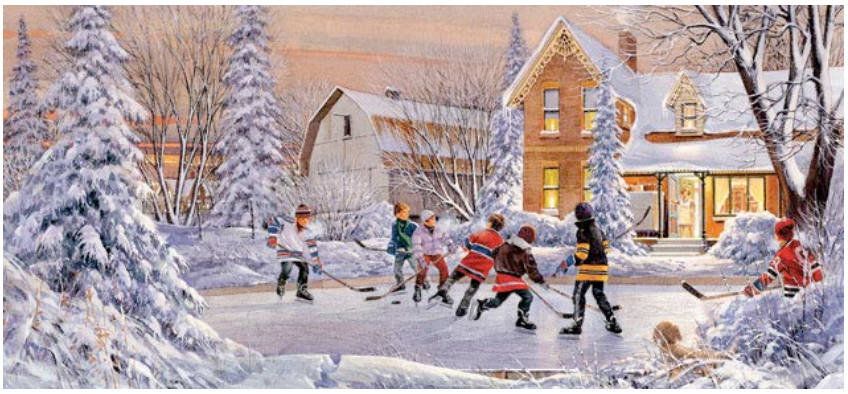
ONTARIO Expropriation ASSOCIATION



WINTER 2013 EDITION

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May your holiday season be wrapped with cheer and filled with celebration for the New Year

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To contribute to future newsletters please contact our editor.

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Complexity of Expropriation Claims Increases when Tenants are Involved

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Overview

An expropriation claim can be complex, and when one or more tenants are involved, the complexity of the claim increases even more. From a quantification of disturbance damages[1] perspective, there are a number of additional issues that must be addressed such as, what the remaining term of the lease was, who owned the various improvements on the expropriated property, how the relocation property compares to the expropriated property and others. It is imperative that the business loss consultant engaged to quantify the disturbance damages, usually a Chartered Business Valuator, conducts the necessary due diligence to ensure that they have the proper factual foundation upon which to consider these additional issues and ultimately, quantify the disturbance damages.

Due Diligence

Due diligence is always a critical component of the assessment of disturbance damages as it allows the business loss consultant to gain a full understanding of the operations of the business in question including the nature of the business, the industry in which the business operates, the economic environment in which the business operated before and after the expropriation, the quality of management and any changes in the management of the company, the agreements to which the business is a party, the competitive landscape, future plans for the business absent the expropriation and so on.

When a tenant is involved in an expropriation, two key documents that need to be reviewed as part of the due diligence exercise are the lease agreements relating to both the expropriated premises (the "old lease agreement") and the new premises to which the tenant has relocated (the "new lease agreement"). It is important to note the remaining term of the old lease agreement at the time of the expropriation, whether the old lease agreement contained any renewal clauses and whether the old lease agreement contained a demolition and/or expropriation clause. Other key information includes the respective square footage of the old location versus the new location, what improvements, if any, were included in the old lease agreement compared to the new lease agreement and the rental rates and other costs (e.g. common area costs, taxes, etc.) under the two lease agreements.

Appraisal reports relating to the expropriated property should also be reviewed to gain an understanding of the basis upon which the appraised market value was determined (e.g. income approach, direct comparison approach and cost approach) and what was included in the market value appraisal. For example, was the property valued as vacant land with no value attributed to any improvements on the property or if a direct comparison approach was used, did the comparable properties have similar improvements as the expropriated property? What was assumed with respect to the ownership of the improvements on the property? Were they considered to be leasehold improvements owned by the tenant or improvements owned by the landlord? Was the rent according to the lease agreement considered to be at market rates? If the rent was below market rates, it may be that the tenant had a "leasehold advantage" and therefore, had an interest in the market value of the property. Lastly, the business loss consultant needs to ensure that the assumptions upon which the business loss analysis is prepared are consistent with the assumptions upon which the real estate appraisal has been prepared.

Other due diligence would include investigation with respect to the tenant's business plans absent the expropriation to ensure that the business losses suffered by the tenant are not due to factors unrelated to the expropriation.

