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Recovery Tempo Edges Up

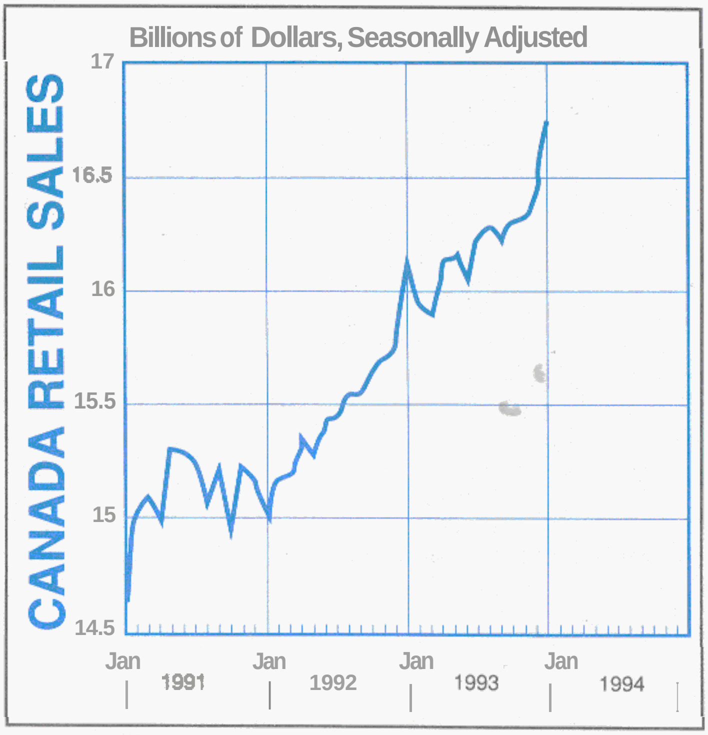
by Dr. Peter R. Andersen

Canada's recovery has more momentum now, but Canadian growth will fall well short of the growth in the U.S. in 1994. Real growth in Canada's Gross Domestic Product (GDP) will be about 3.0% compared to U.S. growth of 4.0%. This is still an improvement from the 2.4% Canadian growth in 1993.

The reasons for this notching up in the growth tempo In Canada axe:

1) a much improved U.S. economy
2) an even lower Canadian dollar. The currency is now down about 20% from its 1991 peak.

The combination has to mean more business for goods-producing Canadian companies.



The U.S. expansion has entered a new phase.
Unlike previous growth spurts in the U.S., the gains are now much better balanced across sectors and mainly reflect final demand, rather than inventory accumulation. Improved business sentiment, however, suggests that inventory accumulation will soon be a factor adding to growth. The volume increase in manufacturing is projected to be more than *6.0%*. However, a strong case can be made that GDP growth will settle down to a 2.3% annualized "inflation safe" rate in the second half of 1994.

Our Canadian growth forecast is still at the low end of the range of forecasts.
The bad news is that governments and financial services companies are still downsizing and shedding employees. There is no growth in personal disposable income (PDI) in Canada after linflation is taken into account. In real per capita terms, it declined by almost *2.0%* from the end of 1992 to the end of 1993.

With personal income this weak, the recovery is still very much an export oriented process with manufacturing the main beneficiary. We are predicting a very modest acceleration in personal spending but even this will be vulnerable to potential adverse shocks.

INSIDE THIS ISSUE

The Canadian dollar is in a new tail-spin.

The Canadian dollar began another step downward in early February when it became clear that monetary policy was taking divergent directions in the U.S. and Canada. The shift to a restrictive policy by the Fed started the sell-off in the Canadian dollar. News of an extraordinarily low February inflation rate in Canada, **0.2%** yearly, did not help the dollar. Instead, it was a sign to the market that the Bank of Canada would not see any inflation risk if the dollar went even lower.

ECONOMIC ALERT

A currency-related spike in Canadian interest rates could be a major blow to the tentative recovery just beginning in Canadian car sales and housing markets. An even lower Canadian dollar will further boost the competitiveness of trade-influenced Canadian companies, though, making the contrast between "hot" and "cold" sectors of the economy even more pronounced.

Don't be surprised if the dollar declines below its previous all-time low of $US **0.6913** (reached in Feb/86) before the sell-off finally ends. The issue of Quebec independence has not yet begun to raise its head. The provincial election in Quebec must be held by late November.

