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PROPERTY UPDATE

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Business property tax assessments: This time it's technical

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

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– 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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Jeff is one of Canada's most highly regarded administrative law and public law specialists. He is a partner at the firm and a recognized senior civil and public law litigation lawyer with extensive tribunal and appellate court experience. Jeff regularly litigates in matters relating to real property, including development approvals, purchase and sale disputes, lease and contract interpretation, expropriation, valuation, taxation, boundary and ownership issues, land claims by First Nations, and arbitration proceedings, including acting as an arbitrator and mediator. Jeff represented one of the largest bank tower complexes in the case discussed. Contact Jeff at 416.947.5007 or jcowan@weirfoulds.com.

DEFINITION OF THE DAY

RECESSION:

As economic growth slows in both the U.S. and Canada, the word recession is on the tips of many tongues. But before those tongues start wagging, let's look at how a recession is defined.

According to the Government of Canada, the term recession refers to a significant drop in economic activity, lasting more than a few months, as measured by the employment rate and real gross domestic product (GDP). GDP is defined as the total market value of all final goods and services produced within the country in a given period of time (usually a calendar year). A commonly noted "signpost" for a recession is two consecutive quarters of negative economic growth as measured by a country's GDP.

We're not there yet. The U.S. economy actually expanded in the first quarter of 2008, at a modest annualized rate of 0.6%. And while the strength of the Canadian economy in 2008 is expected to be equally modest, the Bank of Canada is still predicting growth for the first two quarters of 2008, not a retraction.

While no one can predict future economic growth with certainty, the recessionary barking in recent months appears worse than its bite. And that could mean business opportunities for those willing to ignore the chatter, assess the realities of the business environment in which they operate, and forge ahead with plans based on those realities – not based on the headlines of the day. □

Tenant bankruptcy and beyond

By Krista Chaytor

"Bankruptcy" is commonly used to describe a number of legal situations involving a tenant's financial distress. But with the rights and obligations of landlords and tenants determined by the true course of action taken, it pays for both sides to get the facts.

It's a common situation. A tenant is in financial distress and a number of terms – receiver, trustee, bankruptcy – get bantered about, with questions about legal obligations cropping up. Can the landlord terminate the lease or collect rent arrears? Is the tenant still responsible for making rent payments? Can the tenant assign or repudiate the lease?

While the term "bankrupt" is often used generically to describe a number of legal situations involving a tenant, the rights and obligations of landlords and tenants are anything but generic in each situation. Here's how different courses of action in dealing with a tenant's financial difficulties can affect the rights and obligations of each party.

PRIVATELY APPOINTED RECEIVER

If a tenant defaults on a loan or security agreement, a secured creditor may have the option of appointing a receiver based on the terms of the loan or security agreement. In general, the receiver steps into the shoes of the tenant and is subject to the same obligations. If the receiver takes possession of the leased premises, it is responsible for paying rent and has no greater rights than the tenant under the lease. Unless a landlord has signed an agreement giving special rights to the privately appointed receiver, they maintain all rights and obligations set out in the lease.

COURT APPOINTED RECEIVER

If a court appoints a receiver, the court order will set out the receiver's powers. Typically, the receiver takes control of the tenant's assets and the landlord is prohibited from terminating the lease or interfering with the receiver's right to possession of the premises without a court order. The receiver must pay rent at the rate set out in the lease, and the court order may allow the receiver to assign or abandon the lease. The landlord is generally prohibited from seizing goods to cover rent arrears without obtaining a court order.

INTERIM RECEIVER UNDER THE *BANKRUPTCY AND INSOLVENCY ACT* ("BIA")

To preserve a tenant's assets after they have filed for bankruptcy, a court will appoint an interim receiver before the petition for bankruptcy is actually heard. Usually, the interim receiver acts as a monitor and the tenant continues to operate its business. The tenant must continue paying rent and comply with the terms of the lease.

However, the landlord will likely be prohibited from terminating the lease or otherwise exercising its remedies, including the right to seize assets for non-payment of rent, unless it first obtains a court order.

TRUSTEE IN BANKRUPTCY

When a tenant's bankruptcy petition is successful and a bankruptcy order is issued, the trustee's role is to help in the orderly administration of the estate. The trustee has the right to occupy the leased premises (and must continue paying rent) for three months after the tenant's bankruptcy and can choose to retain, disclaim or in some circumstances assign the lease. The trustee's conduct is not governed by the terms of the lease as the trustee is entitled to take whatever steps are necessary for the orderly administration of the estate. The landlord cannot terminate the lease during this three-month period or seize a tenant's assets. Once a bankruptcy order is issued, however, the landlord has a preferred claim for 3 months arrears and 3 months accelerated rent.

BIA PROPOSAL

The BIA provides a system under which a tenant can restructure its business, make a deal with creditors to accept a percentage of the debts owing to them and continue in business. While the tenant is restructuring, a landlord can't interfere with the tenant's occupancy of the premises, take any steps to collect arrears, or terminate the lease without an order from the court. However, the tenant must continue to pay rent and is required to comply with the terms of the lease. At any time between the filing of the notice of proposal and the filing of the proposal itself, a tenant can disclaim the lease by giving the landlord 30 days' notice. The BIA contains a procedure allowing the landlord to challenge the disclaimer.

CCCA PROPOSAL

Under the *Companies Creditors Arrangement Act*, a tenant can also restructure and continue in business based on a court order, with rights and obligations similar to a BIA proposal. The court order frequently requires tenants to comply with the terms of use contained in the lease. The landlord cannot take steps to collect arrears, but arrears payments are usually dealt with as part of the proposal to creditors. Court orders frequently allow the tenant to abandon, disclaim or assign the lease, and provide that any resulting damages to the landlord be dealt with in the proposal. □

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Krista is an experienced litigator with a practice focused on business litigation. She represents both landlords and tenants in a variety of lease disputes including those related to use clauses, common area maintenance, lease terminations and relief from forfeiture, options to renew/extend, assignments/subleases and bankruptcy. Contact Krista at 416-947-5074 or kchaytor@weirfoulds.com.

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