

## **CHANGING MARKETS, CHANGING VALUES, and CHANGING ASSESSMENTS**

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This paper considers the assessment valuation problem which arises because of changing economic circumstances after the statutory valuation date. In Ontario, this problem is particularly critical because of the four-year assessment cycle: assessments for 2009, 2010, 2011, and 2012 are all based on a January 1, 2008, valuation date. Since July 1, 2008, we have already witnessed a volatile market significantly impacting current values, inevitably creating inequitable relationships amongst previously comparable properties. It is unlikely that the sharply swirling market will have impacted equally and uniformly all properties. The recent economic collapse of some sectors of the economy in the fall of 2009 is particularly topical.

The guiding objects of assessment practice and procedure are “consistency, uniformity and equity”<sup>2</sup>. These objects are particularly difficult to achieve during a time of volatile or limited market activity when true value is difficult to assess, or when a property is on the brink of a major directional change.<sup>3</sup>

The assessor’s longstanding objects of uniformity and equity were captured by the following words of the Supreme Court of Canada:

“Unless the legislative authority otherwise ordains, everybody having property or doing business in the country is entitled to assume that taxation shall be fair and equal, and that no one class of individuals, or one species of property, shall be unequally or unduly assessed.

Uniformity and impartiality in the imposition of taxes may in many cases, we all know, be very difficult: still, in construing Acts of Parliament imposing burthens of this description, I think we must assume, in the absence of any provision clearly

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<sup>1</sup> Originally presented to the Canadian Property Tax Association (“CPTA”) Annual Workshop - October 6, 2009.

<sup>2</sup> Standard Life Assurance Co. v. British Columbia (Assessor of Area #01 - Capital) (1997), 146 D.L.R. (4<sup>th</sup>) 247 (B.C.C.A.).

<sup>3</sup> “Using Classic Valuation Methodologies to Properly Value in a Declining Market” by David Lennhoff, presented to CPTA National Valuation and Legal Symposium, February 17, 2008.

indicating the contrary, that the legislature intended the Act to be construed on the principle of uniformity and impartiality. . .”<sup>4</sup>

Achieving these objects requires adherence to two fundamental assessment practices:

1. The totality of the land must be assessed on a common basis (which in Ontario is “current value”), assessed as of a common valuation date, ordinarily set by statute, which leads to uniformity in valuation.<sup>5</sup>
2. The level of assessment on every property must be fair and equitable when compared with that level which is applied to determine assessments of other similar properties in the municipality.<sup>6</sup>

This paper concludes that the assessor in Ontario must achieve both uniformity of valuation and uniformity of assessment, which, in a declining market requires consideration and analysis of economic events, data and trends after the statutory mandated valuation date.

The statutory equity mandate in Ontario (section 44(2) of the *Assessment Act*), was amended for taxation year 2009 and thereafter to make it mandatory for the Assessment Review Board to adjust assessments downward based on equitable principles.

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<sup>4</sup> Jonas v. Gilbert (1881), 5 S.C.R. 356 (S.C.C.).

<sup>5</sup> *Assessment Act*, R.S.O. 1990, c. A.31, as amended, sections 19 and 19.2.

Vancouver v. Attorney General of Canada, [1944] 1 D.L.R. 497 (S.C.C.) per Rand J.

<sup>6</sup> See for instance:

Dreifus v. Royds (1920), 57 D.L.R. 44 (S.C.C.)

Empire Realty Co. v. Metropolitan Toronto (Assessment Commissioner) (1968), 69 D.L.R. (2d) 387 (Ontario C.A.)

Bramalea Ltd. v. British Columbia (Assessor of Area #09 - Vancouver) (1990), 76 D.L.R. (4<sup>th</sup>) 53 at 57 (B.C.C.A.); leave to appeal refused 79 D.L.R. (4<sup>th</sup>) vi. (S.C.C.).