Canadian interest rates will go higher if the dollar continues to weaken.

The Bank of Canada has tried to avoid pushing rates up and has intervened directly in the foreign exchange market to stabilize the Canadian dollar. However, currency weakness has pushed rates up anyway. The bank rate spiked to 5.0% in late March. Further increases should not be required. The three-year to five-year yields in the Canadian bond market are up by about 150 basis points since early February and these rates set the pattern for mortgage rates.

The underlying trend in inflation in the U.S. is still downward.

Recognition of this fact should help to stabilize U.S. rates. This, in turn, could be the good news that prevents too large a jump in Canadian rates. The **2.8%** year over year increase in U.S. core consumer prices in February was the lowest in more than 20 years. Core producer prices in the U.S. were up by only **0.3%** year over year in February. The only sign of prices heating up is in materials prices at the very early stages of production. The non-food, non-energy crude materials part of the producer price index (which includes such things as iron and steel scrap, aluminum base scrap, waste paper, copper ores, softwood logs and cattle hides), is up **10.2%** year over year.

There are signs of improvement in Canadian retailing but the evidence is spotty.

The export oriented companies that are doing better still are not producing enough job creation and disposable income growth to allow a meaningful upturn in retail sales. Where there is growth in specific kinds of consumer spending, it is coming at the expense of either other kinds of purchases or cross-border shopping. Car sales have moved up in January and February, indicating an increased willingness to make discretionary purchases.

The softness in disposable income in Canada contrasts with the improving trendlines in the U.S.

The **U.S.** economy has clearly moved into a new and stronger phase of expansion, thanks to more satisfactory growth in personal disposable income. The latest figures show real PDI growing at a 3.6% annual rate since mid **1993.** This compares with an outright decline at an annual rate of almost 5.0% in Canada over the same six months.

Ontario housing demand has begun 1994 in a recovery mode.

Existing home sales in the Greater Toronto market have been strong since November. The latest data (Feb) shows a 47% year over year increase in Toronto resale transactions and a sharp decline in the ratio of active listings to sales to less than a five months' supply. It is still not clear, though, how the market will react to higher mortgage rates. The initial increase from their cyclical low still leaves them at a historically low level. However, further increases could be a problem.

Canadian building materials prices are showing large increases because of strong U.S. demand and the drop in the Canadian dollar.

Gypsum wallboard, concrete powder, float glass, aluminum siding and sheet steel are all showing double digit price increases this spring.

Dr. Peter R. Andersen is president of Andersen Economic Research Ltd. This article is excerpted from The Andersen Monthly Economic Report, March 21, 1994.

Annual General Meeting

June 16,1994

Guest Speaker:

HELEN COOPER

Chair, Ontario Municipal Board

Vaughan Estate
2075 Bayview Ave.
Toronto

Meeting Credits

The January 27 OLE dinner meeting featuring Chris Fillingham has been awarded one (I) auxiliary recertification credit by the Appraisal Institute of Canada. The blizzard on March 3 meeting unfortunately forced us to cancel the meeting featuring Ron Morrison. Check the next issue of The Land Economist to find out how many credits have been awarded for our April 15 seminar.

Confirmed speakers include:

April 15,1894

9:00 a.m. to 4:30 p.m.
Ramada Inn
89 Chestnut St., Toronto

LAND ECONOMICS & GOVERNMENT

The Ontario land economics scene is changing rapidly. It has been devastated by the recession, investigated by the Sewell Commission and confronted with a whole new set of draft policies, while the GTA struggles to find its way into the future.

On Friday, April 15, you can hear experts from the private and public sector grapple with:

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- Federal, provincial and municipal options
- Changing market forces and demographics
- New constraints on planning and development

Where is it all leading?
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Register now, by contacting the Association of Ontario Land Economists.
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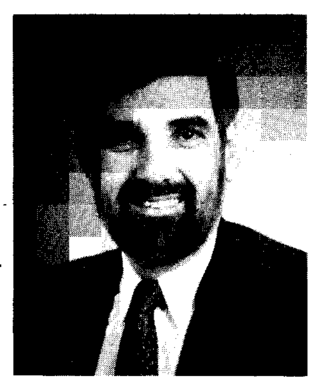


Edward Sajecki, Commissioner of Planning and Economic Development, City of York

LAST CHANCE AT THE CAPITAL

by Steve Z. Ranot, CA, CBV
Neil L. Maisel, CA, CBV, ASA

On February 22, 1994, Federal Finance Minister Paul Martin presented his first budget. In advance of the budget, rumours abounded that the $100,000 lifetime capital gains exemption would be abolished. It was, but not before the Minister gave taxpayers one last chance to use it. This article will examine changes made to the capital gains exemption in 1992 and 1994 and how taxpayers should take advantage of these changes.

