Alberta Assessors' Association (AAA)
Report on

***REGULATED INDUSTRIAL PROPERTY ASSESSMENT GUIDE* (RIPA) VERSION 2.0.8**
Released for Consultation July 30, 2018

Executive Summary

The Alberta Assessors' Association strongly opposes RIPA 2.0.8 as a significant departure from the CCRG that will have the overall effect of reducing assessments resulting in less taxable assessment and (or) a shifting of the tax burden to residential and non-residential (commercial) ratepayers.

The significant policy changes between the CCRG and RIPA will create inequities between those properties outside the Edmonton area and those within the Edmonton area. There will also be inequities between existing property where the included costs were determined under the CCRG, and those determined under RIPA.

The six main policy issues in which the Association has determined are significant in RIPA are outlined in more detail in the report and briefly described as follows:

Labour Costs
RIPA directs that all labour costs are to be reconciled to the Edmonton area. However, RIPA does not stipulate how the reconciliation will occur. Rather, it allows individual companies to determine how they reconcile, essentially by comparing budgeted amounts (estimates) to actual costs to determine their own excluded costs. The assessment community does not support a policy change that allows assessments to be prepared using estimates for excluded costs.

Annual Capital Expenditures/Alterations
Current policy pursuant to *the Construction Cost Reporting Guide* (CCRG) holds that expenditures that are capital and not purely maintenance-related account for part of assessment growth which is consistent with the definition of "improvement" in the Municipal Government Act (MGA).

RIPA posits that annual construction costs may only be assessed if the output of a plant is increased or improved, which is rarely the intent or effect of annual construction costs. Assessable improvements should be determined by the MGA, not accounting principles.

Grandfathering/Equity
Without clear language limiting or enabling grandfathering, RIPA lacks transparency and does not contribute to its intended objective of "consistent practice." It is not clear whether RIPA continues the CCRG process for properties 2018 and prior or replaces the CCRG as the resulting different included cost outcome is not stipulated. Also, there is a risk that past assessments may be appealed to reconcile labour costs to the Edmonton area or to appeal annual construction costs that possibly no longer meet the capital expenditure threshold.

Pre-Construction Costs

In recent years, property owners have spent more on pre-construction studies and engineering planning documents and the studies and plans themselves have improved to the extent that owners and assessors agreed that feasibility studies would be excluded costs, but other pre-construction engineering documents would be included provided they were used to develop the final "issued for construction documents." This agreement and practice has been removed from the RIPA document.

Commissioning

Commissioning essentially is a trial operation phase that ensures equipment operates as it is intended. The draft RIPA document has altered the definition to included "functioning according to design objectives." Many plants do not reach their "designed" function for months or years after they are operational, sometimes never. The clear risk to municipalities is the argument that a property cannot be assessed as it is still in the commissioning phase.

Travel within the site

Under the CCRG, the time to travel within the site was an included cost and under RIPA it would be an excluded cost. We cannot support this change as the time for workers to travel within a large site is typical and normal on all sites.

Exhaustive list of Excluded Costs

The definition of total project costs is valuable as is the list of excluded costs. Both are an improvement of the CCRG.

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Background – Purpose of the Change from CCRG to RIPA

It was our understanding that the intent of the RIPA consultation was two-fold: (i) first to clarify the CCRG thereby reducing the number of complaints filed, and (ii) to develop benchmarks for normal/typical labour costs in the Edmonton area. Claims for excluded labour costs would then be compared against these benchmarks. Version 2.0.8 accomplishes neither of these two objectives. Version 2.0.8 changes assessment practice without the policy reasons for doing so being explained. Version 2.0.8 does not contain benchmarks to determine typical labour costs and typical labour productivity. With the exception of the provisions discussed below under the heading "Total Project Costs and the Exhaustive List of Excluded Costs," the Association cannot support RIPA Version 2.0.8.

