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## BRITISH COLUMBIA FOREST PRODUCTS LIMITED

v.

## ASSESSOR OF AREA 3 - COWICHAN VALLEY

Supreme Court of British Columbia (A832201) Vancouver Registry

Before: MR. JUSTICE G.G.S. RAE (In Chambers) Vancouver Registry

November 1 and 2, December 5, 1983

B.J. and M.A. Wallace for the Appellant  
P.W. Klassen for the Respondent

### Reasons for Judgment

December 14, 1983

This appeal from the Assessment Appeal Board concerns the assessed value of the Youbou Sawmill at Lake Cowichan on Vancouver Island, owned by the appellant B.C. Forest Products Limited. It appears that there was no issue as to the value of - land. The appeal is brought to this Court by stated case pursuant to s. 74 (2) of the *Assessment Act*, R.S.B.C. 1979, c. 21.

The mill is relatively old; it was built and, from time to time, renovated and expanded over the period from 1929 to 1981.

The responsibility of the Board, as was that of the Assessor under the Act, was to determine the "actual value" of the mill for the 1982 roll. It is well known to those concerned in the field and, indeed, it is recognized in the provisions of the Act that there are a number of different approaches or methods which may be followed to assist in arriving at a conclusion as to the actual value, and often the resort to more than one method is helpful.

The *Assessment Act* in s. 26 (1) and (2) reads:

26. (1) The assessor shall determine the actual value of land and improvements.

(2) In determining the actual value under subsection (1), the assessor may give consideration to the present use, location, original cost, cost of replacement, revenue or rental value, the price that the land and improvements might be reasonably expected to bring if offered for sale in the open market by a solvent owner, and any other circumstances affecting the value, and the actual value of the land and the improvements so determined shall be set down separately in the columns of the assessment roll, and the assessment shall be the sum of those values.

In addition, s. 56 of the Act reads:

56. The board may, in its discretion, accept and act on evidence by affidavit, or written statement, or by the report of any officer appointed by it, or obtained in any manner as it may decide.

Here, the Board had a great deal of evidence before it dealing *inter alia* with a number of different approaches and methods, with many details of factors to be considered in arriving at the actual value. Among these was an appraisal by General Appraisal submitted on behalf of the appellant. In addition, the appellant called a number of witnesses to support and explain its position and that appraisal. This appraisal was filed as Ex. 5 before the Board, and was produced before this court and referred to by counsel in argument. It is incorporated into the case stated by reference.

There was not before this court any certified copy of the evidence dealing with the purported questions of law taken during the appeal as referred to in s. 74 (5) of the Act. There was before the court, appended to and made part of the stated case and referred to at various points therein, a copy of the decision or reasons of the Board. They are in approximately 100 typewritten pages and to a large extent consist of a review of the evidence before the Board and the submissions made thereon by counsel.

It is apparent therefrom that the Board was called upon, as one would expect, to consider, weigh, and accept or reject various items of evidence on the issues which arose. That, of course, is part of its function as a trier of fact.

This court, of course, can properly be called upon under the statute only to answer "a question of law only" in the stated case. It appears in the circumstances of this case, however, to be appropriate to outline some of the evidence before the Board and its findings of fact as disclosed in the decision of the Board before proceeding to consider whether the four questions posed in the case or any of them raise pure questions of law. In the circumstances here, and rightly so in my view, counsel for the respondent did not raise that issue by way of preliminary objection, but it was argued.

In determining actual value the Board accepted as a basis from which to proceed the appraisal of General Appraisal (hereinafter referred to as Ex. 5), already referred to above. The method there used is, essentially, "replacement cost" with modifications thereto to arrive at "actual value". It appears from the reasons of the Board that that was the only appraisal following precisely that method which the Board had before it. The respondent seemingly had not the resources to do such an appraisal, even where appropriate, as it was in this case.

As already stated, the Board used Ex. 5 as a base from which to proceed, being the best available evidence it had before it.

It is necessary next to state as shortly as possible, at perhaps some risk of oversimplification, the method underlying Ex. 5. The goal, of course, is to determine actual value as at December 31, 1981. This appraisal first estimates "reproduction cost" defined therein:

*Reproduction Cost* - The estimated cost, *at current price levels*, of reproducing new substantially *the identical property*. This implies similar design and layout, and the same construction materials, if currently available. [Ex. 5, p. 7 - emphasis added.]