The *Assessment Act* now requires the Board to reference “the value at which similar lands in the vicinity are assessed and adjust the assessment of the land to make it equitable with that of similar lands in the vicinity if such an adjustment would result in a reduction of the assessment of land”<sup>7</sup>. [emphasis added]

Previously the *Assessment Act* only prescribed that the Board must reference equity - but did not require the Board to adjust assessed value for equitable reasons. This statutory amendment reflects the decision of the Assessment Review Board in Dawson Properties<sup>8</sup> wherein the Board held:

“The Board is of the view that the inherent tension between s.19(1) and s.44(2) should be resolved in this way:

All taxpayers are entitled to have their property assessed at its current value. This is the fundamental right contained in the Act. If, after the mandatory “shall” obligation in s.44(2) has been carried out, it appears that “similar lands in the vicinity” have a lower level of assessment, the taxpayer is entitled to have its assessment reduced to that lower level. The reason for this entitlement is that the *Assessment Act* first gives the right to be assessed at current or market value and in addition s.44(2), now with its mandatory language, entitles the taxpayer to be assessed equitably with other taxpayers. But the converse is not true; the primary right is contained in s.19. While it is true that it may also be inequitable if the other “similar lands in the vicinity” are assessed higher than their current values the answer is that the Board cannot resolve an inequity unless an appeal is brought before it.”

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<sup>7</sup> *Assessment Act*, section 44(2)

<sup>8</sup> Dawson Properties Limited v. Municipal Property Assessment Corporation  
46 O.M.B.R. 147 at 160.

## **ECONOMIC OBSOLESCENCE**

This paper, while not intended to be comprehensive, considers the phenomena of post-valuation date economic obsolescence and its potential impact on assessment values.

The cost approach values a property based on comparison with the cost to build a substitute property. The cost estimate is adjusted for the depreciation evident in the existing property. Depreciation can result from three major causes: physical or chronological depreciation, functional obsolescence, and external or economic obsolescence.

The effects of a declining market are manifested in the cost approach as external or economic obsolescence.

There is limited jurisprudence in Ontario addressing issues of economic obsolescence. The most prominent case is the Dofasco<sup>9</sup> decision from 1989. In the Dofasco decision, the assessments under appeal for tax years 1984, 1985 and 1986, were derived with respect to a 1975 valuation date. The assessments in Ontario were then subject to the rule of uniformity or equity.

The Court of Appeal in Dofasco accepted that economic obsolescence was a species of depreciation, and also accepted the definition provided by the Ministry of Revenue assessment program policy manual:

“Economic obsolescence refers to a loss in values to a building arising from diminished utility due to locational causes external to the property.”

The Court directed that obsolescence should be considered, as a question of fact. The Court referenced its earlier decision in Re Dominion Bridge<sup>10</sup>, which clearly articulated the principled foundation for obsolescence allowances:

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<sup>9</sup> Re Regional Assessment Commissioner, Region No. 19 et al., and Dofasco Inc. (1989), 68 O.R. (2d), 46 (Divisional Court); reversed in part; Dofasco Inc. v. Ontario Regional Assessment Commissioner, Region No. 9 and City of Hamilton (1992), 94 D.L.R. 4<sup>th</sup>, 146 (Court of Appeal).

<sup>10</sup> Re Dominion Bridge Co. Ltd., and Town of Mississauga (1974), 3 O.R. (2d) 205 (C.A.), per Dubin J.A. at 207.

“The underlying premise of an allowance for obsolescence is that a taxpayer should not be taxed on the non-productive features of his building. . .”

The *Assessment Act* at that time was characterized as having frozen assessments. The Court concluded in Dofasco that:

“Assessment appeals, on the basis that the assessment does not accurately represent market value, are impossible under the *Assessment Act*. To succeed in altering an assessment, an appellant must meet the requirements of the subsection [65(1)]. These are:

- a. the tribunal must have reference to the value at which similar real property in the vicinity is assessed;
- b. the tribunal must be satisfied that the assessment is inequitable with respect to the assessment of similar real property in the vicinity; and
- c. the tribunal shall not alter the assessment to any greater extent than is necessary to make the assessment equitable with the assessment of such similar real property.”<sup>11</sup>

Equity within the *Assessment Act* at that time was achievable only via assessment appeals:

“It was not the intention of the Legislature to permit during the years 1971 to 1974 the regular course of correction of the assessment rolls to permit a reflection of market value and, therefore, the lack of similarity between the market value and the assessed value could not be the subject of a successful assessment appeal. That matter stood to be corrected when the provincial assessors’ appeals were completed under the plan. What only was to be subject to an assessment appeal

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<sup>11</sup> op.cit. Footnote 6.

was this inequity between 'similar properties in the vicinity' . . . (emphasis added)."<sup>12</sup>

The question which arises in this paper is whether the current legislation:

1. Intends that:
  - a. market or current value is fixed as of the January 1, 2008, valuation date; and
  - b. subsequent assessments during the four-year assessment cycle cannot be adjusted but for inequities with respect to similar real property in the vicinity on the last assessment roll (ie. on the same basis as was the case in the 1970's and 1980's); or
2. That it intends that:
  - a. market or current value is assessed annually as of the January 1, 2008, valuation date; and
  - b. each assessment can be adjusted for either or both of:
    - i. changes in current value arising from normal and abnormal depreciation (including economic obsolescence), subsequent to January 1, 2008; and
    - ii. inequities with respect to similar real property in the vicinity on the last assessment roll;

The latter approach would recognize changes in market or current value after the statutory valuation date as a sufficient basis for an assessment adjustment. This interpretation is certainly preferred by advocates for unique properties or industries for which there is no similar real property in the municipality<sup>13</sup>. However, such an approach will tend to invoke opposition from the local municipality.

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<sup>12</sup> Ontario Regional Assessment Commissioner, Region No. 13 v. Downtown Oshawa Property Owners Association, (1978), 88 D.L.R. (3d) 303 (S.C.C.), at 306 per Spence J.

<sup>13</sup> Ontario Property Assessment Corporation and City of Thunder Bay v. Saskatchewan Wheat Pool et al. (2001), 18 M.P.L.R. (3d) 212 (Divisional Court).

Nonetheless, this approach was accepted by the Divisional Court in the Peat Marwick decision (supra).

The recognition of economic obsolescence is now entrenched in the assessment process. In 1997, MPAC published a memorandum which stated:

“ . . . we must value properties based on a value in exchange and not a value in use. . . . If there is strong evidence in the market place of the existence of economic obsolescence, then we must be prepared to recognize it. . . .”<sup>14</sup>

MPAC applies a market adjustment factor (“MAF”) to the total square footage of industrial buildings. The MAF percentage varies from region to region across the province. In 2000, MPAC issued guidelines for applications of MAF’s which states:

“The purpose of the MAF is to recognize the effect of the market place when comparing cost values for industrial properties to estimates of market values based on actual sales prices.”

The MAF is a crude attempt to quantify economic obsolescence, as it generally considers sales of all industrial properties and does not set MAF’s for different property types. The only variable built into MPAC’s MAF model is property size. Nonetheless, the MAF is an attempt to appraise en masse an adjustment required “to recognize the effect of the marketplace”.

Many assessment appeals have floundered on the economic obsolescence issue for lack of evidence.<sup>15</sup> Conversely, the weakness of the MAF as a property-specific tool of appraisal has led to the negotiated resolution of appeals which raised economic obsolescence issues, where quantitative evidence of obsolescence existed.

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<sup>14</sup> Memorandum of Larry Hummel, Director, Appraisal Services Branch of Municipal Property Assessment Corporation dated December, 1997.

<sup>15</sup> R. Difruscia Holdings Ltd. v. Ontario Property Assessment Corporation, Region No. 18, O.A.R.B.D., May 11, 2001, 2001 CarswellOnt 8725.

Noble Industrial Enterprises Inc. v. Municipal Property Assessment Corporation, Region No. 13, O.A.R.B.D. August 3, 2007, 2007 CarswellOnt 5061.

As discussed below, the appraisal of real estate requires the valuator to provide an opinion of how much a knowledgeable buyer would pay - in this case on January 1, 2008 - for the right to the property's future benefits:

“When a property is on the brink of a major directional change, its value must accurately reflect the markets anticipation and properly factor it into each of the applicable valuation methods.”

