MUNICIPAL PROPERTY ASSESSMENT CORPORATION

METHODOLOGY GUIDE

VALUING LONG-TERM CARE HOMES IN ONTARIO

Valuation Date: January 1, 2016

AUGUST 2016

MUNICIPAL PROPERTY ASSESSMENT CORPORATION

August 22, 2016

The Municipal Property Assessment Corporation (MPAC) is responsible for accurately assessing and classifying property in Ontario for the purposes of municipal and education taxes.

In Ontario's assessment system, MPAC assesses your property value every four years. This year, MPAC is updating the value of every property in the province to reflect the legislated valuation date of January 1, 2016.

MPAC is committed to provide Ontario property owners, municipalities and all its stakeholders with the best possible service through transparency, predictability and accuracy in values. As part of this commitment, MPAC has defined three levels of disclosure of information in support of its delivery of this year's assessment update. This Methodology Guide is the first level of information disclosure.

This guide provides an overview of the valuation methodology undertaken by MPAC when assessing long-term care homes for this year's update ensuring the methodology for valuing these properties is well documented and in alignment with industry standards.

Property owners can access additional information about their own properties through aboutmyproperty.ca. Login information for aboutmyproperty.ca is provided on each Property Assessment Notice mailed this year. Additional information about MPAC can be accessed at mpac.ca.

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1.0 Introduction

The Municipal Property Assessment Corporation (MPAC) – mpac.ca – is responsible for accurately assessing and classifying property in Ontario for the purposes of municipal and education taxation.

In Ontario, property assessments are updated on the basis of a four-year assessment cycle. In 2016, MPAC will update the assessments of Ontario's nearly five million properties to reflect the legislated valuation date of January 1, 2016. Assessments updated for the 2016 base year are in effect for the 2017–2020 property tax years.

The last Assessment Update was based on a January 1, 2012, valuation date. Increases between the 2012 assessed value and the 2016 assessed value are phased in over a four-year period. Any decreases in assessment are applied immediately.

It is important to ensure that the valuation methodology applied is capable of providing a realistic estimate of current value at the relevant valuation date, which, in turn, enables all stakeholders to understand the valuation process and have confidence in the fairness and consistency of its outcome.

This Methodology Guide has been prepared for the benefit of MPAC assessors, property owners and their representatives, municipalities and their representatives, Assessment Review Board members, provincial officials, and the general public.

This guide outlines the valuation process to be followed by an assessor, including steps that require appraisal judgment. It is incumbent upon the assessor to make informed decisions throughout the valuation process when arriving at estimates in current value.

1.1 Properties Covered by This Methodology Guide

This Methodology Guide applies to long-term care homes in Ontario. The types of properties used for long-term care vary considerably and range from relatively small properties to much larger establishments offering a variety of facilities. Long-term care homes require skilled nurses who are able to provide comprehensive support to the residents. In Ontario there is a statutory requirement to provide care to each resident.

The following MPAC property codes are used to categorize the various types of long-term care homes in Ontario:

- 623 Continuum of care seniors' facility

- 624 Retirement/nursing home (combined)
- 625 Nursing home

It should be noted that these are general guidelines that vary depending on the specific circumstances of a particular property.

An assessor may also make reference to additional Methodology Guides for properties that do not fall precisely within the description of one of the property codes listed above.

1.2 Legislation

In Ontario, long-term care homes are governed under the Long-Term Care Homes Act.[1] Long-term care homes are places where people can live and receive care services, including nursing and personal assistance. They are sometimes referred to as long-term care facilities or nursing homes.

The Ministry of Health and Long-Term Care regulates long-term care homes through licencing, building design and funding.

The Ministry of Health and Long-Term Care issues licences for long-term care beds and places long-term care homes into one of four design classes: A, B, C or D. These classifications are based upon established structural design standards. Long-term care homes within the “A” classification are further categorized as homes that meet the design standards (of the *Long-Term Care Facility Design Manual, May 1999*) and homes that do not meet the standards.