The appraisal then proceeds to estimate "replacement cost". With respect to this Ex. 5, p. 7, says in part:

*Replacement Cost* - The estimated cost new, *at current price levels*, of all or portions of a *property having a utility equivalent to the property being appraised*. The replacement property may be of any type necessary *to achieve the most economical and preferred service - (utility)*. It may or may not be the current cost of an exact replica property. . . .

[Emphasis added.]

Exhibit 5 then goes on to say, still under the heading of "Replacement Cost" that

In the more common case in which the replacement cost of the equivalent utility is less than the reproduction cost, the difference is generally considered to *reflect the elimination of functional inutility - one form of depreciation* which would otherwise have to be considered in the depreciation applied to reproduction cost. [Emphasis added.]

The appraisal in Ex. 5 set out these costs, as above, dealing separately with "yard improvements, structures and buildings" on the one hand and "machinery and equipment" on the other. Bearing in mind the definitions and explanations, supra, in each case the replacement cost is less than the cost of reproduction. The difference is "functional inutility" which, as noted above, is "one form of depreciation".

In the same Ex. 5 there is then applied a percentage under the heading of "Physical Depreciation" by way of deduction from replacement cost to arrive at what is there termed "actual value". For the purpose of these reasons the percentage depreciation under the head of "Physical Depreciation", both in the case of Ex. 5 and as used by the Board, is approximately 50%. It seems to me appropriate to refrain from citing precise figures at this point. One is concerned with the method.

I turn next to another aspect of depreciation, i.e. "functional obsolescence". The appellant sought before the Board to have it accept, as a proper deduction in arriving at actual value under the statute, a further amount in respect of "functional obsolescence". This was said to arise from excess costs to be incurred by a prospective buyer of the mill as is. The mill as is has less utility than would a modern mill by reason of its physical functional obsolescence. The consequence of that is that a buyer of the mill as is, it was submitted, incurs excess operating costs over the remaining life of the mill.

The excess cost was calculated by multiplying the annual wage cost per excess man and multiplying by the number of excess men. This gave the annual excess wage cost. Such cost was then reduced by 50% because the next cost to the operator of the mill would be after income tax. (One of the assumptions in Ex. 5 is that "the prospective earnings of the mill will provide a fair return on the appraised value of the assets. . . and adequate net working capital "). The net annual cost after income tax is then multiplied by an adjusted factor representing the remaining years of life of the mill. The sum so determined is then discounted to capitalize the sum as of December 31, 1981.

Such a process was followed in Ex. 5, and the capitalized sum there estimated at \$4,000,000 was allocated as to 30% to "yard improvements, structures and buildings" and 70% to "machinery and equipment". The Board accepted that there should be such an allowance in this respect but it did not allow the sum estimated in Ex. 5. It allowed a slightly lesser sum, i.e. \$3,486,835.00, distributed 30/70 as above. The Board followed the same method, including deduction for income tax but with slight changes in one factor. That change in factor had a base in the evidence on cross-examination of one of the appellant's witnesses.

There was then an issue before the Board as to the point in the estimating process, as in Ex. 5, at which the amount so determined should be deducted. The Board had before it conflicting evidence on this issue, i.e. as to whether it should be deducted as the last item in the mathematical process, i.e. after deducting for physical depreciation or, alternatively, whether it should be treated in the same way as the other form of functional obsolescence, i.e. a factor which reduces the figure for "replacement cost new".

Ex. 5 did the former, i.e. it arrived at what is called "actual value" and then at that point deducted \$4,000,000.00 (its figure) for excess operating costs (again distributed 30/70). These excess operating costs are sometimes referred to by the Board as "special functional obsolescence" to distinguish them from the other form of functional obsolescence.

Before proceeding further there are a number of further definitions in Ex. 5 which are necessary to be kept in mind in understanding Ex. 5, as indeed Ex. 5 itself recognizes.

"Depreciation" is defined in Ex. 5 as (in part):

Depreciation - The sum total of all elements contributing to a "difference in value" (generally a loss) within a property as compared to the upper limit of value - the current cost to acquire the equivalent service in a new condition. This loss in value can be attributed to the following major causes:

Physical Deterioration  
Functional Obsolescence  
Economic Obsolescence

So from this it appears that each of "physical deterioration", "functional obsolescence" and "economic obsolescence" is a form of depreciation.