History of the Consultation – Labour Costs

The province extended the RIPA consultation for a year to allow, among other things, the developing of standard labour costs in the Edmonton area. It has been the experience of our members that labour costs amount to between 30 – 40 % of the total project costs, and so the Association appreciated this delay. Municipal Affairs hired consultants to develop benchmarks for labour costs in the Edmonton area and benchmarks for determining unproductive labour. Stantec was the company hired to prepare a report, however the approach taken by Stantec relied upon estimates and factoring rather than actual costs. Accordingly, the Association could not support the Stantec methodology.

The approach of standardization and benchmarks was being pursued in Schedule 1 of Version 2.06, and the Association was in support of this approach. Version 2.06 set out benchmarks for typical labour costs in the Edmonton area. For example, in the Edmonton area it is normal to have typical labour rates, schedule slippage, 3.5 months of winter work, and the availability of skilled craftspeople. Version 2.0.8 has completely departed from the goal of determining standardized labour costs to be used to compare against claims for actual labour costs incurred outside of Edmonton. Version 2.0.8 no longer contains benchmarks for determining labour productivity norms in the Edmonton area. The Association does not support these policy changes.

History of the Consultation – Changes from Version 2.0.6 to Version 2.0.8

Over the last two years, the consistent message delivered by the province during the stakeholder sessions, was that the goal of the consultation was to <u>clarify</u> the intent of the CCRG by preparing a new document. In keeping with this goal, there were a number of decisions that the AAA understood had received support from the stakeholders, ie. meaning that the intent was agreed upon. For unexplained reasons, these provisions were fundamentally changed from Version 2.06 to Version 2.0.8. These changes resulted in departures from how the CCRG has been historically applied, which the Association cannot support.

Here is a summary of the major areas of Version 2.0.8, which we see as being a policy change from how they were applied under the CCRG. The first three items listed below are principle-based policy changes from the CCRG, and are of equal importance and impact.

1. **Edmonton Area** – There are 3 aspects to this concept, (i) reconciliation of labour costs to the Edmonton area, (ii) determining typical labour costs in Edmonton, and (iii) determining claims for unproductive labour.

   Under the CCRG there was a debate as to whether all costs are to be reconciled to the Edmonton area, or only transportation costs. Under RIPA there has been a clear statement that labour costs are to be reconciled to the Edmonton area. This will mean that assessments outside the Edmonton area will be reduced, as typically labour costs are higher outside the Edmonton area, so the included costs will be reduced for the cost of labour.

   Version 2.0.8 allows the individual company to determine how this reconciliation is to be done by using their own budget (which is an estimate) to compare to their actual labour costs. This means that the property owner is self-determining their claim for excluded costs by comparison to their own estimate. At the RIPA meeting of June 8, 2018, there was consensus to introduce an alternative methodology to supplement the standard benchmarks in Schedule 1 version 2.0.6. If the owner could provide a reconciled quantity adjusted project budget, to the Edmonton area (using the benchmarks in Schedule 1 Version 2.06), the Assessor may give this consideration in lieu of Schedule 1. There was not consensus to replace the standard benchmarks in Schedule 1 Version 2.0.6 with the wording in Schedule 1 Version 2.0.8.

   The Association cannot support the policy change to have assessments prepared using estimates, and to allow a property owner to self-determine their claim for excluded labour costs. We are concerned that Version 2.0.8 will allow property owners to provide an estimate they prepare themselves to compare against their actual labour costs, rather than comparing their actual labour costs against what is typical in the Edmonton area.

   Estimates are prepared with 5 levels of categories. Version 2.0.8 does not require the company to state the estimate category, and the tolerance range for that category. Version 2.0.8 does not stipulate that the highest accuracy level of estimate is required. In addition, even the best quality of estimate has an accuracy tolerance range (for example the highest quality of estimate has a +/- tolerance of 15%). Version 2.0.8 does not require the adjustment of the estimate by the tolerance range.

   If the province remains committed to this policy change, then the language of Schedule 1 should be changed to require:

   (i) the highest quality of estimate must be used,
   (ii) the estimate must be dated close to the project's mechanical completion date,
   (iii) the estimate must adjusted by the tolerance range, and
   (iv) the property owner must establish using third party sources, that its estimate was typical in the Edmonton area.