Impact On Appraisers

The changes could impact significantly anyone involved in the valuation of real property. In order for taxpayers to realize the benefit of the budget amendments, many will have to file a special election claiming a deemed disposition of capital assets at February 22, 1994, along with their 1994 personal income tax returns (which are due on or before April 30, 1995).

It is likely an assessment of fair market value of the related properties as at February 22, 1994, will be required to be filed along with this election. As a result of this potential requirement, individuals owning affected property will almost certainly want to obtain appraisals of these properties by qualified experts.

As a result of the introduction of capital gains taxes in Canada, December 31, 1971, became known as V-Day, or the valuation day upon which many future capital gains were determined. Subsequent amendments to the capital gains rules regarding the ownership of cottage properties created another V-Day at December 31, 1981. Many real estate appraisers may recall performing a disproportionate number of appraisals based on the value of properties at these two dates.

Since the 1994 budget places a special emphasis on the value of property as at February 22, 1994, it appears as if the Finance Minister has created another V-Day, and accordingly the potential for another appraisal at that date.

Appraisers should be cautioned that many clients stand to benefit by obtaining appraisals indicating inflated values at February 22, 1994. Appraisers may wish to advise their clients that unreasonable appraisals may be rejected by Revenue Canada, leading to adverse income tax consequences.

Early Birds Did Not Get The Worm

Back in the 1992 budget, former Finance Minister Michael Wilson amended the capital gains exemption such that gains on dispositions of real property held as investments or for personal use could not be sheltered completely with the capital gains exemption. As a result of those 1992 changes and then again with the pre-budget rumours, many affected real estate owners rushed to "crystallize" their accrued capital gains on real property prior to the 1994 budget by:

- disposing of these properties to related parties

or

- actual dispositions to third parties

These transactions may have involved professional fees, land transfer taxes and income taxes which in hindsight were not necessary.

In the 1992 budget; as mentioned above, certain real property was restricted in its eligibility for the capital gains exemption for dispositions occurring after February 29, 1992. A proportion of the gain — based on the number of months the property was held after February 29, 1992, divided by the number of months the property was held in total since December 31, 1971 — was not eligible for the capital gains exemption.

This amendment created an incentive for individuals to crystallize their gains on real estate held as investment or for personal use soon after the

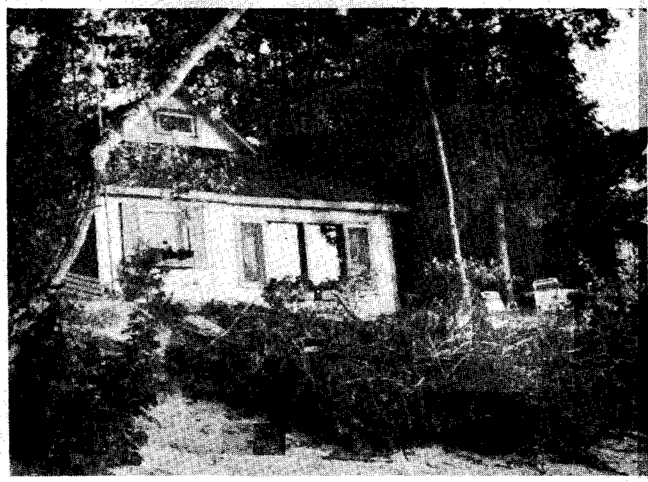


Photo M. Wilson

Example 1

Sharon bought a cottage for $90,000 on March 1, 1986. On February 22, 1994, the property was appraised at $130,000. Sharon has used $10,000 of her lifetime capital gains exemption before 1994.

