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B.C. TIMBER LTD.

v.

ASSESSOR OF AREA 18 - TRAIL

Supreme Court of British Columbia (A841323) Vancouver Registry

Before: MR. JUSTICE C.M. LANDER

Vancouver December 18, 1984

B.J. Wallace for the Appellant
J.K. Greenwood for the Respondent Assessor of Area 18 – Trail
J.R. Pennington for the City of Castlegar[1]

Reasons for Judgment February 8, 1985

This case is stated pursuant to s. 74 of *The Assessment Act*, R.S.B.C. 1979, Chap. 21.

The Assessment Appeal Board stated four questions upon which it required an opinion of this court. However, counsel advised that an opinion on questions 2 and 4 were not required. Before setting out those questions I feel constrained to mention that in the stated case the Board has seen fit to include explanatory notes on each question stated. These explanatory notes have been judicially referred to on two previous occasions; see *British Columbia Forest Products Limited and Assessor of Area #03 - Cowichan Valley* Vancouver Registry No. A841788 decision of Gibbs, J. and *Allied Contractors* v. *The Assessor of Area # 12* (1984) unreported Vancouver Registry No. A841238, McKay, J. Each of my brothers disregarded the Board's comments and I do the same but I respectfully suggest that the Board should be discouraged from presenting argument as it were, on its' behalf while stating a case.

The facts are that the appellant owns a pulp mill and sawmill located at Castlegar, B.C. At the conclusion of the hearing on the appeal before the Board the Board allowed the appeal to the extent that it revised the 1983 assessment roll values confirmed by the Court of Revision from $29,227,998 to $19,093,000. This matter is concerned only with improvements and machinery, in that latter figure the Board found was the value established by the applicant as the total of the replacement values (including a tax adjusted cost of interest during construction) of each of the components of the sawmill on the date of evaluation less depreciation.

The applicant before the Board submitted that a further reduction for excess operating costs should be made because the applicant was required to operate what it considered to be "functionally obsolete sawmill" rather than a modem replacement model. The Board found the following facts relevant to this issue of "functional obsolescence":

> (a) the Appellant is in the process of and has completed the design of the production line realignment and layout;

(b) the Appellant has and intends to replace some of the existing machinery and equipment with modem machinery and equipment;

(c) the appraisers for the Appellant based their calculation of functional obsolescence on the designs and replacements of components of the existing facility as foreseen by the Appellant to create a modern production facility;

(d) the replacement cost new was calculated by the appraisers for the Appellant and functional obsolescence (excluding functional obsolescence represented by ongoing excess operating costs) identified by the deduction of replacement cost new from reproduction cost new on certain components.

The Board found, as a fact, that all functional obsolescence was accounted for in the deduction of replacement cost from reproduction cost. The Board went on to conclude that the situation of the applicant was one in which this "functional obsolescence" was curable rather than incurable. Therefore it disallowed any further deductions for allowance for these excess operating costs. On this issue the Board stated the question as follows:

1. Was the Board's conclusion that there should be no allowance deducted from actual value to reflect the fact that a purchaser would deduct, as an allowance, the present value of the ongoing costs of excess labour in the Sawmill because these "excess operating costs "were" curable" contrary to all the evidence, and therefore an error of law?

The Chairman of the Board at p. 8 of the reasons dated the 27th day of January, 1984 stated as follows:

The Board finds the piecemeal calculation of functional obsolescence, on only certain components of the production facility, by the Appellant, to be inconsistent with the preferred modern production equivalent model concept, wherein all functional obsolescence is accounted for in an uncomplicated manner.

The Board concludes, as did the Court in the Bend Millwork case, that the deduction of excess operating costs must be taken from the reproduction cost *if* the facts warrant such deduction. In the instant case the facts disclose that *the functional obsolescence is curable* as opposed to the incurable nature of the functional obsolescence in the Bend Millwork case and, therefore, the Appellant fails on the issue of excess operating costs.

Aside from the facts and conclusions in the instant case, the Board has serious reservations as to the validity of any consideration of a deduction in the cost approach for excess operating costs. It must be remembered that actual value is the market value of real property. Although the excess operating costs may be considered by a potential purchaser, it is the Board's opinion that such a consideration would in all probability be considered on review of the income-producing capability of the production facility as a standard accounting principle. The accountant is not concerned with real estate value, while this is the main interest of the appraiser.

Mr. Greenwood on behalf of the respondent submitted that the findings made by the Assessment Appeal Board in the case at bar were findings of facts in that there is no question of pure law raised on this appeal: see *British Columbia Forest Products Limited* v. *Assessor of Area #03 - Cowichan Valley*, Vancouver Registry No. A832201, December 14,1983, Rae, J.