   As Version 2.0.8 is currently written, there is no expectation that the property owner will provide confirmation that their estimate is typical in the Edmonton area, and no expectation that the property owner will reconcile their excess labour claims to what is typical in the Edmonton area. However the draft places an expectation on the assessor to do so when reviewing the claim. One of the reasons for going to typical labour benchmarks in the Edmonton area was to reduce the need for retaining engineers and cost estimators to review

the claims for labour excluded costs. With the absence of labour benchmarks in Version 2.0.8, assessors will need to retain this type of assistance.

For property located in the Edmonton area, it is not clear from Version 2.0.8 whether or not an eligible claim can be made for excess labour rates. It is also unclear whether claims for unproductive labour can be made either within or outside the Edmonton area.

2. **Annual Capital Expenditures / Alterations** – Under the CCRG the cost of annual additions to a plant are reported to the assessor. Some of these expenditures are maintenance activities and the costs are not assessed. However, there are other expenditures where an old component of the plant is replaced with a new component (ie. a new improvement). If these new components are additions, upgrades, modifications which improve that component - then the cost is added to the assessment (and the cost of the old component removed). These annual capital expenditures account for part of the assessment growth and are consistent with the definition of improvement in the Act. This is how the CCRG has been applied.

   Under Version 2.0.8, the annual construction costs may possibly only be assessed if the output <u>of the plant</u> is increased by the work performed, and if the cost is reported as a capital expenditure under the rules of the Canadian accounting standards. There are two issues with this approach. It should be the provisions of the Act which determine if new property is an improvement and subject to assessment, not the Canadian accounting rules. Secondly, in our experience, increasing the plant output is <u>rarely</u> the outcome of annual capital expenditures. Increasing the plant output is usually restricted to a plant expansion or debottlenecking project. This is a significant policy change in the RIPA draft. If this change is implemented, the result will be lower assessments, as the municipality will now be reliant on new construction and possibly changes to the AYM.

3. **Grandfathering and Equity Concerns** - RIPA is meant to apply to assessments on a go forward basis, however the 'grandfathering' provisions are not very clear. If the intended policy consideration of RIPA is meant to arrive at different included cost outcomes, these should be made transparent as a preamble to RIPA. Similarly, if the intended policy consideration of RIPA is to continue the policies under the CCRG, then this should be made transparent. Without the intent being made transparent we see this argument surfacing on every project. Part 2-Section 8 refers to the requirement to use the CCRG for 2018 Assessment Year (and prior) construction, and to use RIPA for 2019 assessment year construction. This could suggest the included cost outcome results are to be construed as different, meaning that RIPA is not a continuation of the CCRG. This same language also leads to uncertainty as to which document ought to be used for a 2019 Supplementary Assessment (2018 assessment Year – 2019 operational date).

   The grandfathering allows for a past assessment to be revisited if there has been an 'error or omission'. The Supreme Court in *Capilano* interpreted this phrase in section 305 to be a change that corrects more than a "typo" including a change of opinion. Our concern is that the potential exists for claims that past assessments should be reduced to reconcile the cost of labour to the Edmonton area, ie. that if RIPA is meant to clarify what should have been done under the CCRG, then labour should have been reconciled to the Edmonton area and if it wasn't this is an 'error' which should be corrected. The other large area for potential claims is that the past assessments should be reduced because they included annual capital additions in 'error' (see point 2 above) that did not increase the name plate design capacity of the plant.

4. **PreConstruction Costs –** Under the CCRG the cost of feasibility studies was an excluded cost. In recent years for the major projects, property owners spent more on engineering planning prior to the start of mechanical construction. The practice under the CCRG was that at least a portion of the costs of these engineering planning documents was an included cost if they were used to facilitate project construction. Stakeholders agreed that feasibility studies should remain as an excluded cost, and the stakeholders had reached agreement that the cost of these engineering planning documents should remain an included cost provided they were used to develop the final 'issues for construction" plans. This agreement was consistent with the CCRG practice.

