SASKATCHEWAN ASSESSMENT MANAGEMENT AGENCY

# Market Value Assessment in Saskatchewan Handbook

# Special Purpose

Valuation Guide

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## *Market Value Based Assessment Legislation in Saskatchewan*

Saskatchewan has different assessment legislation[1] than other jurisdictions in Canada that must be taken into account when valuing properties for assessment and taxation purposes. There are specific definitions in Saskatchewan for "base date", "market value", "Market Valuation Standard" and "mass appraisal". It is important to understand how these definitions relate to one another and the requirement for market value based assessments to be determined in accordance with the Market Valuation Standard.

**Base Date** is defined as "...the date established by the agency for determining the value of land and improvements for the purpose of establishing assessment rolls for the year in which the valuation is to be effective and for each subsequent year in which the next revaluation is to be effective;" (Refer to the Preface for specific base dates.)

**Market Value** is defined as the "...amount that a property should be expected to realize if the estate in fee simple in the property is sold in a competitive and open market by a willing seller to a willing buyer, each acting prudently and knowledgeably, and assuming that the amount is not affected by undue stimuli;".

**Market Valuation Standard** means the "standard achieved when the assessed value of property:

(i) is prepared using mass appraisal;

(ii) is an estimate of the market value of the estate in fee simple in the property;

(iii) reflects typical market conditions for similar properties; and

(iv) meets quality assurance standards established by order of the agency;"

**Mass appraisal** is defined as "…the process of preparing assessments for a group of properties as of the base date using standard appraisal methods, employing common data and allowing for statistical testing;".

Assessment legislation in Saskatchewan requires that non-regulated property assessments be determined pursuant to the Market Valuation Standard. Throughout this Handbook the term "market value based assessments" is used to refer to non-regulated property assessments. Unlike single property appraisals, market value based assessments must be prepared using mass appraisal and "...shall not be varied on appeal using single property appraisal techniques". All Handbook references to market value are subject to the requirements of the Market Valuation Standard.

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[1] The following Acts provide the statutory basis for property assessment in Saskatchewan:

- *The Assessment Management Agency Act*
- *The Interpretation Act, 1995*
- *The Cities Act*
- *The Municipalities Act*
- *The Northern Municipalities Act, 2010*

For more details on how to access this information refer to Appendix 2: Resources - Section 2a (Queen's Printer).

# 1.0 Introduction

A special purpose property (also known as a specific use property or special design property) is characterized as a "property with a unique physical design, special construction materials, or a layout that restricts its utility to the use for which it was built"[2]. In addition, these properties may also contain a significant amount of equipment and/or machinery integrated into the structure. Due to their unique nature and special design, these properties provide limited utility for alternate uses. Converting a special purpose property to an alternate use usually requires significant renovations at considerable financial cost.

The unique characteristics inherent in special purpose properties results in a limited market where they are seldom leased and rarely sold except for nominal amounts at the end of their economic life. This serves to limit the approaches to value that can be applied when valuing special purpose properties using mass appraisal techniques.

In Saskatchewan, a special purpose property is valued pursuant to legislation using either the Market Valuation Standard or the Regulated Property Assessment Valuation Standard. The appropriate valuation standard for a given special purpose property is established in legislation. *(Refer to Section 1.2 Special Purpose Properties in the Context of Saskatchewan Assessment Legislation for additional details.)*

This valuation guide focuses on the valuation of special purpose properties that are valued subject to the Market Valuation Standard. This valuation guide is not applicable to the valuation of special purpose properties that are valued subject to the Regulated Property Assessment Valuation Standard. Grain elevators are an example of a special purpose property that is valued using the Market Valuation Standard; however, there is a separate Grain Elevator Valuation Guide that specifically addresses this type of property.

## 1.1 Special Purpose Properties Covered in this Valuation Guide

The methods presented here may be applicable to other types of properties, but unless otherwise stated, the material in this valuation guide does not directly address any type of property other than special purpose property valued using the Market Valuation Standard.

## 1.2 Special Purpose Properties in the Context of Saskatchewan Assessment Legislation

Property assessments in Saskatchewan are governed by several acts including *The Cities Act*, *The Municipalities Act*, and *The Northern Municipalities Act, 2010*. Although there are differences between

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[2] *The Appraisal of Real Estate, Second Canadian Edition* (UBC Real Estate Division -Appraisal Institute of Canada-Appraisal Institute. 2005, Glossary).

these Municipal Acts, the legislation with respect to property assessment is very similar. Given this fact, all references for the remainder of this valuation guide will refer to *The Municipalities Act*.