Fair Market Value of property at Budget Date	$ 130,000
Adjusted Cost Base (purchase price)	90,000
Capital Gain	$ 40,000

Eligible Gain:

$$\frac{\text{Months held before March 1, 1992}}{\text{Months held after December 31, 1971}} \times \text{Capital Gain}$$

$$\frac{72}{96} \times \$40,000 = \$30,000$$

After applying the formula, Sharon determines she has an accrued capital gain of $40,000 of which $30,000 is eligible for the capital gains exemption. As her unused capital gains exemption of $90,000 (the original $100,000 less $10,000 already used) exceeds the $30,000, Sharon may elect to dispose of her property for $120,000, which is $30,000 above her adjusted cost base.

An equivalent capital gains exemption amount will be claimed on her 1994 personal income tax return so that the deemed disposition will not affect her taxable income. After the election, Sharon's adjusted cost base on the cottage is $120,000 ($90,000 original cost plus $30,000 representing eligible portion of gain at February 22, 1994).

1992 budget announcement. For those individuals who disposed of this type of property between March 1, 1992 and February 22, 1994, some measure of income tax was payable with respect to the portion of the gain not eligible for the exemption.

Some of these people may have sold their. property for tax reasons, even though for personal reasons they wanted to keep the property. For these people, the sale was not required, given the new budget amendments.

"Holders" Won

One group of Canadians which can be considered winners from Mr. Martin's budget are those who continue to hold real property as investment or for personal use which was purchased prior to March 1, 1992, and upon which there exists an accrued gain. As a result of the recent budget, these property owners will be permitted to deem a disposition to have occurred in 1994, based on the fair market value of the property at February 22, 1994, in order to realize any unused capital gains exemption they may have.

However, taxpayers are permitted to chose an appropriate value for these deemed dispositions so as not to exceed the maximum allowed capital gain exemption. Thus, the property owner will not be required to pay any income tax due on the rest of the gain reflecting the number of months held after February 29, 1992, until the property is actually sold or otherwise disposed of.

As a result, those with accrued gains on real property who chose not to crystallize their gains will benefit to the same extent as those who did crystallize their gains, but without incurring early prepayment of certain income taxes or the other costs of crystallization such as professional fees and land transfer tax. Further, unlike those cases where taxpayers sold the property.to an arm's length third party, they will not have to suffer the loss of personal enjoyment of the property.

The charts accompanying indicate how two different taxpayers will be affected by the 1994 budget amendments .

Don't Miss Out

As the phase-out of the capital 'gains exemption also applies to other capital property such as publicly traded securities, mutual funds, partnership interests, shares in privately held corporations and tax sheltered investments, many taxpayers and business people should review the rest of their personally held assets as well.

If accrued gains existed as at February 22, 1994, taxpayers will need to determine the proper election amount for their 1994 personal income tax returns. In the case of some of these investments, such as publicly traded securities and mutual funds, a review of the February 23, 1994, financial newspapers may be sufficient in order to determine fair market value as at the close of business February 22. In the case of partnership interests, shares in privately held corporations and tax sheltered investments, valuations performed by other experts may be required.

It is imperative that all taxpayers who have not fully utilized their $100,000 lifetime capital gains exemption and who owned capital assets with accrued gains as at February 22, 1994, properly complete their special election on time. The department of Finance has created a one-time window of opportunity for these individuals to claim their remaining capital gains exemption and reduce future tax liability.

It is not often that taxpayers are offered such a plum. Don't ignore your plum to the point it turns into a prune.

Photo. Para Paints Inc.

Example 2

Angela bought a triplex on September 1, 1985, for $150,000. On February 22, 1994, the property was appraised at $350,000. Angela has never used any of her lifetime capital gains exemption.

Fair Market Value of property at Budget Date	$350,000
Adjusted Cost Base (purchase price)	150,000
Capital Gain	$200,000

Eligible Gain:

$$\frac{\text{Months held before March 1, 1992}}{\text{Months held after December 31, 1971}} \times \text{Capital Gain}$$

$$\frac{78}{102} \times \$200,000 = \$152,941$$

As the eligible gain exceeds Angela's unused lifetime capital gains exemption ($100,000), Angela's election is limited to the lesser of these two amounts. As a result, Angela may elect a deemed disposition at $250,000 (being $150,000 original cost plus $100,000 of the accrued gain to February 22, 1994). An equivalent capital gains exemption amount of $100,000 will be claimed on her 1994 personal income tax return in order to result in no change to her taxable income. After the election, Angela's adjusted cost base has been increased to $250,000.