What happens after “directional” economic change occurs and the assessor resists factoring that change into the valuation method because of a fixed valuation date?

### **UNIFORMITY IN VALUE**

The generally accepted assessment practice in Ontario for an assessment valuation to the statutorily mandated valuation date will consider economic events not only in the base year for valuation, but also in the two shoulder years. For purposes of this discussion, where Ontario has established a January 1, 2008 valuation date for taxation years 2009-2012, the shoulder years are 2007 and 2009.

The principles of anticipation, change, supply and demand, competition and substitution are fundamental to understanding the dynamics of value. The anticipation of future benefits is the fundamental basis of value, or as Justice Oliver Wendell Holmes is reputed to have said: “All values are anticipations of the future”.<sup>16</sup> Underlying the theory of value is the prescription of a stable market in the time of valuation.

In determining the value of an income producing property, the assessor must ask and answer “What would the typical tenant be willing to pay for occupancy of a particular property for a specified period of time?”<sup>17</sup>

Expert opinion evidence given on behalf of MPAC and referenced in the “Bank Towers” decision of the Assessment Review Board indicated that leases commencing during the base year and the two shoulder years were relevant to answering that question:

“During the course of the hearing, counsel for MPAC indicated that ‘the scope of the inquiry’ was ‘three calendar years, that is

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<sup>16</sup> The Appraisal of Real Estate (2<sup>nd</sup> Edition): Appraisal Institute of Canada, pages 3.2 - 3.3 and 20.2.

<sup>17</sup> Re Cardinal Plaza Ltd. and Regional Assessment Commissioner, Region No. 19 (1985), 15 D.L.R. (4<sup>th</sup>) 156 (Ontario C.A.).

the middle year and the two shoulder years, in terms of negotiation’.”<sup>18</sup>

It is generally accepted that sales or rents in the base year and the shoulder years for the subject property are the best indicator of current value. The use of shoulder years, both looking back and looking forward, is an accepted principle of assessment practice in Ontario.<sup>19</sup>

The object of considering three years is to establish a stabilized picture of value, which is the proper foundation for expert opinion. In order to establish a correct opinion of current value, the value must reflect “the buyers’ anticipation of the future and the position of the subject in its market cycle”.<sup>20</sup>

The application of the forward-looking elements of this principle require consideration of, for instance, leases signed in 2009 for commercial office buildings and shopping centres, and the reference to 2009 vacancy rates and 2009 REVPAR for hotels.

The *Assessment Act* provides that, upon appeal, the Assessment Review Board may reopen the whole question of the assessment and the Board, for purposes of the review, has all the powers and functions of the assessor. It has been said that any assessment is provisional until all assessment appeals are finalized and then entered on the roll. In that case, any assessment determined on appeal will be necessarily

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<sup>18</sup> BCE Place Ltd. v. Municipal Property Assessment Corporation, Region No. 9, [2008] O.A.R.B.D. No. 61.

<sup>19</sup> Regional Assessment Commissioner, Region No. 3 v. Assessment Review Board, [1997] O.M.B.D. No. 1458; 1997 CarswellOnt 6440.

Regional Assessment Commissioner, Region No. 7 v. Hunt (1996), 34 O.M.B.R. #1, 1996 CarswellOnt 5682.

Valenti v. Ontario Property Assessment Corporation, Region No. 28, [1999] O.A.R.B.D. No. 324; 1999 CarswellOnt 6443.

Westgate Holdings Inc. v. Municipal Property Assessment Corporation, Region No. 15, 2001 CarswellOnt 9314.

Simpson v. Ontario Property Assessment Corporation, Region No. 22, [2000] O.A.R.B.D. No. 1184; 2001 CarswellOnt 9633.

<sup>20</sup> “Marketability Analysis: The Key to Credible Valuation in a Changing Market” by David Lennhoff, presented to the CPTA National Symposium in Toronto, February 17, 2009.

retrospective, but based on evidence looking both backwards and forwards from the valuation date. The Board determines current value as of the valuation date, but must consider the state and condition of the property as of return of the assessment roll.