*The Municipalities Act* legislates that the assessed value of a property is to be determined using either the:

- Regulated Property Assessment Valuation Standard, or the
- Market Valuation Standard.

**1) Regulated Property Assessment Valuation Standard – Relevant Definitions**

i) Regulated Property Assessment Valuation Standard

The regulated property assessment valuation standard is defined as "the standard achieved when the assessed value of the property is determined in accordance with the formulae, rules and principles set out in this Act, the regulations made pursuant to this Act, the *Saskatchewan Assessment Manual* (*Manual*) and any other guideline established by the agency to determine the assessed value of a property." [193(i)]

ii) Regulated Property Assessment

Regulated property assessment is defined as "an assessment for agricultural land, resource production equipment, railway roadway, heavy industrial property or pipelines." [193(h)] The *Manual* contains a definition* of heavy industrial property that includes the following types of property uses:

i) extracting, producing, processing or refining a mineral resource;

ii) producing, upgrading, refining or transmitting petroleum;

iii) producing ethanol and has a design capacity greater than 50 million litres per year;

iv) manufacturing of plywood, particleboard, wafer board, fertilizer, malt, paper, pulp, steel or steel pipe;

v) generating power; or

vi) manufacturing lumber and other wood products from raw logs in a sawmill and have a design capacity greater than 15 million fbm per year based on 480 shifts a year of 8 hours each shift."

* Refer to the *Manual* for the most up-to-date definition of heavy industrial property.

**2) Market Valuation Standard – Relevant Definitions**

For the Market Valuation Standard and market value definition see the "Market Value Based Assessment Legislation in Saskatchewan" overview.

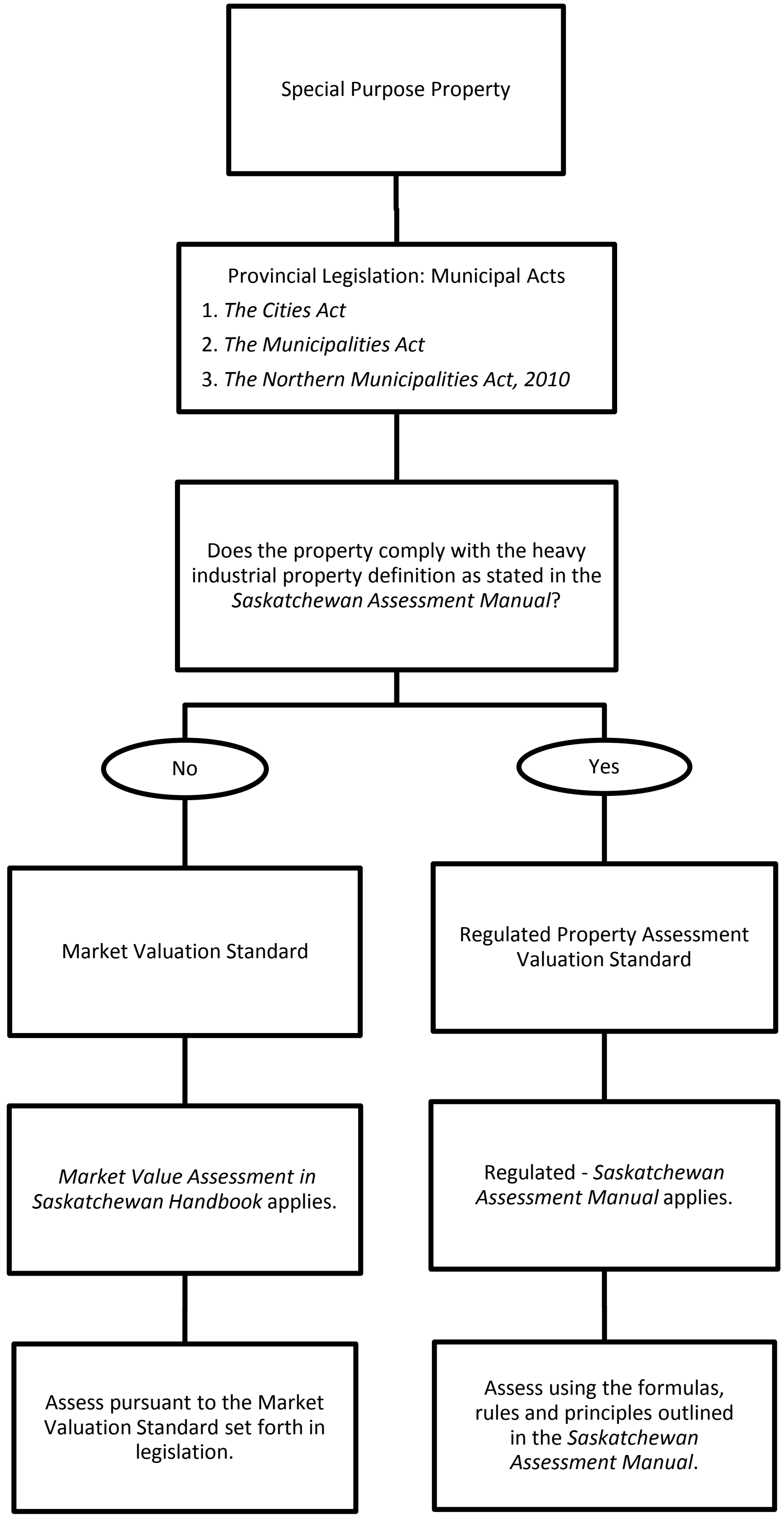
# 1.3 Determining the Correct Valuation Standard