   For an unexplained reason, this agreement was removed between Version 2.06 and Version 2.0.8, and the Association cannot support this change. Version 2.0.8 allows the cost of these engineering planning documents to be an excluded cost when historically they were an included cost.

   As a method of determining the costs which contribute to construction, the stakeholders had reached agreement that RIPA would be enhanced by defining a timeline for the start of construction and the end of construction. This timeline would determine the costs related to construction of the project, regardless of the terms used by individual property owners. Similarly, this language has been removed from Version 2.0.8, to the detriment of the document.

5. **Commissioning –** After a project completes construction (mechanical completion), it moves into a trial operations phase called commissioning. Commissioning involves putting product through the equipment to ensure that it operates as intended. Our concern is that the definition of commissioning includes a requirement that the equipment is *functioning according to design objectives*. Many plants do not reach their 'design objectives' until well after they have been in full time operations. For example, a SAGD plant can take months to build up the steam pressure/heat necessary to produce at or near capacity. There are other facilities that rarely produce at design capacity, and others which never produce at design capacity. This language could be used to delay the point in time when a new property goes on the roll because it will be argued that commissioning is not complete, and therefore the property is not operational.

6. **Travel within the site –** Under the CCRG it was clear that the additional cost of travel and transportation from the Edmonton area to the project location was an excluded cost. This remains an excluded cost under RIPA 2.0.8. Historically there have been claims for excluded costs for travel time within the project site. These claims were not supported under the CCRG. A policy change has been made in RIPA 2.0.8 to allow as an excluded cost, travel time within the site itself. Travel time within a large site is a typical occurrence on all large sites, and the Association does not support this additional excluded cost.

Total Project Costs and Exhaustive List of Excluded Costs

There are some provisions of RIPA 2.0.8 which do provide clarity over the CCRG. Version 2.0.8 contains a comprehensive definition of total project costs which we see as very valuable. This definition reflects the reality of how projects are built in Alberta, and makes it clear that costs incurred by the owner to supervise the contractors are a project cost, whether or not that cost is incurred on or off of the site.

The other area which has added clarity, is that the list of excluded costs is exhaustive. This is an improvement over the CCRG provision which allows a claim for 'abnormal costs' – without any indication of how to determine what was abnormal or normal. Version 2.0.8 clearly states that a cost can only be claimed as an excluded cost if it meets one of the listed excluded costs. This list of excluded costs largely replicates those which are allowed under the CCRG, with the exception of the claim for excess labour which we have discussed above. The list of excluded costs also clarifies that RIPA is not meant to apply to the assessment of buildings and structures assessed on cost. This has been a point of uncertainty in the past, and Version 2.0.8 clarifies this point.

Conclusion

The AAA cannot support Version 2.0.8 as it has not met the two stated objectives of the consultation process, to improve the clarity of the CCRG and to establish benchmarks against which to measure claims for excluded labour costs. Version 2.0.8 contains significant departures from the CCRG, all of which tend to reduce the included costs, thereby reducing the assessments.

Since RIPA will also apply to the *regulated rates for machinery and equipment and linear property, these same lower included costs will* also affect property assessed using regulated rates. The province has not provided assessment examples which would illustrate how an assessment would be prepared under the CCRG and how it would be prepared under RIPA, so that impact analysis could be considered. RIPA impacts the *Minister's Guidelines* Schedule A base cost, however the assessments can be equally impacted by the assessment year modifier in Schedule B, and the age lives and depreciation tables in Schedule C. To understand the full impact of the assessment changes, it will be necessary to understand the model review changes for the assessment year modifier, age lives and depreciation tables. Because of these large unknowns, the Association recommends that RIPA be delayed until the policy decisions are communicated to stakeholders on the assessment year modifier, age lives and depreciation, and after impact analysis is prepared and provided to stakeholders.