"Physical Deterioration", in turn, is defined in the same exhibit, in part, as:

*Physical Deterioration* - This form of depreciation has two basic causes: decrepitude due to the passage of time and exposure to the natural elements or the atmosphere of the operations; and, physical impairment from wear and tear of the operations due to friction, impact, vibration, or deformation or distortion due to stress or force. . . .

"Functional Obsolescence" is defined:

*Functional Obsolescence* - The loss in value from the new condition as a result of *technology and impairment of functional capacity*. Causes include but are not limited to:

1. change in design and construction materials;
2. lack of adequate capacity for present needs;
3. excess capacity for prevailing needs;
4. inadaptability for production requirements (inefficient plant layout and materials flow); and
5. excessive operating cost.

Functional obsolescence or inutility (attributable to the first four causes above) is generally measured by the difference between the replacement cost and the reproduction cost.

So that "physical deterioration" is one form only of three forms of "depreciation" as defined and "functional obsolescence" has at least five forms. The first four of these five are measured in Ex. 5 by the difference between the "Reproduction Cost" and the "Replacement Cost", both as referred to above.

Still under the heading of "functional obsolescence" Ex. 5 says:

Another form of functional obsolescence is created by technological advances, inefficient plant layout, or excess decrepitude resulting in additional manpower costs. The magnitude of this form of loss in value is measured by the determination of the present value of the prospective differential income.

This form of functional obsolescence is Item 5, referred to above, i.e. it is the excessive operating costs which have given rise to the immediate issue here.

The following is taken from a table " Summary of Values" , an appendix to Ex. 5, for the purpose of illustration only:

December 31, 1981

Yard Improvements, Structures and Buildings	Cost of Reproduction New	Functional Obsolescence	Replacement Cost New	Physical Depreciation	Actual Value
TOTALS	\$17,510,000	\$1,820,000	\$15,690,000	\$7,935,000	\$7,755,000

It will be noted that the \$7,755,000 Actual Value is arrived at after deduction for Physical Depreciation of approximately 50% of "Replacement Cost New". The amount for Functional Obsolescence does not include the 30% of \$4,000,000 special functional obsolescence (excess operating costs) and yet the \$4,000,000 is by definition a form of functional obsolescence, as noted *supra*.

Exhibit 5 then in another table makes the whole of the deduction of \$4,000,000.00 from the "Actual Value" already set out in Ex. 5 thus:

#### SUMMARY OF VALUES

Classification	Actual Value as of December 31, 1981
Yard Improvements, Structures and Buildings	.....\$7,755,000
*Less: Portion of excess operating costs	..... <u>1,200,000</u>
Sub Total	\$6,555,000
Machinery and Equipment	.....17,160,000
*Less: Portion of excess operating costs	..... <u>2,800,000</u>
Sub Total	<u>14,360,000</u>
Total	20,915,000
Rounded to	\$20,900,000

\*(Total \$4,000,000, distributed 30/70).

The effect of this is that the approximate 50% deduction for physical depreciation has also been applied to the allowance of \$4,000,000.00 (Ex. 5 estimate figure) for special functional obsolescence, because that amount still remains in the figure for "replacement cost new". The Board considered that the sum for special functional obsolescence (it itself being a form of allowance for depreciation) should be deducted from the figure for "replacement cost new". Being so deducted this reduces the amount of the approximate 50% deduction for physical depreciation by approximately 50% of the \$3,486,835.00 (the Board's figure) and the actual value is increased accordingly.

Question 1 in the stated case reads:

*Question 1.* Having found that there were 42 excess men in the mill and having concluded that a purchaser would deduct as an allowance the present value of the ongoing cost of that excess labour from the amount he would otherwise be willing to pay for the mill, *DID THE BOARD ERR IN LAW* by reducing that allowance by an amount for physical depreciation in its determination of Actual Value?

It is not happily worded. The Board did not do precisely what the question states. As I understand the matter as argued and as stated earlier the central issue between the parties is whether the Board erred (and if it did err whether it was purely on a question of law) in deducting the allowance for excess labour costs from the replacement cost new, thus reducing the amount otherwise charged (as in Ex, 5) for physical depreciation, with a resultant increase in actual value.

