



Hamilton

**CITY OF HAMILTON**

**CORPORATE SERVICES DEPARTMENT**  
*Taxation and Financial Planning & Policy Divisions*

<b>TO:</b> Mayor and Members General Issues Committee	<b>WARD(S) AFFECTED:</b> CITY WIDE
<b>COMMITTEE DATE:</b> November 26, 2013	
<b>SUBJECT/REPORT NO:</b> Assessment Appeals Restricting Assessment Growth (FCS13080) (City Wide) (Outstanding Business List Item)	
<b>SUBMITTED BY:</b> Mike Zegarac Acting General Manager Finance & Corporate Services	<b>PREPARED BY:</b> Larry Friday ext 2425 Maria Di Santo ext 6247
<b>SIGNATURE:</b>	

**RECOMMENDATION**

- (a) That finance staff, through the General Manager’s office, continue to work with the Regional Treasurers group and the Ministry of Finance in their Special Purpose Business Property Assessment Review;
- (b) That recommended changes to legislation and processes outlined in Appendix “A” to FCS13080 be considered by the Ministry of Finance and the Minister of the Attorney General as a way of strengthening property valuations and processes for appeals on commercial, industrial and multi-residential properties;
- (c) That finance staff continue to monitor major building permit activity and subdivision approvals to ensure that MPAC is picking up the new values and placing them on the assessment rolls as quickly as possible;

- (d) That finance staff continue to monitor the returned assessment roll and look at challenging assessment values as previously authorized under By-Law 13-064;
- (e) That finance staff continue to monitor all outstanding assessment appeals filed for commercial and industrial properties and participate in such appeals so that all parties are aware of the municipalities' concerns in getting appeals settled quickly and fairly for all parties;
- (f) That report FCS13080 be forwarded to the Association of Municipalities of Ontario (AMO) and the Regional Treasurers group for their support and endorsement and to the Ministry of Finance and the Ministry of the Attorney General;
- (g) That the subject matter be identified as completed and removed from the Outstanding Business List.

## **EXECUTIVE SUMMARY**

During the 2013 budget process, Finance staff were directed as follows:

“That staff be directed to bring a report back to the General Issues Committee outlining what measures can be taken, both through internal staff resources, through the Association of Municipalities of Ontario (AMO) and inquiries of other municipalities, to address and challenge issues that are detrimental to municipalities with respect to restricting assessment growth through assessment appeals.” (February 28, 2013 GIC)

This report will detail the issues, what is being done or has been done, and what measures can be taken both internally and externally. Assessment appeals have always been a large factor in municipal budgeting, affecting growth and leading to large tax refunds. While there is a regulated system in place for assessment appeals, staff feel that with a little adjustment, the system can be improved.

While the past few years have seen record building permit activity due to the activities of the City of Hamilton Economic Development division, there have also been a number of assessment appeals which has lessened the overall impact on assessment growth. The assessment appeals that have reduced the assessment base have occurred primarily in the commercial, industrial and multi-residential property classes.

Another factor to consider is the timelines associated between getting a building permit and having the construction complete, occupied and assessed by the Municipal Property Assessment Corporation (MPAC). An example of this would be the new Maple

Leaf food plant originally showing on 2011 and 2012 building permit activity reports but not expected to show as assessment growth until 2014.

Another significant factor is that not all types of building activity translate into equal or similar taxable assessment growth. For example, institutional or government building activity can account for large building permit revenue but these types of developments may result in some exempt assessments for tax purposes. Machinery and equipment sometimes is also included in building permit numbers, but are not assessable for tax purposes.

***Alternatives for Consideration – Not Applicable***

**FINANCIAL / STAFFING / LEGAL IMPLICATIONS** (for Recommendation(s) only)

**Financial: N/A**

**Staffing: N/A**

**Legal:** Possible changes to the Assessment Act. No impact for City Staff.

**HISTORICAL BACKGROUND** (Chronology of events)

While Hamilton has been doing quite well with record building permits, there have also been a number of assessment appeals which has lessened the overall impact on assessment growth. One of the major factors is the result of large assessment losses in the commercial, industrial and multi-residential property classes. These types of assessment appeals tend to be quite complex and time consuming. Municipalities are increasingly experiencing more and more province-wide appeals for certain types of properties, such as major retail chains. As a recent example, there were assessment reductions on a province-wide basis for golf course appeals that covered, in some cases, over 10 years of outstanding appeals. Hamilton had a total of 22 golf courses under appeal, some dating back to 2003. The cumulative reduction over a 10-year span in taxes amounted to \$1.9 million.