[1] Disturbance damages can include both relocation costs and business losses incurred as a result of the expropriation.

Situations may also arise where the landlord and tenant belong to the same corporate family. In these circumstances, the business loss consultant must consider whether the rent being charged between related parties was at market rates. Further, they must gain an understanding of what the landlord was compensated for through the expropriation related market value payment to ensure that the tenant does not claim costs in relation to new improvements when the landlord was already compensated for these same improvements at the old location.

Relocation Costs

When a tenant is required to relocate due to an expropriation, they often incur relocation costs relating to moving, new stationery, incremental advertising and leasehold improvements at the new location. How much of these relocation costs are claimable? Factors to be considered include:

a) Was the tenant planning on relocating in any event or would they have been required to relocate absent the expropriation?

b) Was the tenant planning on renovating the old location absent the expropriation?

c) Are the new improvements better than the old improvements?

d) Has the landlord already been compensated for similar improvements at the old location through the market value assessment?

For example, if there was only two years left on the old lease and no option for renewal, should the tenant be able to claim 100% of the relocation costs? In this example, absent the expropriation, the tenant would have been required to relocate when the lease expired in two years time. Accordingly, the expropriation simply accelerated the relocation. We understand case law[2], namely the Frankel Steel case[3], indicates that in situations such as this, the tenant is only entitled to the present value of the carrying costs (i.e. interest costs) associated with the tenant incurring the relocation costs sooner and not the actual relocation costs themselves.

Now consider an example where there are twenty years left on the term of the old lease, but the leasehold improvements are eight years old. Should the tenant be able to claim 100% of the relocation costs? Relocation costs relating to moving, new stationery and incremental advertising to promote the new location would likely be fully claimable as the tenant was not expected to have to relocate for another 20 years. However, with respect to the cost of the new leasehold improvements, the estimated useful life of the old leaseholds has to be considered and when the leasehold improvements would have been replaced absent the expropriation, as well as other betterment issues. What if the estimated useful life of the old leaseholds was ten years or the tenant was a party to a franchise agreement that required the leasehold improvements be replaced every ten years? What if the new leasehold improvements were not just newer, but also better than the old leasehold improvements (e.g. a more elaborate security system or more efficient HVAC system)? Adjustments to the amounts claimable for the new leasehold improvements would be necessary in most of these cases.

Business Losses

Many of the issues discussed above must also be considered in quantifying business losses suffered by a tenant. For example, the tenant may have been planning to relocate absent the expropriation because its lease was expiring in the near term, it had outgrown its current location, or its customer base had relocated. In these circumstances, the business would likely have incurred the same business losses upon its planned relocation and therefore, the expropriation only accelerated when the business incurred these losses. As discussed above, case law indicates that the tenant might only be compensated for incurring these losses sooner than it otherwise would have, and not for the absolute dollar value of the business losses.

In other cases, it may be that the lease agreement had a demolition clause allowing the landlord to terminate the lease early so it could demolish the building and redevelop the property. If the real estate appraisal valuing the market value of the property was based on the assumption that the demolition clause would have been exercised, then the tenant's business loss claim (and claim for relocation costs) cannot be based on the assumption that the tenant would have continued operating for another five years. These two underlying assumptions are contradictory.

Situations may also arise wherein a tenant's operating costs increase as a result of the relocation.

[2] We are not providing any legal opinions herein.
[3] Source: Supreme Court of Canada, *Frankel Steel Construction v. Metro Toronto* [1970] S.C.R. 726.

For example, the rent and/or operating costs may be higher at the new location even though it is a comparable property to the old location, or the new location may not be accessible by public transportation, while the old location was and therefore, the tenant must provide its employees with car allowances. In these cases, the increased operating costs may be expected to occur for a number of years into the future. For what period of time should the tenant be compensated for these increased costs? Again, the term of the old lease agreement will be a key consideration in answering this question.