The main legislation governing the assessment of properties in Ontario for property tax purposes is contained in the Assessment Act.[2]

The Act contains important definitions and states that all property in Ontario is liable to assessment and taxation, subject to some exemptions. Section 19(1) of the Act requires that land be assessed at current value, which is defined to mean, in relation to land, “the amount of money the fee simple, if unencumbered, would realize if sold at arm's length by a willing seller to a willing buyer.”

On December 18, 2015, the Minister filed Ontario Regulation 429/15, amending Ontario Regulation 282/98. This amendment prescribed the conditions under which “land that is used as a non-profit long-term care home” shall be exempt from taxation pursuant to Section 3(1)7.2 of the Assessment Act. Section 3(1)7.2 provides an exemption for “land that is used as a non-

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[1] Long-Term Care Homes Act, 2007, S.O. 2007, c. 8: https://www.ontario.ca/laws/statute/07l08.
[2] Assessment Act, R.S.O 1990, c A.31: https://www.ontario.ca/laws/statute/90a31.

profit long-term care home, if the conditions prescribed by the Minister are satisfied." The following conditions detailed in Subsection 23 of Ontario Regulation 282/98 must be met for the purposes of property tax exemption under Section 3(1)7.2 of the Act.

The land must be:

- owned by the licensee of a non-profit long-term care home
- leased by the licensee of a non-profit long-term care home and would be exempt from taxation if it was occupied by the owner, or
- leased by the licensee of a non-profit long-term care home and on January 1, 2016, the land was used as a non-profit long-term care home

Ontario Regulation 429/15 came into effect on January 1, 2016. Note that the exemption provided under Section 3(1)7.2 of the Act does not extend to any portions of the property occupied by commercial tenants.

1.3 Classification

MPAC's role is to accurately assess and classify all properties in Ontario in accordance with the Assessment Act and its associated regulations established by the Government of Ontario. The classification of a property will determine which tax rate will be applied by the municipality or taxing authority. All properties are classified according to their use, and Ontario Regulation 282/98 of the Assessment Act sets out how various property uses are classified.

There are two provisions contained within Ontario Regulation 282/98 that deal with the classification of long-term care homes. Section 5(1)2 of the regulation includes in the Commercial Property Class "a care home, as defined in the Residential Tenancies Act, 2006, to which that Act does not apply, that is operated with the intention of generating a profit and that does not have seven or more self-contained units."

Section 3(1)1.viii. of the regulation includes in the Residential Property Class "a care home, as defined in the Residential Tenancies Act, 2006, that does not have seven or more self-contained units and that is not included in the commercial property class under paragraph 2 of section 5."

If a portion of the property is used for other purposes, the total value of the property will be apportioned between the various uses to ensure that the appropriate tax rate is applied to the relevant parts of the property.

1.4 The Use of This Methodology Guide

This Methodology Guide is intended to:

- Ensure MPAC's assessed values for these properties are fair, accurate, predictable and transparent.
- Provide direction to assessors and clear explanations to municipalities, taxpayers and Assessment Review Board members.
- Ensure that MPAC's methodology for valuing these properties is well documented and aligns with industry standards.
- Explain the thought process/decision-making process that an assessor should undertake to apply the valuation methodology.
- Ensure a consistent approach to valuing these property types.
- Support MPAC assessors in conducting their due diligence in:
    - applying Ontario's legislation and regulations
    - adhering to industry standards for market valuation in a mass appraisal environment

It should be noted that this Methodology Guide is not intended to be a substitute for an assessor's judgment in arriving at a market value–based assessment (i.e., current value) for a particular property. However, given that the Methodology Guide explains industry standards for property assessment, conforms to valuation industry norms, and adheres to provincial legislation and regulation, MPAC assessors are expected to follow the procedures in the Methodology Guide and be able to clearly and satisfactorily justify any deviations from it.