The economic collapse of late 2008 and into 2009 is a relevant consideration for 2009 taxation.

A property specific market analysis must be incorporated into the valuation process in order to properly reflect the onset of a severe market decline.<sup>21</sup>

A marketability analysis is a demand and competition study for a specific property. The analysis forms the basis of the subject property's forecast of future revenues. A revenue forecast as part of applying the income capitalization approach is a marketability conclusion. The estimate of economic obsolescence in the cost approach is another marketability conclusion. The selection of comparable properties and their comparison in applying the sales comparison approach also requires a marketability conclusion.<sup>22</sup>

The prospect of determining a substantially reduced value for assessment purposes might well be tempered by consideration that the future contemplated value of the property exceeds the current value. The Supreme Court of Canada in the second decision in the matter of Dreifus v. Royds (for a subsequent taxation year) wrote:

“It is in many cases no easy matter to determine the ‘actual value’ of lands in many unsettled parts of Canada. Lands which a few years ago were in great demand and could easily be sold are now a drag on the market. In many cases they cannot be sold at all, and in such cases where there is practically no market or other equivalent tests of the actual value, it is plain that it is no easy matter to determine what the ‘actual value’ of the land is. It is plain, land cannot be treated as valueless because there are no purchasers to be found for it when assessed for taxes, and equally plain to my mind that in such cases the probabilities of a reasonably early return of a ‘market’ must be considered and weighed. Expert evidence on this point may be given and must be fairly weighed. This

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<sup>21</sup> Supra.

<sup>22</sup> Stephen F. Fanning, “Market Analysis for Real Estate”, Chicago: Appraisal Institute.

was done in the case before us after we had remitted it back.”<sup>23</sup>

In other words, in the face of a collapsing market, the administrative tribunal must consider “the probabilities of a reasonably early return of a ‘market’ . . .”.

Where there is clear evidence available to identify and measure economic obsolescence, such as a direct sale of the real estate, then the Board will be compelled to adjust the value, and, if necessary, can look to a sale which takes place outside the shoulder years.

In appropriate cases, a direct sale of the land and buildings in tax years 2009, 2010, 2011, or 2012 can be used to establish a 2008 assessment value and thus, measure the obsolescence inherent in the property. In a case on point, the Divisional Court said:

“Assessments are an annual matter and normally the Board should be afforded the opportunity to determine the market value for each year. In the present case, the evidence is overwhelming that the market value in the years 1986 and 1987 was less than the 1989 sale value.”<sup>24</sup>

In the absence of a direct sale, notwithstanding a freeze in assessments, the administrative tribunals and courts in Ontario historically recognized that changed market factors would produce changes in market values and thus, rigid uniformity of assessment would create inequities addressable in assessment appeals.

Starting with the 1970 taxation year, the Province of Ontario legislated the 1969 assessment roll to be used as the basis for taxation, pending the provincial reassessment. The purpose of this “freeze” was to facilitate the province-wide reassessment of lands to a subsequent base year. As it turned out, the provincial reassessment was delayed until the 1998 tax year.

The Courts found that, notwithstanding the apparent freeze, subsequent changes in values arising from changes in market forces could not be ignored:

“We do not think that all assessments are frozen for all time, in spite of whatever occurs in the market. The base remains the same, of course, but

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<sup>23</sup> Dreifus v. Royds, [1923] 2 D.L.R. 656 (S.C.C.) per Davies C.J.

<sup>24</sup> Peat Marwick Ltd., as court-appointed Receiver of Massey Combines Corp. v. Regional Assessment Commissioner, Region No. 20 et al. (1994), 31 O.M.B.R. (Div. Ct.).

if events alter values, creating inequities among similar properties in the same vicinity, it is open to the Board and the assessors to alter the assessments in order to reduce inequities."<sup>25</sup>

This reflects the general principle that there is a distinction between requesting a revaluation because the original assessment was in error, and requesting a revaluation because of circumstances subsequent to the initial valuation (ie. the 2008 current value) have caused a change in the present value of the property.<sup>26</sup>

### **UNIFORMITY OF ASSESSMENT**

Once consideration has been given to the economic circumstances and valuation of the particular property within the base year and the shoulder years, consideration must then be given to the equitable relationship of the taxpayer's property to its competitors within the marketplace.