On the issue of whether this "functional obsolescence" is curable or not reference must be made to the transcript of the hearing to the Board on November 15 and 16, 1983 where the chairman and a Mr. W. Irwin, an appraiser called on behalf of the applicant, had the following exchange:

THE CHAIRMAN: Okay, you're referring to page?

A Page 1 identifies what Mr. Tredwell is trying to put across. Page 2 is a chart showing how the penalties, physical, functional and excess operating cost should be applied and at what order they should be applied.

THE CHAIRMAN: Would you care to advise me where this paper says that you should take excess operating costs from the replacement cost?

A Where I should take it from the replacement cost? I don't take it from the replacement cost, I deduct it from the actual value as determined after considerations for functional obsolescence, physical and incurable and curable physical.

THE CHAIRMAN: If you cure depreciation by using the replacement cost, you've taken care of the functional obsolescence of the plant. How is it then possible to deduct an excess operating cost which no longer exists from a replacement cost? Is that not double depreciation?

A It does exist, sir, it's still there. I have cured the functional obsolescence as it pertains to the assets but it's still there. I haven't built that replacement mill. I've still got this mill that has this functional obsolescence built into it and until I build a new mill, I'm still going to incur those excess operating costs.

And on p. 130 when questioned by Mr. Hobson, a member of the Board, the following:

A That's correct.

MR. HOBSON: Okay, the question then is, this functional obsolescence which you've calculated, would you agree that it is entirely curable functional obsolescence?

A It is not economically curable.

MR. HOBSON: No, but is it curable functional obsolescence?

A Yes. I mean, it is uneconomically curable.

MR. HOBSON: But was it not calculated from those improvements which you described as what should be done or in the process of being done?

A In our replacement concept we have in theory cured them.

THE CHAIRMAN: Well, we're going to have to proceed with this line because that isn't a sufficient answer.

MR. HOBSON: You don't agree then that it's entirely curable functional obsolescence which you've calculated.

A No, it's not curable.

THE CHAIRMAN: And has not testimony been received by this hearing to the effect, from the gentleman who is the foreman and from yourself that, in fact, some of these items are being cured, that certain lines are being straightened out, that certain sheds are being redone, et cetera, et cetera, et cetera?

A That's correct.

THE CHAIRMAN: That makes it curable, doesn't it?

A Yes, they are cure-, yes, I have to agree, yes.

THE CHAIRMAN: Now, there is a plan to make these deficiencies correct.

A That's right.

THE CHAIRMAN: And, in fact, we have heard testimony that they are in the process of correcting these deficiencies so therefore the entire functional obsolescence in this case would be called curable.

A Yes, if they proceed with all of the plans, that's correct.

THE CHAIRMAN: Do you have any reason to disbelieve that they will proceed with these corrections of deficiencies?

A No, I don't.

MR. HOBSON: Your last answer was you don't know whether they are or not, are you have evidence to the fact that they're not?

A I would assume that they are going ahead with it as far as the plans and the projections that they have.

The applicant argues that because of the particular nature of this sawmill as it exists today, there are excess operating costs in that more men are required to operate it and therefore these excess costs have a negative effect on the actual value that a prospective purchaser might place on the operation. (underlining mine) Further, the applicant submits that the conclusion arrived at by the Board was in error based upon interpretation of s. 26 of the *Assessment Act* (supra) in particular 26 (2); sec. 26 (1) (2) (3) reads as follows:

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.

(3) Without limiting the application of subsections (1) and (2), where an industry, commercial undertaking, public utility enterprise, or other operation is carried on, the land and improvements so used shall be valued as the property of a going concern.

This particular issue was dealt with by Gibbs, J. in *British Columbia Forest Products and Assessor of Area #03-Cowichan Valley and Prince George Pulp and Paper Limited and Assessor of Area #26-Prince George*, supra. Mr. Justice Gibbs at p. 12 stated as follows:

I do not understand how it can be said that, in these circumstances, the market value of the real property can be different than what a prudent purchaser would be willing to pay. If the prudent purchaser would take excess operating costs into account on a review of the income producing capability, ipso facto he must take it into account in valuing the real estate. That is because, in simplified terms, in the absence of comparable sales data, the value of the real estate is the present value of the net income it will produce over a

> selected period of years. The sections 26 (2) and (3) expressions "revenue or rental value", "any other circumstances affecting the value" , and "a going concern" are sufficiently broad to embrace that concept.
>
> I can reach no other consideration than that the Board did not apply sections 26 (2) and (3) in its consideration of the reduction for excess operating costs. As pointed out earlier, failure to do so is an error in law.