The assessor must apply the Regulated Property Assessment Valuation Standard whenever a property is included within the definition of regulated property assessment, as defined by legislation. A potash mine is one example of a special purpose property that would be valued using the Regulated Property Assessment Valuation Standard as it is included within the definition of heavy industrial property. Therefore, a potash mine's buildings and structures, resource production equipment (used to extract potash to the surface) and land must be valued in accordance with the formulas, rules and principles set out in the *Manual*.

Special purpose properties that are not included within the definition of regulated property assessment are governed by the Market Valuation Standard. This valuation guide focuses on special purpose properties that are valued using the Market Valuation Standard.

The following diagram *(Figure 1)* illustrates the steps in deciding when the Market Valuation Standard is appropriate for valuing special purpose properties.

## Figure 1: Special Purpose Property - Determining the Valuation Standard



## 1.4 Scope of Valuation Guide

- This valuation guide is designed as an aid in the valuation of special purpose properties for assessment purposes when the Market Valuation Standard is used.
- It sets out a procedure to derive market value based assessments for special purpose properties using the cost approach.
- The valuation guide provides a practical tool to evaluate and determine market value based assessments as of the base date.
- The valuation guide is designed as a tool to aid the assessor in deriving market value based assessments; it is not intended to replace the assessor's judgement in the valuation process.

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| The exact form of the market value analysis is up to the discretion of the assessor subject to the Market Valuation Standard and other relevant legislation. |

# *2.0 Analysis of Valuation Approaches*

Special purpose properties may be identified by their unique physical design, special construction materials, and layout as well as their place within a specialized market and limited utility in alternate uses. These factors restrict the availability of market data, which in turn limits the approaches that can be used to value special purpose properties.

# 2.1 Approaches to Value

## Sales Comparison Approach

The sales comparison approach is typically unsuitable for establishing the value of a special purpose property. Generally there are no available sales of comparable properties to apply the sales comparison approach. When special purpose properties do sell, it is usually only at the end of their economic life, making the available sales poor comparables for functioning special purpose properties. Due to the fact that special purpose properties do not frequently sell, and due to the resulting lack of available sales data, the sales comparison approach is not recommended for determining market value based assessments for special purpose properties.

## Income Approach

The income approach tends to be unsuitable for determining market value based assessments for special purpose properties for two primary reasons:

1) These properties typically do not lease (most are owner occupied).
2) There is insufficient sales data to establish an appropriate capitalization rate.

Furthermore, although special purpose properties generate an income stream, this income pertains to the business as a whole. The complexity of factors that contribute to the generation of this income makes it very challenging to isolate the income attributable to the real estate alone. For these reasons it is difficult to establish the valuation parameters that are required in an income analysis.

## Cost Approach

The cost approach is based on the development of replacement cost models depicting the average costs to build special purpose buildings and structures to which the value of land is added. Such models can be developed from local construction cost data or obtained from cost publications such as *Marshall Valuation Service*.

Typically, a cost publication will utilize replacement cost rates to determine the cost of the special purpose improvements as new. Tables in these publications indicate normal physical deterioration caused by aging. Other forms of obsolescence may be established by research and comparison of property values established by using the sales comparison or income approaches. Since the requisite cost data is usually available, the cost approach is typically recognized as the most appropriate method for establishing market value based assessments for special purpose properties.

