Big Box Assessment Valuation
A Canadian Success Story?
Presenters

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Property Assessment in Ontario

• The basis of valuation is **Current Value**

• "Current Value means in relation to land, the amount of money the fee simple, if unencumbered, would realize if sold at arm’s length by a willing seller to a willing buyer”

• Essentially, the assessed value is to reflect the market value of the fee simple interest in the real property
Property Assessment in Ontario

• Assessed values are derived every four years (i.e. 2008, 2012, 2016) and their sole purpose is for the allocation of property taxes

• The Municipal Property Assessment Corporation (“MPAC”) is responsible for estimating the current values for all 5.5 million properties in Ontario

• If a party (i.e. owner, tenant, municipality) disagrees with the assessed value they may file an appeal with the Assessment Review Board
• There were appeals filed for 162 big box freestanding stores owned by a single operator

• The appeals related to the 2008 and 2012 current values and spanned 8 taxation years (i.e. 2009 to 2016)

• While working toward a resolution of the 2008 and 2012 current value appeals the parties kept an eye on the 2016 current values that would eventually impact the property taxes for 2017 to 2020
In recent years there has been extensive litigation throughout the United States. The issue is referred to as the ‘Dark Store’ approach whereby box stores have nominal values. Some states have revised their property tax laws to account for the issue. The decisions from the various states differ, but in many cases the assessed values are reduced dramatically leading to hardships for the cities and towns where they reside.
• Often appeals in Ontario are resolved by way of lengthy and contentious litigation – the appraisers and assessors are regularly subjected to examination for discovery and cross-examination by experienced legal counsel

• To resolve the appeals related to the 162 stores, the appraiser working for the assessed person and MPAC collaborated to solve the appraisal problem

• The appraiser and MPAC were also joined by a Municipal Working Group to assist in the process
Overview of ‘Canadian Success Story’

- While the appeals were resolved in a cooperative basis there was still supervision being offered by legal counsel (note that MPAC retained counsel too)

- Furthermore, the Assessment Review Board monitored the progress of the parties to ensure that progress was being made

- After many lengthy discussions an agreement in principle was reached between MPAC and the assessed person that addressed the 2008, 2012 and 2016 assessed values (i.e. 12 taxation years)
History of Big Box Assessments

- The 2008 assessed values were derived via the income approach.
- The assessed person stated the values were incorrect – the primary issues were Fair Market Rent and Capitalization Rate.
- The assessed person stated the cost approach was more suitable.
- After considering the assessed person’s concerns, MPAC opted to derive the 2012 values by way of the cost approach.
MPAC determined the cost of the stores by way of its Automated Cost System ("ACS")

The only form of depreciation reflected was physical deterioration and it was based upon a view that the stores have a 50-year useful life.

The land values were determined by way of the direct comparison approach.
While the assessed person may have agreed with MPAC’s decision to rely upon the cost approach they had three main concerns:

- The costs of the stores were overstated
- The depreciation was understated
- Some of the land values were incorrect (an issue some municipalities shared)

As it turned out, other big box retailers shared similar concerns – the list of appeals was much greater than for the 162 stores

A few hundred stores, 8 taxation years and over 100 impacted municipalities – absent typical litigation there was still going to be scrutiny
How Was the Appraisal Problem Solved

• MPAC needed to understand why it’s ACS overstated the cost of construction

• The assessed person shared the actual cost information for over 25 stores that it built in the relevant period

• The appraiser and the assessor each examined the information and arrived at similar conclusions – the costs were overstated by approximately 8 to 10 percent

• Reviewing the cost information was a highly objective exercise – similar conclusions were not surprising
Comparison of Cost New Analysis

Cost New Analysis

Building Footprint

Cost Per Square Foot

AEC Rate per SF

MPAC Rate per SF*

6/23/2017
• MPAC needed to understand why the depreciation was understated

• The assessed person stated that the stores suffered from functional and external obsolescence in addition to the physical deterioration already accounted for by MPAC

• This part of the problem was the most difficult to solve – however, the parties did agree that the best method would be to extract depreciation from the available market data
How Was the Appraisal Problem Solved