As to the evidence before the Board I do not conclude from the cited portion of the transcript reproduced herein that in any way did the applicant's appraiser resile from his position that this was a legitimate cost consideration be made by "prudent prospective purchaser" of the applicant's mill. As long as the excess operating costs are being incurred by this mill notwithstanding the fact that they have plans to change the operation to reduce these particular costs the adverse effect of the market value still exists. I have concluded that the Board's failure to consider this is a factor in the determination of the fair market value of the applicant's operation was an error in law. In this connection I adopt the reasoning of Gibbs, J. in *Prince George Pulp and Paper Limited and Assessor of Area #26-Prince George*. The answer to question one is yes.

The remaining question that is to be answered is number 3 and it is stated as follows:

> 3. Was the Board's decision not to reduce the replacement cost less depreciation of the Sawmill by a 5% "economic allowance" to arrive at an actual value contrary to all evidence?

The Board decision does not refer to the 5% allowance which I understand was set by the assessor in the West Kootenay area at a flat 5% based on his view of the economic downturn which is prolonged rather than temporary, in the forest industry. Counsel for the respondent submits that this is clearly a question of fact and not of law. Gibbs, J. also dealt with this issue in *British Columbia Forest Products Limited and Assessor of Area #03-Cowichan Valley and Prince George Pulp and Paper Limited and Assessor of Area #26-Prince George*. (supra). Gibbs, J. at p. 4 states:

> The alleged error in principle arises from the Board's application of the "cost approach" to valuation, that is to say, a determination of what it would cost to reproduce the property in its present condition. BCFP, Prince George, and the assessor contend that in law, the Board must make an allowance for external obsolescence when there is evidence to support such a finding. They go on to say that in these circumstances the proper method of valuation is to determine what a prudent purchaser would pay as an alternative to reproducing the present mill. Their argument is that a prudent purchaser would have regard, among other things, to potential profit, and that as potential profit depends upon market or economic conditions there must be a reduction when depressed market conditions are shown to be more than temporary.

At p. 6 Gibbs, J. concludes with a reference to the decision of the Board and I reproduce, for these reasons, the latter portion of the Board's decision together with his reasons.

> The Board finds as a fact that external obsolescence has been applied incorrectly by the assessor and the 10% reduction allowance is, therefore, rejected.

I am not deterred by the statement, in the last paragraph of this quotation, that the Board has made a finding of fact. It is clear from the preceeding paragraphs that it is not the method of incorporating external obsolescence that the Board disagrees with, but whether, as a matter or principle, the element of external obsolescence should be employed at all. The parties before me argue that that is a question of principle, or law, regardless of what the Board chooses to call it. I agree with that submission.

The Board's reasoning in rejecting an allowance for external obsolescence is faulty in at least two major respects. Firstly, in applying the textbook quotation which it adopted, the Board failed to recognize that depressed market conditions are as much a "negative influence from outside the site" as are zoning regulations or inharmonious uses of adjacent properties. Secondly, it is inconsistent with the realities of the market place to conclude that a prudent purchaser looks only at capacity without regard to the market for the commodity which the capacity can produce. However, even though the reasoning is faulty, does the failure to take external obsolescence into account amount to an error in law?

It must be stated that the appraisal done by the applicant filed before the Board makes a broad reference to "economic forces" affecting depreciation. (pg. 291rwin appraisal). It appears from the submissions before me that the assessors in particular regions throughout British Columbia elected to provide this form of an allowance.

Gibbs, J. concluded that "off site" influences, such as the effect of a sluggish economy particularly in the lumber industry was a circumstance that the Board should consider under sections 26 (2) and (3) of the Act supra. He considered that when the Board disallowed a reduction for the "economic allowance" where there was uncontradicted evidence the Board failed to give effect to subsections (2) and (3) of s. 26 and therefore erred in law.

I concur with Gibbs, J. that the matter as stated in the case at bar is a question of law and may be properly dealt with by this court. The material filed and in particular the portion of the transcript provided and filed does not reveal that any evidence on this issue was advanced before the Board. I do not think that the Board is obliged to consider the matter in a vacuum. Evidence should have been led on which the Board after proper consideration, could have arrived at a decision. After consideration of s. 74 of the Act it does not in my opinion provide for a court to remit the matter to the Board to hear further evidence on a particular question stated. Therefore, the answer to question 3 is no.

The matter is remitted to the Board pursuant to s. 74 (6). The applicant shall have its costs.

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[1] amended 26.8.85