The principle of equity as discussed above is broad-reaching, not only for purposes of establishing equity in the burden of taxation, but also equity in assessment. Recent amendments to the *Assessment Act* in Ontario clearly establish that for the 2009 taxation year the task is to:

- a. determine the current value of the land; and
- b. have reference to the value at which similar lands in the vicinity are assessed and adjust the assessment of the land to make it equitable with that of similar lands in the vicinity if such an adjustment would result in a reduction of the assessment of land."<sup>27</sup>

The recent economic dislocations which became manifest in late 2008 and thereafter have affected disproportionately different properties with different uses. In Ontario, steel mills and automobile plants have been severely disadvantaged by the economic downturn: much more than, for instance, high-tech production facilities. Similarly, it would appear that convention hotels have been disproportionately impacted when compared to suburban budget hotels.

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<sup>25</sup> Juper Holdings Limited v. Regional Assessment Commissioner, Region No. 30 et al., Ontario Divisional Court decision February 25, 1983 (unreported).

<sup>26</sup> Jupiter Realty Corporation v. Board of Tax Review of the Town of Vernon, (1997), 242 Conn. 363 (Superior Court 15580).

<sup>27</sup> *Assessment Act*, R.S.O. 1990, c. A.31, as amended, section 44(3).

If the decline in property value is disproportionate to that of similar real property in the vicinity, then section 44(3)(b) of the *Assessment Act* provides a clear remedy to establish an equitable lower assessment.

Concerns may be raised that the assessment base becomes unfairly distorted if other similar properties are assessed higher than their current values. However, the Assessment Review Board clearly addressed that concern when it said:

“While it is true that it may also be inequitable if other ‘similar lands in the vicinity’ are assessed higher than their current values, the answer is that the Board cannot resolve an inequity unless an appeal is brought before it.”<sup>28</sup>

If all similar real property in the vicinity, including the subject property, have declined in value, then in effect the obligation to establish current value is paramount. In that circumstance, any inquiry with respect to levels of assessment of similar real property in the vicinity will yield no justification to lower the assessed value of the subject property.

Thus, the application of equity may not produce a reduced assessment, if the assessor establishes that the proposed assessments of the subject property and the comparables “bear the same relationship to the true value, one with each other” because:

“It has been recognized that it is not particularly important that an assessment be individually correct, provided that all properties are assessed at the same proportion of their true values, so that each bears its fair share of the tax burden.”<sup>29</sup>

The object of ensuring an equitable and uniform burden of taxation will typically be a foundation of the assessor’s (and the municipality) opposition to property-specific value adjustments based on economic changes which impact the taxpayer’s property disproportionately when compared to similar real property in the vicinity. There is potentially a discordant policy tension between the quest for true value by the taxpayer on the one hand and the need for a uniform and consistent tax base on the other hand. The taxpayer will require skilled advocacy to advance appropriate valuation and assessment principles and help the Board to resist the simplistic, siren call of uniformity. However,

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<sup>28</sup> Dawson Properties Limited v. Municipal Property Assessment Corporation, Region No. 32 and the City of Thunder Bay (2003), 46 O.M.B.R. 147.

<sup>29</sup> Re Campeau Developments Ltd. et al., and Regional Assessment Commissioner, Region No. 29 et al. (1983), 41 O.R. (2d) 39 (Ontario C.A.).

appropriate uniformity of both value and assessment is achieved by considering various sources of information, comprehensive data and analysis. Refusal to consider the data and analysis referenced in this paper, and highlighted below, may lead to inappropriate assessments. Examples include:

- a. shoulder year data, for January 1, 2008 values;
- b. quantitative evidence of economic obsolescence arising after roll return; and
- c. forward-looking marketability analysis incorporated into the valuation process: whether cost or income based.