This trend in appeals is not unique to Hamilton and is affecting every municipality with major retail chains, older industrial properties and multi-residential properties. Through the Regional Treasurers Association, these issues have been brought forward to the Ministry of Finance. In the 2013 Provincial Budget the province has set up a “Special Purpose Business Property Assessment Review”. For more detail on this please see Appendix “B” attached to this report FCS13080.

### **Assessment Appeal Process**

The Municipal Property Assessment Corporation's mandate is to assess every property in Ontario on a four year assessment cycle. There are over 4.9 million properties in Ontario. Property owners and or tenants can appeal assessment values on a yearly basis. Appeals must be filed by March 31 of the tax year for which they are appealing their assessment. Residential appeals are first handled by MPAC and the property owner. If there is no agreement these can then be taken to the Assessment Review Board (ARB).

Commercial, Industrial and Multi-residential appeals are much more complex and are usually taken directly to the ARB where they are streamed depending on certain factors. Large complex appeals can take years before they are resolved. The complexity of the property and the issues are a major factor, but so are the resources of MPAC, the ARB, lawyers, tax consultants and expert witnesses. It should be duly noted that both the ARB and MPAC recognize in their 2013 work plans that the length of appeals from start to finish are taking too long. Both organizations have promised that at least 90% of all current appeals in this new assessment cycle (2013 to 2016) will be heard and rectified within this four year period. Municipalities are encouraged by this commitment and will be participating and monitoring this to hopefully see that this goal is met.

By law municipalities are party to the ARB appeals. To actively participate would require a number of lawyers trained in assessment law and large budgets for expert witness fees and consultant fees. Staff currently monitor the ARB appeals and participate in a variety of pre-hearing events in order to maintain status and to ensure that the City's interest is protected. This is accomplished by ensuring that there are proper factual justifications for revisions or reductions prior to signing off any appeals. This also enables staff to voice their opinions on processes during the events and ensures that the ARB, MPAC and property owner or tax agents are aware of the City's concerns with respect to any delays which helps to ensure appeals are dealt with as quickly as possible. In this regards staff have also acted as arbitrators getting both sides together to reach fair settlements within a shortened time frame. Staff also belong to and participate in a municipal group titled Municipal Assessment Review Representatives (MARR), that meet regularly to discuss common assessment appeals and assessment issues that affect each and every one of us.

### **Commercial Assessments**

There are a number of standard assessment practices for commercial type properties that MPAC uses to value a property. The direct comparison approach (sales), a costing approach which estimates the land value plus the replacement cost of the improvements (buildings, structures), or an income approach that factors in rents,

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expenses and a capitalization rate. Descriptions and more details of these valuation methodologies are included in Appendix "C" to FCS13080.

While the sales approach should be the most defensible, there are not usually many of these properties entirely comparable in the same geographic locations, or doing exactly the same commercial type of activity. Under the income approach, in many cases MPAC is not being supplied with the income and expense information. When the information is finally provided, it becomes factual information that may will lead to a valuation reduction, and hence a refund of taxes. The cost approach is based on estimating the land value in addition to the cost to replace the improvements [building(s) and/or structure(s)] factoring in such things as depreciation. Assumptions and opinions under this method are open to interpretation and can be challenged. Experts in the field can have differing opinions, putting a chairperson at the ARB in a position of which expert to believe.

Commercial properties tend to be unique and constantly changing. MPAC may change the valuation methodology from one assessment cycle to the next, which may lead to assessment challenges. Tax consultants will always look for the methodology that leads to the lowest assessment value and challenge properties where that would lead to an assessment reduction. Tax consultants have recently been bundling these appeals province wide, leading to long time frames to settle such appeals. These appeals cover major retail chains as well as other types of commercial properties such as all big box type retailers. While the yearly appeal amounts may be low, when you factor in the large number of properties and the years under appeal, it can lead to significant refunds that the municipality has to pay back.

A current trend has many retail businesses expanding their product lines to remain competitive. There are pharmacies and general merchandise stores selling food, grocery chains selling clothing and branching into pharmacies. By branching out to be competitive, their profit margins are dropping and hence their values. Tax consultants are therefore challenging the values and winning reductions based on factual information. To the detriment of municipal taxes, this is taking time and leading to lower commercial values and taxes affecting any gains made in overall growth.

### **Industrial Assessments**

Industrial properties are generally unique and for the most part valued on the cost approach. They have many factors that go into costing models that MPAC uses to value these types of properties. Everything from the thickness of a cement floor, to the type of metal used to clad a building, to the value of the Canadian dollar, can affect the ultimate valuation of a property. The condition of the buildings and lack of maintenance by the owners can also lead to adjustments to the value. In many cases these types of properties have not undergone a detailed review by MPAC and the property details

inputted in the costing valuation may not be current or accurate. As Hamilton has a fair number of older industrial properties, we have seen a fair number receive reductions based upon corrections to property components which are factual in nature.