Steve Z. Ranot is an associate and Neil L. Maisel is a partner in Marmer Penner Inc., a firm specializing in business valuation, litigation support and financial advisory services.

Environmental Caveat Emptor: A Case For Environmental Audits

By Robert C. Hodgins, BSc(Ag), MBA and Allan N. Windrem, MCIP, OPPI, PLE, CLP

A recent paper in the Journal discussed the municipal realty tax assessment implications of valuing lands which became contaminated after development. This particular circumstance resulted from the failure of an existing private sewage system. It underscored the need to understand the potential impacts of contamination upon land use and valuation that can also present themselves at the time of acquisition and development of any real property and in particular raw land.

Given the continual proliferation of environmental legislation and case law, the financial implications of these impacts may not be fully appreciated by today's vendors, purchasers and lenders.

What do the laws mean?

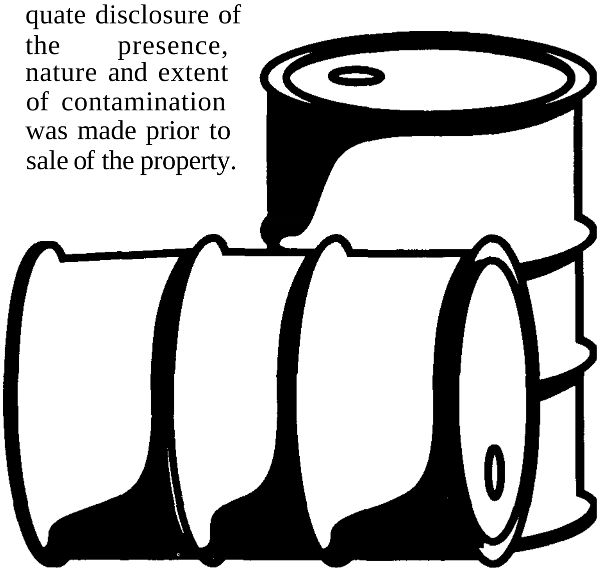
During the past ten years considerable legislation has been enacted to protect the environment and to assign responsibility for the cleanup of environmental discharges and contaminated sites. In Ontario, the Environmental Protection Act places cleanup responsibilities on the "person responsible", which means "the owner, or the person in occupation or having control of a source of contaminant" (including contaminated land).

This legislation places greater potential liabilities on all parties involved in the acquisition and development of real property, including vendors, purchasers, lenders, insurers, and receivers. In so doing, it creates a need for greater attention to risk management and financial exposure.

Indeed, the days when a property transaction was a simple exchange of real property for money are long gone. Under environmental legislation it is not unusual to have unforeseen liabilities survive closing and be transferred with the sale of real property, thereby inflicting a significant burden on the unsuspecting purchaser. Unless one is careful, what originally appeared as a "sweet deal", may turn out to be a "Pandora's box".

These requirements could also have dramatic impact upon the developability and value of real property. In addition to the expense and delay that cleanup can entail, restrictive changes in land use may be imposed by government authorities as a condition of development approval. These conditions may include zoning controls to prohibit development of the contaminated land and a specified buffer strip for any contamination-sensitive land use until remediation activities are completed and approved by the appropriate government authority.

As the liability related to contaminated lands can rest with the current owner and tenant as the person responsible for the site or having ownership or control of the contaminant at the time it becomes an environmental problem, this responsibility may not disappear when the lands are sold. Former owners and others including Directors, Officers, Employees and Agents could still carry liability if inadequate disclosure of the presence, nature and extent of contamination was made prior to sale of the property.



Why an environmental assessment?

Cleanup costs for contaminated sites represent significant financial exposure to all parties in a land transaction and, depending upon the nature of the contamination, can range from tens of thousands to hundreds of millions of dollars.

It therefore becomes imperative that vendors, purchasers, lenders, and receivers be aware of, and properly assess any environmental contamination prior to finalizing and/or closing a sale of real property. This is best done through environmental site assessments which are often conducted in the due diligence segment of the deal.