- Market Extraction Method to estimate total depreciation – what did we need?
  - Reliable cost estimates – after reviewing the cost data we had that part covered
  - Reliable land values – there were a sufficient number of vacant land sales
  - Sales of box stores that reflected market value – that was the hard part

- This is where the parties worked the hardest to solve the problem
How Was the Appraisal Problem Solved

- Both parties went to their separate corners and began to search for sales of box stores

- Many of the sales were clearly not market transactions and the parties pared the list down over the period of many months

- Many of the sales were also foggy due to the presence of restrictive covenants

- The suitability of some of the sales was less clear – in those cases each party would ‘make their case’ to the other and generally that led to a consensus (i.e. market or non-market)
How Was the Appraisal Problem Solved

• After reviewing the available market data and meeting to discuss the merits of the sales that were unclear, the parties agreed upon approximately 20 sales that could be relied upon to extract depreciation

• The resultant depreciation rates ranged from 1.3 percent to 6.8 percent per annum and the median was 3.0 percent

• At 3% percent per annum the implied economic life is 34 years – recall that the assessed values only reflected physical deterioration over a 50 year useful life – more depreciation was present
How Was the Appraisal Problem Solved

• The appraiser and the assessor didn’t arrive at identical conclusions regarding the economic life of a store
  
  • The assessor concluded 40 years – slightly greater to account for the restrictive covenants
  • The appraiser concluded that larger stores had a much shorter economic life of 20 to 25 years and that smaller stores had economic lives of 30 to 35 years
What Do the Sales Indicate?

Big Box Stores
Depreciation at Time Of Sales
Ultimately legal counsel negotiated a settlement whereby:

- the economic life for the 2008 and 2012 values was 35 years (no distinction for size) and 30 years for the 2016 assessed values; and,
- the depreciation would stop at 80% (20% good).
Depreciation Compared

Big Box Depreciation Comparing Existing and Proposed with MS Tables 25 and 30 (Arrows at 15 Years Old)

- Existing MPAC Table 83%
- MS 30 Year Table 65%
- MS 25 Year Table 52%
- SL 35 Year Table 57%

Building Age

Percent Good

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How Was the Appraisal Problem Solved

• It is important to note that neither the assessor nor the appraiser engaged in the negotiations – we left the advocacy to the lawyers.

• The assessor and appraiser each provided legal counsel with highly credible analysis that ensured that the lawyers could negotiate on equal footing.

• Legal counsel for both sides emphasized the importance of the valuators remaining objective throughout the exercise – *don’t* be influenced by the outcome – just arrive at the right answer.
• With 2 of the 3 main issues resolved, cost new and depreciation, only land values remained

• In a similar fashion, both parties retreated to review the available land sales to arrive at conclusions

• Equipped with market data the parties would meet to discuss the values and would once again ‘make their case’ as to what they considered the value to be – more often that not there was consensus.
How Was the Appraisal Problem Solved

- When the parties couldn’t agree upon the land value it was left to the lawyers to reach a negotiated settlement

- The parties engaged in respectful discussions throughout with the realization that capable appraisers would occasionally interpret the same data and arrive at different conclusions

- Periodically the municipalities would also participate in the discussions involving land values

- It must be noted that in some cases the assessed person agreed to land values that were greater than what was reflected in the original valuations
As previously stated, there were appeals spanning 8 years involving a few hundred stores and over 100 municipalities.

The parties worked together to explain the analysis to stakeholders on numerous occasions.

Given the magnitude of the property tax impact the parties understood that there was a shared responsibility to respond to municipal queries.

Often the assessor bears the entire burden of explaining revisions – the presence of the assessed person ensured that the full perspective was communicated to stakeholders.
Success???

When big companies chase tax cuts, small towns suffer

ANALYSIS: Cities and towns across Ontario are at the mercy of a tax system in which their revenue can simply evaporate overnight — taking community projects and jobs with them

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Summary

• Determining the market value of a box store is harder than it sounds

• The appeal process doesn’t have to be so combative

• Collaboration is possible if the parties are competent and respectful

• Appraisers can view the same data and arrive at different conclusions

• Leave the advocacy to lawyers

• Lawyers need appraisers to equip them for negotiations