Assessment consultants have the expertise and staff to evaluate MPAC's costing models and challenge areas where they know the data may not be correct. Once again this is a rather large and time-consuming task. These types of appeals can take on average 3 to 4 years to settle, which has led to some large reductions on the industrial side. The older the facilities, the greater the chance of reductions in the assessment value due to functional and/or economic obsolescence.

### **Multi-Residential Assessments**

Multi-residential properties, similar to commercial properties, are assessed on an income approach. The methodology used for these properties is the "Gross Income Multiplier", which is derived from comparing sales of similar apartments based on an apartment's actual operating statements and the rental rolls provided by the owners. In many cases there are challenges as the market value rents are different than the actual rents charged, full expenses may not be correct or the extent of vacancies may not be known. If MPAC is not provided with the correct information, they need to make assumptions which, under appeal, may not hold up. Once the factual information is provided, it may lead to assessment reductions and hence tax refunds.

Another issue that is starting to occur is the conversion of multi-residential properties into condominium corporations. This would lead to negative growth in the Multi-Residential sector and growth in the Residential sector. In a number of properties the same owner(s) of the apartment will create the condo corporation and continue to rent out the units to the current tenants. The benefit to the property owner is that a condo unit is taxed at the residential rate versus the multi-residential rate which is 2.74 times higher. MPAC would value the condo units based on what they determine they could sell for on the open market. If the value is less than 2.74 times the current value of the apartment unit, the municipality would see a net loss in the taxes on that property. Where the property is remaining as rental condos we are seeing the unit valuations increase, but only by up to double the apartment value per unit, leading to a net loss in these conversions. Generally there have been no significant improvements to the units in changing them over to condo units which would substantiate a larger valuation increase. Without any actual sales in the building to third parties it is then difficult to challenge the valuations put on the units by MPAC.

As there has been very little growth in the building of multi-residential properties in Hamilton in the last 20 years, any loss in value and/or conversion to condos is going to show as negative growth in this sector. It is important to note that newly constructed multi-residential buildings and/or conversions from non-residential to multi-residential

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are assessed similar to older existing multi-residential properties. However, these new multi-residential properties are classified as New Multi-Residential (NT) which has a tax rate equivalent to that of the residential tax rate. Therefore, even if we experience assessment growth for multi-res properties, the municipal levy generated would be significantly less as they are taxed at a reduced rate.

**Residential Assessments**

Residential values are based on very good data MPAC tracks on home sales by area. For the most part they have these values correct and there is little lost in assessment appeals. Hamilton has seen some large growth areas in residential building and this is the one area where the assessment growth is offsetting the assessment losses in the other areas.

**Assessment Growth**

As identified in staff report FSC13021 “2012 Assessment Growth” the following table breaks down the 2012 assessment growth into major property class:

	Change in Unweighted Assessment		Change in Weighted Assessment		Change in Municipal Taxes	% Class Change <sup>1</sup>	% Total Change <sup>2</sup>
Residential	\$ 551,562,110	→	\$ 551,562,110	→	\$6,014,130	1.3%	0.9%
Multi-Residential	\$ (41,542,080)		\$ (87,309,940)		(\$1,033,310)	-1.3%	-0.1%
Commercial	\$ 6,180,020		\$ 17,043,890		\$187,050	0.2%	0.0%
Industrial	\$ 2,410,410		\$ 12,456,180		\$34,380	0.3%	0.0%
Other	\$ 6,439,740		\$ (681,450)		\$15,110	-0.1%	0.0%
<b>Total</b>	<b>\$ 525,050,210</b>		<b>\$ 493,070,800</b>		<b>\$5,217,370</b>	<b>0.8%</b>	<b>0.8%</b>

<sup>1</sup> % change in respective property class weighted assessment

<sup>2</sup> % change in total weighted assessment

As shown above, the 2012 net assessment growth of 0.8% is primarily driven by the residential property class (0.9%), reduced slightly by reductions in the Multi-Residential property class (-0.1%). Changes (either increasing or decreasing) in the remaining classes, as a whole, did not have an overall impact on the net growth realized. Although growth was experienced in the remaining classes (for example industrial assessment growth as a result of Canada Bread), significant write-offs and successful appeals have offset this growth, resulting in marginal growth of the commercial and industrial property classes of 0.2% and 0.3% respectively. When compared to the entire assessment base, however, this marginal growth did not improve the overall net growth of 0.8%.

