

# LIMITED MARKET, SPECIAL PURPOSE VALUATION REVISITED

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**"IF THERE ARE NO BUYERS AND SELLERS FOR A SPECIAL PURPOSE PROPERTY, WHAT CAN FORM THE BASIS OF THE MARKET VALUE OPINION?"**

**A** bidding by a legal requirement to render an opinion of market value (e.g., real property assessment) for limited market, special purpose properties presents a difficult challenge for the appraisal community. If there are no buyers and sellers for a special purpose property, what can form the basis of the market value opinion?

Until 2004, the unequivocal answer throughout Canada was that the owner of a limited market, special purpose property could be regarded as a potential purchaser and the amount the owner would pay to replace the property could be taken as a measure of market value. In 2004, the British Columbia Court of Appeal in *Southam Inc. v. Surrey/White Rock Assessor, Area No. 14*, 2004 BCCA 245 [*Southam*] held that, where there is no market of buyers and sellers, reliance upon the amount an owner will pay produces nothing more than the value to the current owner and thus violates the proscription against ‘value to owner’ in assessment law. *Southam* directed that market value is to be established according to some alternate use for which there is a demonstrable market of buyers and sellers. Early in 2016, the Court of Appeal rendered its decision in *Assessor of Area #01 – Capital v. Nav Canada*, 2016 BCCA 71 [*Nav Canada*] overturning *Southam* and reinstating the pre-*Southam* position.

## Appraisal guidance

*The Appraisal of Real Estate* (3d Cdn. ed.), at page 2.13, provides the following guidance:

Limited market properties may be appraised based on their current use or the most likely alternative use. Due to the relatively small markets and lengthy market exposure needed to sell such properties, there may be little evidence to support an opinion of market value based on the current use ...

If a property’s current use is so specialized that there is no demonstrable market for it, but the use is viable and likely to continue, the appraiser may render an opinion of use value, if the assignment reasonably permits a type of value other than market value. Such an estimate should not be confused with an opinion of market value. If no market can be demonstrated or if data is not available, the appraiser cannot develop an opinion of market value and should state so in the appraisal report. However, it is sometimes necessary to render an opinion of market value in these situations for legal purposes. In these cases, the appraiser must comply with the legal requirement, relying upon personal judgement and whatever direct market evidence is available ...<sup>1</sup>



Does *Nav Canada* give a basis for establishing market value for limited market, special purpose properties? If so, is it any more compelling than the *Southam* alternate use approach?

**Assessment of real property for tax purposes**

Where *ad valorem* real property assessment imposes a legal requirement to determine market value, there is no proviso limiting the requirement to instances where there is a demonstrable market.<sup>2</sup>

Until the early years in this century, *Montreal v. Sun Life Assurance Co. of Canada*, [1952] 2 D.L.R. 81 (J.C.P.C.) [*Sun Life*] and the cases that followed *Sun Life* allowed that the owner of a special purpose property could be considered a potential purchaser and that the cost the current owner would pay to replace the property could be used as a gauge of market value. In this way, use of the cost approach to determine market value was endorsed by the courts.<sup>3</sup>

In 2004, the efficacy of employing the cost approach in relation to limited market, special purpose properties was challenged in *Southam*.<sup>4</sup> The court concluded that market value is premised on the market-derived concept of highest and best. At paragraph 22 of *Southam*, Madam Justice Levine writing for the Court of Appeal stated the following:

[22] It seems to me that, if the owner is to be considered a potential purchaser, there must be at least one other potential purchaser for the current use. Otherwise, there can be no competitive bidding and no market. This is this case: there is no market, other than the current owner, for the current use. Therefore, determining the market value of the property based on its current use inevitably leads to determining the value of the current use to the owner, and not market value.

The Supreme Court of Canada dismissed an application for leave to appeal *Southam*.

In retrospect, *Southam* did not gain the traction many of us in the

assessment community thought it would. Subsequent judicial consideration of *Southam* has been spotty, perhaps having its greatest influence in the assessment community of Newfoundland & Labrador, but receiving little attention in the remaining jurisdictions in Canada. However, in 2012, *Nav Canada* initiated appeals of assessments of its air traffic control towers at airports throughout British Columbia relying upon the limited-market, special purpose nature of the properties on the one hand and, on the other hand, the restricted uses dictated by the operating agreements in place with the federal government.

In *Nav Can*, the British Columbia Property Assessment Appeal Board and the British Columbia Supreme Court believed they were bound by *Southam* and reduced the assessments to a nominal sum. The Assessor appealed to the British Columbia Court of Appeal. Chief Justice Bauman, writing for the court, defined the issue: “How does one value lands and improvements for

assessment purposes that are dedicated to a single purpose, entirely unique, with no identifiable market and used by a monopoly for the restricted use?”