Environmental site assessments (also referred to as Environmental Audits, or Property Transaction Audits) represent a risk management tool that is rapidly becoming a key component to any land transaction. Generally these assessments represent a retrospective review of past and current uses of the subject property to assess the actual and potential environmental problems with the site, and the potential for environmental liability. These problems could result from site contamination issues (e.g. spills, on-site waste disposal involving buried waste and/or leaking underground fuel storage tanks), or other issues such as non-compliance with pollution control permits, or improper waste handling and disposal.

While each party to the land transaction process has an interest in ensuring that a proper environmental site assessment is conducted, the value to the purchaser is most evident. Purchasers generally will use the Audit findings for three main purposes. The first is in making the "Go-No Go" decision on the purchase. If site contamination is suspected, the purchaser may decide to walk away from the deal rather than take the chance of buying a future liability. If the purchaser decides to proceed with the deal, the Audit findings are useful in negotiating the purchase price. Often the cost of cleanup will be deducted from the purchase price, or a sharing in the cleanup cost will be negotiated. Finally, the findings will be useful when negotiating conditions of the deal that apportion future liability

For the vendor, an environmental site assessment is a "double edged sword". Owners may be required to give representations or warranties regarding the site by the purchaser or lender. Without a site assessment, the vendor may not know of any site contamination and therefore could unwittingly misrepresent the site conditions. However, failure to properly disclose site contamination may provide the purchaser with grounds to set aside the agreement and/or seek damages.

Many site assessments are conducted in response to requirements imposed by lending institutions. Often the only security the lender has for the loan is the property itself. There are many examples where owners, upon discovering site contamination with cleanup costs in excess of the value of the land, have walked away from the property and left the land to the lending institution. The lending institution soon discovers that rather than having a valuable asset it has a huge liability, as it has become the "person responsible" under the Environmental Protection Act. Therefore, before financing a land transaction, lending institutions will often require a site assessment.

Finally, receivers often find themselves in possession of lands as part of a bankruptcy or foreclosure. Normally they earn an agreed fee by maximizing the realization on the assets and increasing the distribution to the creditors. However, as is the case with the lender, the receiver can inadvertently become the "person responsible" and take on significant cleanup liability. Therefore, before agreeing to become the receiver for a given property, a firm should first assess its risk through a site assessment.

What are they?

Typically, Environmental Site Assessments are conducted in three Phases. This is to ensure that only as much analysis as is required for the decision is undertaken.

In most cases, only a Phase I Site Assessment is required. This is a non-intrusive survey (i.e. no soil or water samples are taken). By reviewing historical and municipal records, walking the site, and inspecting any on-site building it is possible to draw conclusions regarding the likelihood of environmental problems. This may be the end of the site assessment.

However, if soil, water or building contamination is suspected, a Phase II study will be required. This involves collecting and analyzing soil, water and building material samples to characterize the nature and extent of contamination, and to determine if site cleanup is required.

If cleanup is required, a site remediation plan (Phase 111) is prepared, and the site is cleaned up.

Conclusion

Environmental site assessments are a vital tool in ensuring that potential environmental costs are factored into land valuation decisions. In light of the significance of the decisions being made, it is important to include site assessments as part of the property transaction process, *to* ensure that appropriately worded environmental investigation clauses are included in the Agreement of Purchase & Sale, and to allow the necessary time and financial resources to prepare the audit.

Clearly the potential financial and land use impact of current environmental legislation upon the acquisition and development of real property cannot be ignored or minimized by any prudent vendor, purchaser or lender. Environmental audits represent the best method of assessing both risk and obligations and should become as integral to the land acquisition process as title searches and development potential reviews.

Bob Hodgins is the Environmental Services Manager and Allan Windrem is the Planning Manager at G.M. Sernas & Associates Limited. The firm undertakes Land Use Planning, Environmental and Municipal Engineering Projects on behalf of public and private sector clients.

Fire Insurance Maps

How do people check whether sites might be contaminated? One common reference is the collection of old fire insurance maps at various city archives and reference libraries.

Drawn to assess the risk of selling property insurance in specific locales, fire insurance maps show building outlines, lot sizes, construction materials and — most important — major uses. Sometimes, storage tanks are indicated.