The submission on behalf of the appellant was that the allowance for excess labour costs should have been deducted as the last item in the equational process, i.e. after physical depreciation had been taken (as was done in Ex. 5). Thus, the actual value is decreased below what the Board set.

The Board did not, as Question 1 states, "reduce the allowance (i.e. for excess operating costs or special functional obsolescence) by an amount for physical depreciation. . . ." It reduced the "replacement cost new" by the allowance for the special functional obsolescence and thus reduced the physical depreciation otherwise charged by the amount of physical depreciation which it considered was wrongly charged on the allowance for special functional obsolescence.

This is apparent from Schedules 1 and 2 to the decision of the Board. Schedule 1 deals with the yard improvements, structures and buildings (and charges 30% of the allowance there) and Schedule 2 deals with machinery and equipment (and charges 70% of the allowance there). The following is a reproduction of Schedule 1 to illustrate the above:

*Schedule No. 1*

December 31, 1981 (Reconstructed - Allowing for Interest During Construction)

Yard Improvements, Structures and Buildings	Cost of Reproduction New	Functional Obsolescence	Replacement Cost New	Physical Depreciation	Actual Value
TOTALS	\$19,260,000	\$1,995,000	\$17,265,000	\$8,680,250 @50.2766%	\$8,584,750
*Less Functional Obsolescence (Due to Excess 30% Attributable to Structures)			<u>- 1,046,050</u>		
Adjusted Replacement Cost New			\$16,218,950		
**Physical De- preciation	\$8,680,250				
Less Physical Depreciation already allowed on \$1,046,050 (Calculated at 50.2766%	<u>- 525,918</u>				
Adjusted Physical Depreciation	\$8,154,332		<u>- \$8,154,332</u>		
			\$8,064,618		
Less Economic Obsolescence of 6.3%			<u>508,070</u>		
			\$7,556,548		- Final Value as found by the Board – Yard Im- provements, Structures and Buildings
General Appraisal Actual Value (allowing for 100% I.D.C. before taxes at 16% interest		\$7,755,000			
		<u>+ 755,000</u>			
		\$8,530,000			
(Adding back depreciation wrongly deducted on "B" Mill)		<u>+ 54,750</u>			
Reconstructed Actual Value		\$8,584,750			

\* The replacement cost new is reduced by 30% of the total allowance for special functional obsolescence.

\*\* The first figure for physical depreciation of \$8,680,250 is reduced by the amount of physical depreciation which the Board considered should not have been charged on that 30%.

It is clear from the Board's reasons that in treating the allowance in question as it did it followed what was done in *Western Forest Products Ltd. v. Assessor of Area #08 -North Shore Squamish Valley*, B.C. Assessment Appeal Board Decisions, No. 58, October 1, 1982. That case was referred to by counsel for the appellant in his submission before the Board in support of making an allowance for the excess operating costs. The Board acceded to that submission. That case dealt with the issues immediately in question here, i.e. whether such an allowance was to be made and, secondly, when made, where it should be deducted in the equational process. A similar appraisal to that here had been submitted in that case (by the same appraiser) and used as a base for the decision, as was the case here. I quote from that case, at p. 10:

*Elimination of Duplicate Depreciation*

The Board accepts the principle of a deduction of excess variable operating expense or functional obsolescence due to an excess, but cannot accept the manner in which it was applied. Functional obsolescence is generally measured by the difference between the reproduction cost new and the replacement cost new. The Board finds that functional obsolescence due to an excess, although not directly attributable to any specific component, still has the effect of reducing the value of the replacement cost new. On that basis, the manner in which it has been applied in the subject appraisal creates a duplication of depreciation which is improper. The Board has modified the technique of measuring such functional obsolescence so that depreciation allowance is not duplicated.

It is apparent, also, that in the case at bar the Board used tables in the decision of that case as a model for the preparation of Schedules 1 and 2 to its decision.

Next there is the issue as to whether Question No. 1 raises a pure question of law. In my judgment it does not. It raises no question of statutory construction. It cannot be said that the Board acted in an arbitrary manner. There is no error in principle at all, let alone in legal principle. The Board has not misdirected itself. It is not a case of no evidence.

It was for the Board to determine on the evidence before it whether such an allowance for excess operating costs was properly to be made and if made how it should be treated in the equational process, all to the end of arriving at "actual value".