In *Nav Canada*, the Court of Appeal pointed to the aspect of market value that hypothesizes a purchase price negotiated by a seller who is not obliged to sell and a buyer not obliged to purchase the subject property and to the recognition in *Sun Life* that this ideal may not be possible for unique or exceptional circumstances. In such circumstances, other means are required to arrive at market value including depreciated replacement cost. In *Nav Canada*, the Court of Appeal held that *Southam* was incorrectly decided because it did not conform to the following passage from *Sun Life* at page 90:

Their Lordships would agree that, where no sale is contemplated and indeed any sale would be difficult, what has been called the higgling of the market is not an element of much if any consequence, but, nevertheless, the ultimate aim is to find the exchange value of the property, i.e., the price at which the property is salable. In reaching their result, the appointed Tribunal must take into account not only the amount that a buyer would give, but also the sum at which the owner would sell. What that sum would be is, as the authorities have pointed out, best ascertained either by regarding him as one of the possible purchasers or by estimating what he would be willing to expend on a building to replace that which is being valued. But the owner must be regarded like any other purchaser and the price he would give calculated not upon any subjective value to him, but upon ordinary principles, i.e., what he would be prepared to pay, if he was entering the market, for a building to meet his requirements, or would be willing to expend in erecting a building in place of that which is being assessed.

In *Nav Canada*, Chief Justice Bauman noted that the ultimate aim is to find the

exchange value of the property and, where there are no buyers and sellers, one has to have regard to the amount the owner would pay for the property; one must consider what the owner would pay to replace the building being valued. The Court stated frankly that, where there are no buyers and sellers, the appraiser must create a proxy for a competitive market. The question to be asked is what would occur if there was a buyer and a seller. One still has to avoid subjective elements of value that would devolve into “value to owner.” Chief Justice Bauman then reviewed the case law following *Sun Life* to affirm that market value is to be determined having regard to the owner as a potential purchaser or to estimate what the current owner would pay to replace that which is being valued.

The British Columbia Court of Appeal allowed the assessor’s appeal on the basis that *Southam* was wrongly decided and *Sun Life* is the binding authority. The case has been remitted to the Board to reconsider the evidence in light of the restoration of *Sun Life* and for consideration of the effect the use restrictions might have on market value.

### **Southam or Nav Canada?**

Is the *Southam* approach more defensible than the *Sun Life* approach? In the *Southam* approach, market value is unlikely to be achieved because the focus is on what a buyer will pay in an alternate use with no apparent regard to price at which the seller will agree to transfer property. On the other hand, *Southam*’s focus on highest and best use – the cornerstone of market value – is a market driven concept and, without a market of buyers and sellers for a property in a particular use, any other valuation approach is almost certainly going to lead to a proxy for market value rather than a direct conclusion obtained from the market.

Whether one favours the *Southam* approach or the *Sun Life* approach may be dependent upon one’s desired tax outcome. The *Southam* approach leads to owners and occupiers of multi-million dollar facilities reducing their assessments

to nominal amounts and thereby contributing only nominal real property taxes in satisfaction of a community’s real property tax burden. As we have seen in British Columbia, this result does not sit well with various levels of government and those sectors of the community that do not own limited market, special purpose facilities. On the other hand, if the assessment system is to be based on *ad valorem*, should the logical extensions of such a system be allowed to play out?

There are some points to bear in mind regarding the impact of *Nav Canada*:

1. The appeal was as much about the valuation consequences of restrictions on use as it was about valuation methodology. We will hear more on this in the not-too-distant future.
2. The decision is limited to situations where there is a legal requirement to set market value whether or not there is cogent evidence.
3. A jurisdictional exception is likely required within the appraisal report.
4. Legislation in a particular jurisdiction can alter the valuation requirements.

It will be interesting to see what other jurisdictions in Canada do with *Nav Canada*.

### **References**

- 1 *The Appraisal of Real Estate* (3d. Cdn. ed.), page 2.13
- 2 See for example *Assessment Act*, RSBC 1996 c. 20, section 19
- 3 *Sun Life, Office Specialty, Golden Eagle, Crown Forest*
- 4 *Southam*

*This article is provided for the purposes of generating discussion and to make practitioners aware of certain challenges presented in the law. It is not to be taken as legal advice. Any questions relating to the role of the appraiser as an expert witness should be put to qualified legal and appraisal practitioners.* 🇨🇦