

# Business property tax assessments: This time it's technical

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By Jeff Cowan

*It took testimony from nine experts, weeks of hearings, and a review of hundreds of exhibits to interpret a statute and determine how business property should be assessed for municipal taxes. For the owners of six office tower complexes in downtown Toronto, it was well worth the effort.*

The February 22, 2008 Ontario Assessment Review Board decision involving six office tower complexes in downtown Toronto (the "Bank Towers decision") represented the culmination of one of the most lengthy and complex assessment appeals ever determined by the Board or its predecessors.

The decision which sided predominately with the taxpayers' interpretation of how business property should be valued could result in a retroactive savings of millions of dollars in assessed taxes for the property owners involved, and may have implications for other commercial property owners.

The City of Toronto and the Municipal Property Assessment Corporation (MPAC) have sought leave to appeal the decision to the Divisional Court, so a final determination of this case has not yet been made. But the findings of the Board will be of interest to commercial property owners throughout the province.

## **First step: Determine what has to be valued**

At issue in this case was a 1998 amendment to the *Assessment Act* that required land (including buildings) to be valued at its "current value", defined to mean "the amount of money the fee simple, if unencumbered, would realize if sold at arms-length by a willing seller to a willing buyer."

MPAC argued that it's not enough to value land by reference only to the owner's interest where that land is subject to a lease that creates a tenant's interest of substantial value. It should be the totality of the interests in the property that are used to determine an assessment value.

The Assessment Review Board disagreed. It noted that the 1998 amendments removed the former requirement that land be assessed against tenants to the extent of their occupancy as the basis for business taxes and it contrasted the *Assessment Act* definition of land (a physical description including buildings and structures) with that of the *Expropriation Act*, which specifically defines the interests in land to be valued, including those of tenants.

It further found that leases were legal encumbrances on an owner's fee simple interest, in that they limit an owner's ability to deal with its fee simple estate. The Board also noted that a tenant's interest in a lease was personal property, which was not subject to assessment.

In the end, the Board found that “fee simple, if unencumbered” did not express a legislative intent to assess all interests, including tenants’ “market” interest or value (positive or negative) of its lease contract.

#### **Next step: Determine how to value**

Having determined the legal meaning of the statute, the Assessment Review Board had to decide which of the two competing valuation methodologies presented at the hearing best met this statutory definition.

MPAC proposed a method that replaced current contract rents with current market rents, with standard allowances for vacancy and management expenses and a capitalization rate determined from market sales of comparable properties.

The taxpayers also advocated a method that replaced current contract rents with current market rent. However, the capitalization rate was adjusted slightly upwards (from 8% to 8.75%) to reflect the added costs and risk of acquiring full current market rents for all leaseable areas for the entire property.

The Board accepted the taxpayers’ methodology, noting that MPAC’s own valuation guidelines provided that the unencumbered fee simple was to be valued “as if the subject space was vacant and available for let”.

The Board also settled a number of corollary but important valuation issues, based on the extensive evidence given at the hearing:

- **Market rents.** The Board found that market rents were to be determined for that of a typical tenant and a typical unit, in this case a tenant occupying one full floor or more. MPAC had used all market rents available in the relevant time frame, including less than full floor leases.
- **Renewal rents.** While the taxpayers proposed assessing the value based on new leases of full floor tenants and not renewal rents, the Board found that renewals, expansions and “blend and extends” for a full floor or more were part of the market, and should be included in the analysis.
- **Adjustments to face rent.** The Board also determined that face rents should be adjusted to reflect cash inducements, lease takeovers, rent-free periods and lease commissions. It also found that the standardized vacancy allowance should reflect the actual revenue loss incurred and be applied to the estimated potential gross revenue of the property, not the revenue after deduction for non-recoverable operating costs.
- **Parking income.** The Board determined that parking revenue should reflect monthly charges for unreserved parking spaces applied to all parking spaces, and that income from transient (daily and hourly) use was not to be added.
- **Tenant improvements.** There was extensive, non-contradicted evidence that new typical tenants attributed no value in exchange to the existing improvements, and the Assessment Review Board determined that the fair market rent was not to be adjusted upwards to reflect any value of tenant improvements. The Board clearly noted however that this finding was restricted to the facts of this case, and that the assessed value in other cases could include the value of tenant improvement.

Based on these new ground rules, the Board asked the parties to determine the appropriate market rents and resultant changed assessments. Both the results of the final assessments and the status of the leave to appeal application remain to be determined.

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