In concluding that the question does not raise a pure question of law I have considered a very considerable number of cases to which I was referred. A quotation from one of these seems appropriate here, i.e. *Crown Zellerbach Canada Limited, et al. v. Assessment Districts of Comox, Cowichan and Nanaimo*, B.C. Assessment Appeal Board Decision #36, 157 Davey J.A. (as he then was) said at p. 176:

The statutory duty of the Assessor is to find the "actual value" of the taxable property, but section 37 permits him to use several different methods and to consider many different elements in finding actual value. I do not think that the use of any specifically mentioned method of finding actual value, or the inclusion or exclusion of any enumerated element, provided there is evidence to support the reasoning, can be said to raise a question of law appealable to the Courts on a stated case, for those matters lie in the judgment of the Assessor and the Assessment Equalization Board (*Reg. v. Penticton Sawmills Ltd.* (1953), 11 W.W.R. (N.S.) 351 at pages 353,356).

This case is also reported, but less fully in (1963), 42 WWR. 480; aff'd 45 WWR. 442 (S.C.C.).

Question 2 in the case reads:

Question 2. Having concluded that "in applying interest during construction and at the same time factoring the same items upward", there was "double indexing" for inflation:

(a) *DID THE BOARD ERR IN LAW* in concluding that it "was not called upon, in the circumstances, to make a ruling on this issue?"

(b) *DID THE BOARD ERR IN LAW* in not reducing the actual value determined by it by an amount to reflect the fact that inflation for the assumed construction period of two years had been indexed twice, once, in interest during construction and once, in the costs factored to December 31, 1981 by General Appraisal?

Counsel for the appellant raised these questions with the Board by letter following the decision. The Board, in a letter of 17 May, 1983, which forms part of the case, replied (in part):

. . .

With respect to the assertion that the Board has included inflation twice over the period of construction, we wish to state that such is not the case. The principles enunciated, at pages 99 and 100 of the Board's decision, apply only to reported costs of the company (historical costs) factored up. General Appraisal Ltd., based on the evidence before the Board, did not factor up actual reported costs of the company in order to determine the December 31st, 1981, actual value.

The question posed in Question 2 seems to me to disclose a basic misunderstanding of the distinction made in the statement quoted from the letter above. What was before the Board in Ex. 5 was an estimate of the replacement cost (new construction) not based on original or historical cost. (For an explanation of the two and their essential differences see, e.g., Bonbright, *The Valuation of Property*, Vol. 1, Chapters VIII and IX, McGraw-Hill Book Co., 1st Ed., 1937).

The Board had before it evidence (other than Ex. 5) of estimates of actual value arrived at in a number of different ways. These included an estimate based on known cost of construction (i.e. original or historical cost) of another existing mill taken by the witness as a reasonably comparable mill, with adjustments. Factors were applied to that known original cost to arrive at a cost for the mill in question here. That is quite a different method from that in Ex. 5 and was not accepted by the Board in its decision.

A number of witnesses gave conflicting views on the application of interest during construction, and whether it should be on full or partial cost and at what rate. Ex. 5, prepared by the plaintiff's witnesses, allowed for interest during construction. That was so because what was being estimated was the cost of construction of a new mill. Part of that cost is interest paid on borrowed money (or lost, if one is funding it oneself) over the period of construction, when the mill is not operating and is giving no return.

Another witness called by the appellant was a chartered accountant, called in rebuttal. How his evidence was admissible as rebuttal evidence is not clear. He appears to have approached the matter of valuation, as might be expected, from the standpoint of an accountant not an appraiser, i.e. by capitalizing original or historical costs of construction and adding thereto or deducting therefrom to bring the figures up to date.

The two approaches, both presented by the appellant, were inconsistent. The distinction is in some respects pointed up in the following quotation from Stewart, *Real Estate Appraisal in a Nutshell*, 2nd Edition, 1972, University of Toronto Press, p. 103:

The accountant is concerned *inter alia* with showing a financial picture of an enterprise to serve as a basis of periodic comparisons and for other purposes; he therefore uses original cost which will not change over future accounting periods. Against this cost he



sets up annual dollar allowances which over the expected life of the asset will total such cost. This use of a historical unchanging cost is very different from the appraisal practice of using constantly changing current costs. Both approaches are valid for their purposes; the accountant is not concerned with value, while this is the main interest of the appraiser.