Conclusion

With the volume of infrastructure projects currently taking place within cities across Canada, there will no doubt be a considerable number of expropriation claims that will involve tenants. As discussed herein, in quantifying the disturbance damages incurred by a tenant, it is critical that the necessary due diligence be performed so that all the facts are known and can be considered. Each case has its own unique circumstances and only by reviewing the relevant documents and talking to the appropriate people can one properly assess what would have happened absent the expropriation and prepare a reasoned and well supported assessment of the disturbance damages.

To contribute to future newsletters please contact our editor,
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4TH ANNUAL SKI, SNOW & SNOWSHOE DAY

AT CRAIGLEITH SKI CLUB

Craigleith Ski Club (164 Craigleith Road, Blue Mountains L9Y 0S4)
Skis/boots/poles, helmets, snowboards/boots & snowshoes are available for rental.
Please visit www.cragleith.com for additional details.

Case Commentary
Roeland v. Manitoba

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Introduction

The Manitoba Court of Appeal recently questioned the "soundness" of an Ontario court decision that is often cited in support of claims by expropriated owners for disturbance damages in circumstances where such awards are otherwise precluded by the *Expropriations Act*.

The Limit on Claims for Disturbance Damages

The common law rule at the crux of these decisions was laid out in the English Court of Appeal case of *Horn v. Sunderland Corp*. The issue is that disturbance damages are generally not recoverable by an expropriated owner with respect to land that is found to have a higher market value for a use other than what the land is being used for at the time of the taking by the authority. This principle is reflected alike in sections 13(2) and 28(2) of the expropriations legislation in Ontario and Manitoba respectively.

The "Exception" in *Pike*

In *Pike v. Ontario (Minister of Housing) (1979)*, 20 L.C.R. 166 (Ont. Div. Ct.), a dairy and cash crop farm was expropriated in connection with development plans in respect of a planned airport in Pickering. In that case, the Ontario Divisional Court ruled on the application of the statutory provisions otherwise operating to limit claims for disturbance damages. In *Pike*, the court held that where land is "ripe" for development to a higher use, section 13(2) of the Ontario *Expropriations Act* does apply, and where land is being used as a holding for future development, and therefore "not ripe" for redevelopment, the limiting provisions of the statute do not apply. The Ontario court applied this reasoning to award the expropriated land owner disturbance damages arising from the taking of farmland in its current use, in addition to market value that reflected the property's potential for future development at a higher use.

Manitoba Treatment of the "Exception" to the Rule

In *Roeland v. Manitoba (2013)*, 109 L.C.R. 1 (Man. C.A.), farmland was expropriated to accommodate the twinning of a major highway. In a fashion similar to *Pike*, the expropriated land in the recent Manitoba case was recognized as having speculative value as development land. In *Roeland*, the decision of the Land Value Appraisal Commission, which applied the rationale in *Pike* in awarding disturbance damages to the land owner, was appealed to the high court.

On appeal, the property owner submitted that although the land was "premium farmland", it was still just "farmland" and the determination of value was therefore not based on a use "other than the existing use." In allowing the authority's appeal, the Manitoba court drew a distinction between land that is "simply farmland" and land that is "speculative farmland." The court reasoned that since the subject property had a higher market value due to its speculative potential, it had in fact been valued at a use "other than the existing use," and disturbance damages were disallowed by operation of the statutory restrictions.

In addressing the claims for disturbance damages asserted in *Roeland*, the Manitoba court considered the "exception" to the statutory rule created by the Ontario court in *Pike*. In reviewing *Pike*, the high court in Manitoba expressed "doubts" concerning the integrity of the reasoning in the Ontario case. In particular, the Manitoba court expressed concern respecting the award of disturbance damages in *Pike* for a property that the Ontario court found to have "retained the same use, but with a twist."