# 2.2 Recommendation

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| The cost approach is recommended for the valuation of special purpose properties for assessment purposes, when the Market Valuation Standard is used. |

# 2.3 Application of the Cost Approach

The theory behind the cost approach follows the principle of substitution: a purchaser will pay no more for a property than the cost to replace it with a substitute of equal utility.

The market value based assessment of a special purpose property is determined when the assessor adds the value of the land to the value of the improvements.

## Market Value Based Land Assessment

Land value is usually established through the analysis of comparable market data.

The initial step of determining the market value based land assessment is to locate applicable land sales data. Preferably, the land sales should be of sites of approximately the same size, with similar zoning, situated in a comparable location, and adjusted to reflect values as of the base date.

Once sales data reflecting the base date have been collected, it becomes possible to establish the value of the special purpose site using the sales comparison approach.

Adjustments to value may have to be made for the following points of comparison:

- Location,
- Access / transportation,
- Size of site,
- Zoning,
- Topography,
- Site servicing costs,
- Environmental concerns, and
- Time of sale.

Comparable land sales should be investigated (sales verification) to ensure the results reflect the market value of the estate in fee simple subject to the requirements of legislation.

## Market Value Based Improvement Assessment

The market value based improvement assessment, using the cost approach, consists of two components:

1) An estimate of the improvements cost new (reproduction or replacement) as of the base date, and
2) A deduction of all forms of depreciation (physical deterioration, functional obsolescence and external obsolescence).

**Reproduction versus Replacement Costs**

The cost of improvements is estimated using either the reproduction or replacement cost method.

The reproduction cost method is the cost associated with the construction of a "reproduction" or exact duplicate of the structure for which an assessment value is being sought. Reproduction costs are based upon the use of identical materials and quality of workmanship. It is frequently not possible or desirable to duplicate an existing property, either because of a lack of certain materials or trade skills, or the functional obsolescence that is associated with an older property. The difficulty of using reproduction cost increases as a property ages.

The replacement cost method is the cost associated with the construction of an improvement or building with the same utility as that for which an assessment value is being sought. Since replacement costs consider any advances in production or technology in the design, layout, and construction of the improvements, it accounts for the elements that give rise to the functional obsolescence inherent in the property. The replacement cost method is the technique normally used to value special purpose properties for mass appraisal purposes. The replacement cost new can be determined using a variety of methods including local construction costs and cost publications such as *Marshall Valuation Service*.

**Estimate all Forms of Depreciation (physical, functional and external)**

Depreciation can be defined as a loss in value from any cause. The value of special purpose improvements may be determined when the following forms of depreciation are deducted from the cost new:

- Physical Deterioration (curable and incurable),
- Functional Obsolescence (curable and incurable), and
- External Obsolescence (also referred to as economic obsolescence).

## Physical Deterioration

Physical deterioration acknowledges that all building improvements deteriorate over time and, as a result, have limited life spans. Therefore, physical deterioration generally relates to the age of the property. Some forms of physical depreciation are curable while others are not economically viable to correct. The loss in value from deterioration is a simple reflection of the fact that a prospective purchaser will pay less for an older building with more physical deterioration than for a similar newer one with less physical deterioration. Physical deterioration is determined by establishing the current condition of the property and estimating the effective age and the physical life expectancy of the improvements.

Physical depreciation can be analyzed in a very detailed manner by judging the condition and expected remaining physical life of each building component. A more generalized approach would be to review the condition of the property on the whole, determine its effective age and, given the expectation of typical maintenance, determine the physical life of the buildings.

Most cost publications contain depreciation schedules that are intended to reflect the amount of normal, physical, and age-related depreciation in a property.

## Obsolescence

Depreciation arising as a result of obsolescence can be broken down into two types: functional obsolescence and external obsolescence.

(See the Depreciation Analysis Guide for a detailed discussion of depreciation and obsolescence.)

# 3.0 *Special Purpose Properties Valuation Process*

## 3.1 Overview of the Procedure

1) Collect appropriate information.
2) Establish land values using the sales comparison approach.
3) Classify special purpose properties by type according to their size and features.
4) Estimate replacement cost new (RCN) of improvements based upon the type of improvement, using local construction costs and/or a cost publication.
5) Determine normal physical depreciation on the basis of the age-life method and condition of improvements. Deduct this amount from replacement cost new. This is often referred to as replacement cost new less depreciation (RCNLD).
6) If present, determine typical functional and external obsolescence. Deduct this from the RCNLD.
7) Add or deduct other appropriate value, if required to determine a market value based assessment of the improvements.
8) Add the market value based assessment of the land to the market value based assessment of the improvements to determine the market value based assessment of the property.

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