This witness of the appellant differed fundamentally from the appraisal in Ex. 5, presented by the appellant through other witnesses, as to the appropriate manner in which one should treat interest during construction. The reason may well have been a matter of starting from different premises. There was evidence from other witnesses on the same subject.

The Board decided to accept that evidence which indicated that the charging of the cost of interest during construction was a proper recognizable part of the cost of new construction. It decided also apparently (by implication) that the approach of the chartered accountant was not acceptable in the circumstance here. It decided, further, that the cost should be applied on the total cost of construction and that applying it to only two-thirds of the cost (as Ex. 5 had done) was not proper or acceptable. The use of two-thirds of the cost of construction was arrived at on the arbitrary assumption that one-third of the money was being provided by the owner and two-thirds borrowed. The Board seems to have accepted the argument of the respondent that, whether the owner had borrowed the money or not, there is cost in either case of either interest paid, or income not earned, on money tied up during construction.

The appellant points to portions of the reasons for decision wherein the Board says that it is critical of adding interest as well as factoring up costs. But the Board says, in effect, that this is not applicable in the case at bar. Further, the appellant points to another statement in the decision to the effect that there was no need for the Board to decide whether there was double indexing here.

The appellant seems to have missed the fact that the Board distinguishes between factoring up costs, and at the same time adding interest during construction, when you are arriving at a cost from an original or an historical cost of construction of a given existing mill (which was not the case in Ex. 5) and, on the other hand, the postulated construction of a new replacement mill as of December 31, 1981 (which was the case in Ex. 5). The costs of the latter construction are estimated from the current costs of new construction. The Board perhaps did not make the distinction as clear as it might have, but that is what it is stating in the letter above referred to.

In any event, the Board concluded that interest during construction was a proper item of cost, as did the appellant's witnesses who prepared and were the proponents of Ex. 5. Again it was the Board's prerogative to decide which evidence to accept and which to reject, and whether to accept or reject in whole or in part, all as part of carrying out its obligation to arrive at actual value.

Question 2 does not in any of its parts raise a pure question of law.

Question 3 is somewhat of the same tenor as Question 2. It arises from the failure to distinguish between two fundamentally different premises in the reasoning process. The question reads:

*QUESTION 3. DID THE BOARD ERR IN LAW* in treating the impact of income tax inconsistently, in that it reduced the allowance for ongoing excess labour costs but did not reduce the additional cost of interest during construction, to reflect the income tax impact, although both such costs are deductible for income tax purposes on the same basis?

Again, the question is unfortunately worded. It really begs the question. That is to say, it assumes by its words that the Board treated the impact of income tax inconsistently as between excess operating costs on the one hand and interest during construction on the other. In fact, as counsel for the appellant, who framed the question, agrees, the question essentially is: "Was the Board

inconsistent in allowing for income tax saved on the excess operating costs (dealt with under Question 1, *supra*) and, on the other hand, not allowing for income tax in the case of interest during construction"?

As already noted, the allowance against the excess labour costs for the savings arising from income tax was postulated on the known mill in question being in operation and earning profit. Its real wage costs would be net of income tax because the wage costs are charged against what would otherwise be profit.

In the case of interest during construction the postulate is quite different. There you have a hypothetical mill under construction, i.e. not in operation, and incurring a cost which cannot be charged against earnings.

The Board concluded that in connection with the interest during construction there should not be an allowance for income tax. That was part of its function as the trier of fact on the evidence before it and by inference therefrom. Again, the question does not raise a pure question of law.

Question 4 reads:

*Question 4.* In its conclusion "that it could not place much reliance on the Discounted Cash Flow method of valuing the Youbou Mill complex", because the method "was hinged to a number of vital assumptions", "a small variation from any of (which) would have a substantial effect on the final value, at the end of a twenty year period." *DID THE BOARD ERR IN LAW* in considering the effect of the assumptions ultimately being proved to have been wrong, rather than considering whether they were the assumptions that a prudent purchaser would have made at December 31, 1981.

During argument it was conceded by counsel that Question 4 should be sent back to the Board for clarification. On receipt of that counsel for the appellant conceded that Question 4 raised no question of law and it is abandoned by the appellant.

The respondent is entitled to costs.