled in favour of disclosure. Taxpayer funded PVSC immediately appealed to the Nova Scotia Public Utility and Review Board (PURB). That decision is pending. If, as we expect, the decision favours transparency, PVSC will probably appeal again… cost, after all, is not an issue when taxpayers foot the bill.

Property Tax Rate

Municipalities in Atlantic Canada have two classes of property (residential and commercial) and levy different property tax rates in each against the assessed value. In addition the tax rate may also vary depending on the services provided: until April 1st 2023 HRM had urban, suburban and rural commercial tax rates. Commercial property bears the brunt of the tax load on an ad valorem basis: in HRM the commercial tax rate is almost triple the residential rate. Outside the Atlantic Region things get more complicated. In Ontario, municipalities have multiple property classes, each taxed differently. Within Atlantic Canada the necessity for a similar measure rears its head from time to time. Broadly speaking property tax is not a function of the benefit conferred on the property, but rather on its assumed ability to pay. The basis of that assumption is murky and reflects the desires of special interest groups and the inability of the political establishment to ignore their wishes (and votes). Unfortunately sticking it to one group often has unforeseen consequences… apart from the inevitable increase in complexity and opacity. After many years of indecision, Halifax Regional Municipality (HRM) has taken its first teetering steps along this slippery slope; from April 1st 2023 their commercial property tax rate will vary by location *and* assessed value (using three tiers – Tier 1 [$0 to $1million], Tier 2 [>$1million to $2 million], Tier 3 [>$2 million]) The property tax rates will be applied to each tier of assessed value i.e. a property assessed at more than $2 million will attract three different tax rates. HRM's objective was to shift the tax burden from SME (Small, Medium Enterprise) to Big Box, High Density and Industrial properties. However, most SMEs also occupy buildings with large assessments and pay a proportionate share of the property taxes… And since the property tax rate varies by location, all businesses in those buildings situated in the City of Lakes Business Park will now pay a higher tax rate than those located in the contiguous Burnside Business Park, and everywhere else other than the Bayers Lake Business Park, the Bedford Industrial Park and Dartmouth Crossing Retail Park. Tier 1 and 2 property tax rates are identical: it is only Tier 3 (that part of the assessment above $2.0 million) that differs. Never in the history of civil society has so much effort, been devoted by so many, to so little effect.