Conclusion

In its final analysis, the Manitoba Court of Appeal determined that it was not reasonable for the Land Value Appraisal Commission to have applied the principles that were set out by the Ontario court in *Pike*, to the circumstances in *Roeland*. In this manner, the court in Manitoba rendered its decision without detailed analysis of the "*Pike* exception". Therefore, the court's questioning of the "soundness" of the decision in *Pike* was only incidental to the ultimate disposition of the matter at issue in *Roeland*.

It may be interesting to see whether future treatment in this Province of the *Pike* decision and the so-called "exception" it created will be impacted as a result of its "soundness" being questioned by a high court outside of Ontario.

Future of the OMB Up for Review

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On October 24, 2013, the Ontario Provincial Government announced that it would review the land use planning approval system in Ontario, including the role of the OMB. This announcement also stated that the Province will review the *Development Charges Act*. Specifically, the announcement states:

The review will also look to find ways to foster better co-operation and collaboration between municipalities, community groups, property owners and developers, so more land use planning matters can be resolved locally, instead of being referred to the Ontario Municipal Board (OMB).

This announcement comes in the context of increasing political attacks against the OMB. The OMB is charged with making decisions in complicated land use planning disputes. The result is that the Board is frequently criticized heavily for its decisions, in what are often politically volatile matters. In many of these volatile matters, regardless of the outcome, the OMB will be the subject of criticism.

The most recent challenge centred on Bill 20, a private members bill in the Legislative Assembly of Ontario given first reading on March 5, 2013.[1] Mr. Rosario Marchese, MPP for Trinity-Spadina, introduced Bill 20, which is entitled "Respect for Municipalities Act (City of Toronto)".

On first reading, Mr. Marchese summarized the purpose of the bill as follows:

My bill, in short, would free Toronto from the Ontario Municipal Board. The bill changes the relationship in law between the City of Toronto and the Ontario Municipal Board. Currently, under various statutes that govern land-use planning, certain municipal decisions can be appealed to the Ontario Municipal Board. Amendments eliminate those rights of appeal with respect to decisions of the City of Toronto. Amendments also eliminate a right to make certain other types of applications to the board with respect to the city. The city is authorized to establish one or more appeal bodies to hear any of these matters and to hear such other matters as the city considers appropriate.[2]

There were numerous criticisms of Bill 20, including that Bill 20 does not compel the City of Toronto to create its own appellate body for local land use planning issues. The City of Toronto would have the discretion to create its own appellate body, but it is unclear that such an appellate body would, in fact, be created.

Bill 20 undermines the OMB, which performs an important role based upon a history of independent expertise in land use planning disputes.

A unique City of Toronto appellate body would also set the stage for potentially inconsistent practices and procedures to those of the OMB. Furthermore, this appellate body would lack the OMB's history of independence and expertise in land use planning across the Province.

Bill 20 passed second reading on March 7, 2013, and the matter was referred to the Standing Committee on Finance and Economic Affairs. Bill 20 did not proceed any further at the Committee stage.

Bill 20 would have represented a fundamental change to the planning regime in Ontario. This change would have created a very real risk of disrupting the planning regime in Ontario. A criticism of Bill 20 was that it was not the subject of a comprehensive review of the entire planning regime to identify the potential impact and issues that would result from this proposed change to the planning regime. On the heels of Bill 20, and in implicit acknowledgement of this criticism, comes this latest review announcement from the provincial government promising a comprehensive review of the land use planning system in Ontario.

As the OMB has exclusive jurisdiction pursuant to the Expropriations Act, changes to its jurisdiction may impact all stakeholders involved with expropriation, including claimants, expropriating authority, and expert consultants. There has been no indication that the jurisdiction related to expropriation will be displaced, but any changes to the land use planning approval system will inevitably impact the analysis of the highest and best use of a property. Regardless, stakeholders involved in expropriation will monitor the province's announcement with keen interest.

[1] Legislative Assembly of Ontario website, Status of Bill 20 [access November 4, 2013]
[2] Legislative Assembly of Ontario Website, Official Records for 5 March 2013 [accessed November 4, 2013]