A survey was done of municipalities in the MARR group as to their expected assessment growth. This was an informal survey as many of these groups have yet to report to their councils. They have all expressed the same concerns that are being

experienced here with appeals and many are expecting lower than average growth for 2013. This will become clearer once the assessment numbers are out provincially.

### **Monitoring of Building Permits Issued**

Staff proactively monitor all building permit activity and track the progress of the permits to ensure MPAC is picking up new construction on a timely basis. Regular meetings are held with MPAC staff and requests for inspections on new or altered sites. While the focus is on commercial and industrial properties, staff also monitor subdivision activity to ensure residential growth is also being picked up actively and assessment class and value changes picked up where property is being developed. On top of this, staff work closely with the Hamilton Port Authority and Hamilton International Airport to ensure any building activity and leases are being picked up. The Building Division of Planning and Economic Development have been working with MPAC to meet their electronic submission of building permit activity which is taking place on a monthly basis. This monthly electronic upload to MPAC replaces a manual system and will have the benefit of having MPAC better able to direct resources to pick up new assessments on a timely basis.

### **POLICY IMPLICATIONS/LEGISLATED REQUIREMENTS**

### **RELEVANT CONSULTATION**

Municipal Assessment Review Representatives  
Regional Treasurers

### **ANALYSIS / RATIONALE FOR RECOMMENDATION**

(include Performance Measurement/Benchmarking Data, if applicable)

Correct property assessment valuation is fundamental to municipalities for the proper budgeting and spending of tax dollars to support municipal services the taxpayers depend on. At the same time assessment appeals are a fundamental right of a property owner, and correct values can provide stability to them when budgeting their tax



expenses and asset values. Municipalities are simply looking for a stable environment in which we can depend on the valuations and the tax dollars collected as a result of those valuations. Having a strong diversified and vibrant commercial and industrial sector is healthy for a growing city providing needed tax revenues and jobs for its citizens.

The Province can greatly assist by looking to initiate changes that will clarify valuations for all involved, making it fair for all parties. As with any legislation or process, there are always adjustments that can only make the legislation stronger and the process fairer.

By simplifying and or strengthening valuation approaches there would be less volatility in the valuation of properties, assisting both municipalities and businesses in their budgeting to ensure stable revenue and expense projections. The Province can also assist by having the Assessment Review Board process looked at and enhanced to ensure that appeals are heard in a timely and effective manner which allows any valuation changes to be adjusted quicker, allowing Municipalities to budget tax revenues on the most up to date assessments.

#### **ALTERNATIVES FOR CONSIDERATION**

(include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)

N/A

#### **ALIGNMENT TO THE 2012 – 2015 STRATEGIC PLAN:**

##### **Strategic Priority #2**

Valued & Sustainable Services

*WE deliver high quality services that meet citizen needs and expectations, in a cost effective and responsible manner.*

#### **APPENDICES / SCHEDULES**

Appendix "A" Recommended Assessment Act Changes, MPAC process changes and ARB process changes.

Appendix "B" Special Purpose Business Property Assessment Review

Appendix "C" Property Evaluation Methodologies

## Recommended Process and Legislation Changes

### **Assessment Act Changes**

Under sections 11, 39 and 40 of the Assessment Act, clearly indicate what information Commercial, Industrial and Multi-residential property owners and tenants must supply to MPAC. Strengthen the legislation that any failure to do so under normal circumstances prevents the right to then appeal the assessment.

Under Ontario Regulation 282/98, clearly define what assessment methodologies are used for assessing properties, by property type. This will eliminate the switching of methodologies from one assessment cycle to another and provided greater stability to all parties.

Under Ontario Regulation 282/98, for larger industrial and commercial properties where sales data is non-existent, set standards on replacement costs per square foot to alleviate the values being subject to interpretation.

### **Process Changes – MPAC**

Have MPAC provide their Automated Costing System data to all properties assessed under a system similar to how Residential properties can access their valuations via the About My Property on MPAC's website. This will allow factual errors to be identified and corrected strengthening the accuracy of the values and leading to less appeals.

Have MPAC initiate a mandatory 5 to 7 year inspection program on Commercial and Industrial properties to correct factual information.

Have MPAC perform mandatory property inspections upon the sale of any commercial or industrial property to help support the recommendations above.

### **Process Changes – ARB\***

Schedule to a first pre-hearing event, those larger commercial and industrial valued property appeals categorized in the case managed stream, within the first year of the assessment cycle to establish clear procedural dates. Any dates not met should require show cause hearings which could result in the dismissal of the appeals for non-compliance. This is required to ensure large value appeals are heard on a timely basis by the ARB and are not being delayed into the following assessment cycle four years hence.