The earliest set in the City of Toronto archives was drawn by W.S. and H.C. Boulton in 1858. Charles E. Goad and his company are responsible for most of the rest of the maps, beginning in 1880. The Underwriter' Survey Bureau published volumes from the 1920's to the 1940's. Today, copyright apparently resides with the Insurers' Advisory Organization. RM

Sponsoring New Members

We'd like to encourage all current OLE members to share the benefits — sponsor a new member! Make sure they meet the criteria set out in the preface to your Directory of Members:

- Full members (who can use the designation Professional Land Economist) must be "persons qualified by education and experience to perform specific professional functions within the scope of land economics".
- Those who do not yet have relevant experience may become Associate members.
- Student memberships are also available.

Land economics functions tend to bring together public, institutional and private enterprise practitioners in a variety of professional disciplines (e.g. Municipal Assessors, Ontario Land Surveyors, Economists, Quantity Surveyors, Real Estate Appraisers, Architects, Professional Engineers, Land Use Planners and Real Estate Brokers). This association is where they meet and exchange views. RM

Is Your Share of the Business at Risk?

by Joseph Harris

As a business owner, you are aware of the necessity to protect your business in the event of the death of a partner. But are you aware of the need to protect against an unexpected disability — temporary or prolonged — of one of your partners?

Your share of the business could be at great risk if your shareholders' agreement does not include provisions for a Disability Buy-Sell (policy). Often thought of as the "forgotten need", this type of provision is most valuable to owners of small and medium sized businesses, where all of the partners are actively involved. But, at this time, only two per cent of business owners invest in this crucial arrangement.

An unproductive owner can seriously hinder the growth and profitability of your company.

Firstly, there is the double expense of having to hire a replacement while the disabled owner continues to receive a share of the profits. Secondly, without a disability buy-sell agreement in place, the disabled partner is free to sell or transfer his share of the business to a third party who may be unacceptable. The rights and wishes of the disabled owner may become the subject of dispute. In addition, the remaining owners must work harder to keep the business stable while these matters are being settled.

Statistics show that chances of suffering a disability are far greater than those of premature death. In fact, before the age of 65, there is an 80 per cent chance that disability will strike one of your partners. The odds increase as the number of partners increases.

If a partner will be disabled for a period in excess of one year, the business will be affected as though the disability were permanent. The agreement should decide what constitutes total disability.

All partners benefit from the security of a disability buy-sell agreement. The active owners are safe from exploitation of unacceptable replacements, or competitors, while they keep their voting control. The buy-out price is set, and funds will be provided to them by the policy, protecting the company's cash flow. Just as importantly, the continuing stability of the management structure will be attractive to customers, creditors and employees.

The disabled owner is guaranteed a set price for his share of the business. His family need not worry about protecting their interests. Nor will possible medical and living costs disrupt the existing estate.

Do you feel satisfied with the provisions that you have made to protect your share of the business?

Joseph Harris is principal of Joseph Harris & Associates, an insurance brokerage specializing in income replacement issues.

Education Charges Upheld

The Ontario Home Builders' Association is seeking leave to take York Region's education levies to the Supreme Court of Canada.

In the original Divisional Court decision (May, 1993), a majority of the three-judge court accepted both of the OHBA arguments:

1) that the levies violate separate school supporters' constitutional rights to direct their moneys and to receive a proportional share of all education funding

2) that the levies are not paid by the developer but passed on to the home buyer, and are a form of indirect taxation (which only the federal government is allowed to do)

However, in its decision released in February, the Ontario Court of Appeal completely overturned that reasoning. Instead, it decided:

1) that home builders should not be arguing the first issue: the separate school board supported the development charge system, so its rights were not prejudiced.

2) that the November 1993 Supreme Court of Canada decision in Allard Contractors Ltd. v. The Corporation of the District of Coquitlam holds that it doesn't matter whether the charges are indirect taxes or not. The education development charges should be seen as licensing fees, which are valid because they are part of a valid provincial regulatory scheme — both of which are clearly within the constitutional powers of the province.

School levies which remained uncollected between June 14, 1993 and February 14, 1994, are now due. The York Region School Boards advise that failure to make full payment before May 2, 1994, (by the building permit applicant or by another person who has assumed legal responsibility), "will result in unpaid charges being added to the tax rolls".

OHBA should hear soon whether it will be allowed to appeal the decision. In the meantime, it advises that school boards collecting education levies should be asked to sign an undertaking that they will refund all monies if the bylaw is found to be unconstitutional.

RM