Raise the threshold amounts for the case managed stream so that more properties are put in the direct hearing stream and therefore heard and settled earlier.

Establish mandatory dates for the production of **Guidelines for Release of Assessment Data** (GRADS) for all property types, to again prevent delays.

If an appeal is based on a property valued using the income approach, establish a mandatory date for the production of income and expense information. Suggestion is August 30<sup>th</sup> in the year of the initial appeal as prior years income statements should have been filed by then. Again this can then lead to earlier settlements of appeals

- These suggested changes are a selection of changes originally filed by the Municipal Assessment Review Representatives to the ARB May 14, 2012

## **Province of Ontario Special Purpose Business Property Assessment Review**

As announced in the 2013 Ontario Budget, the Province will be working with municipalities, the Municipal Property Assessment Corporation (MPAC) and taxpayer representatives to review options to further strengthen property assessment processes and the property tax system in Ontario.

The review will be led by Steven Del Duca, Parliamentary Assistant to the Minister of Finance. It will build on prior initiatives including:

- clarifying and refining the assessment methodologies applied to special-purpose business properties, such as mills, landfills and billboards;
- revisiting the timelines for the assessment appeal process; and
- considering other opportunities to strengthen MPAC.

Ontario's property tax system plays a fundamental role in supporting local municipal services as well as the province's elementary and secondary school systems.

The intent is to complete the process in the fall of 2013, with potential for early resolution of certain issues.

An important part of the review is to receive input and ideas directly from stakeholders.

### **Working Groups**

Working groups are being established with municipalities and stakeholder representatives (including industry associations, taxpayer groups and other interested parties) to discuss the specific assessment issues that are part of the review. The purpose is to share information and establish a common understanding about proposed approaches.

## Accepted Property Valuation Methodologies

### 1. Direct Comparison Approach

This valuation method uses data collected in respect of properties sold in the market.

MPAC experts analyze the sale price and determine a "unit of comparison" (e.g. a price per square foot of floor space) which can be used, with adjustments, to value other properties of a similar type in the same locality.

Single Family Residences, Condominiums, Vacant Lands.

### 2. Cost Approach

The cost approach is based upon the "principle of substitution" which means that, if the direct sales comparison or income approaches are not appropriate, a prospective purchaser of a property would have regard to the cost of providing a similar property to the one being valued in determining the current value of the property.

The method is based upon estimating the cost of replacing the existing building, adjusting that cost to reflect any depreciation in the existing building, and adding the value of the land. MPAC's experts have access to up to date, comprehensive building cost data to support this valuation approach.

Industrial and Commercial properties (typically single occupant), i.e, Manufacturing Plants, Big box stores for the 12CVA (was on Income - Direct Capitalized for the 05 and 08CVA's)

### 3. Income Approach

#### A. Direct Capitalization

The income approach is normally used where the value of the property is dependent upon the income it can generate. The income that is, or can be, generated from rents or other income in relation to the property being valued is converted into a capital sum (current value) by the use of a capitalization rate which is derived from analysis of actual sales in the market.

MPAC use the "direct capitalization" method for the valuation of a variety of properties.

Direct Capitalization - Hotels, Motels, Nursing Homes, Retirement Homes, Office Buildings, Shopping Malls/Centres, Commercial & Industrial Plaza's & Strip Malls, etc.

Market value (MV) =  $\frac{\text{Net Annual Operating Income (NOI)}}{\text{Capitalization Rate (R)}}$

Net Annual Operating Income (NOI) = \$100,000

Capitalization Rate (R) = 10%

Market Value (MV) = \$1,000,000

B. Gross Income Multiplier

Gross Income Multiplier (GIM) - Multi-residential Apartment Buildings - 7 or more units (Hi-rise, Walk-up's, etc.)

MPAC uses the Gross Income Multiplier (GIM) method to value apartment buildings. This is a mix of the income approach and the direct sales comparison approach.

This method calculates the potential gross income that can be generated by the apartment building with reference to market rents then applies a multiplier (the GIM) to arrive at a current value for the property.

GIMs and rents are derived from information obtained from sales of apartment buildings and from annual operating statements and rent rolls reported by owners.

The GIM valuation method is based upon a comparison of sales of various types of apartment buildings and their gross potential annual income.

That is why the method is described as a combination of the income approach and the sales comparison approach.

The basic formula is: Potential Gross Annual Income X Gross Income Multiplier

Potential Gross Annual Income (PGAI) = \$100,000

Gross Income Multiplier (GIM) = 10

$PGAI \times GIM = \$100,000 \times 10$

Current Value Assessment (CVA) = \$1,000,000