1.5 Consultation and Disclosure

MPAC is committed to providing municipalities, taxpayers and all its stakeholders with the best possible service through transparency, predictability and accuracy. In support of this commitment, MPAC has defined three levels of disclosure as part of its delivery of the 2016 province-wide Assessment Update:

- **Level 1** – Methodology Guides explaining how MPAC approached the valuation of particular types of property

- **Level 2** – Market Valuation Reports explaining how the methodology outlined in Level 1 has been applied at the sector level for the purposes of each assessment

- **Level 3** – Property Specific Valuation Information available to property taxpayers, their representatives and municipalities

2.0 The Valuation Process

The valuation process always begins with a determination of the highest and best use of the subject property.

Any reliance upon this guide is made only after the assessor has determined that the highest and best use of the subject property is that of a long-term care home.

Assessors determine the value of a property using one of three different approaches to value:

- the direct (sales) comparison approach
- the income approach
- the cost approach

2.1 Outline

In the **direct (sales) comparison approach**, value is indicated by recent sales of comparable properties in the market. In considering any sales evidence, it is critical to ensure that the property sold has a similar or identical highest and best use as the property to be valued.

In the **income approach** (or, more accurately, the income capitalization approach), value is indicated by a property's revenue-earning power, based on the capitalization of income. This method requires a detailed analysis of both income and expenditure, both for the property being valued and other similar properties that may have been sold, in order to ascertain the anticipated revenue and expenses, along with the relevant capitalization rate.

In the **cost approach**, value is estimated as the current cost of reproducing or replacing the improvements of the land (including buildings, structures and other taxable components), less any loss in value resulting from depreciation. The market value of the land is then added.

MPAC uses the income approach to value long-term care homes. The method of income capitalization used is the direct capitalization method.

This approach estimates the annual revenue that can be generated by the long-term care home, deducts annual expenses necessary to support the revenue stream, and then uses the direct capitalization method to apply a capitalization rate to the net income to arrive at a current value for the property.

The direct capitalization method involves the following steps for long-term care homes:

1) Determine the potential gross income (PGI).

2) Adjust for typical vacancy, based on the location and physical attributes of the property, to determine the effective gross income (EGI).

3) Deduct operating expenses to determine the operating income (OI).

4) Deduct fixed expenses, including insurance and a reserve for replacement, as a percentage of EGI.

5) Determine the net operating income (NOI) before municipal taxes.

6) Select the appropriate capitalization rate from sales data.

7) Determine the effective tax rate (ETR) used to represent property taxes. To determine the ETR, the municipal commercial tax rate is referenced and adjusted to account for the subsequent personal property deduction from the capitalized value.

8) Calculate the effective tax rate.

9) Add the effective tax rate to the capitalization rate.

10) Capitalize the NOI into an estimate of value.

11) Deduct personal property from the capitalized value, with the result being the current value assessment.

2.2 Approach

There are three main phases in the process used by MPAC:

- data collection
- analysis of the data collected
- valuation

2.3 Data Collection

The data required for long-term care home valuations come from a number of sources:

- MPAC conducts periodic inspections of long-term care homes.
- Property owners are required to provide MPAC with details including actual income and expenses.
- MPAC also collects information about sales and transfers of long-term care homes.
- There are a number of guides and other published information about long-term care homes.

MPAC generally collects the following types of data for long-term care homes:

- property description (location, age, condition, design, quality, type, number of rooms, licenced beds, size)
- amenities and parking information
- property revenue
- vacancy information
- property expenses
- property sales information for other long-term care home properties in Ontario

Confidentiality

As outlined above, it is important to be aware that, in order to enable MPAC to produce an accurate valuation of the property concerned, information needs to be obtained from a variety of sources.

This will include information from MPAC's records, from the owner or operator of the property, from the municipality in which the property is located, from the assessor's visit to the property, and from other sources.

All stakeholders in the property tax system have an interest in ensuring that the current value provided by MPAC is correct; in order to achieve this, it is necessary for all parties to cooperate in the provision of information.

It is appreciated that some of the information outlined above may be of a commercially sensitive nature. MPAC recognizes the need to ensure that any information provided to them is properly safeguarded and only used for the purpose for which it is supplied. Assessors must appreciate the nature of this undertaking and ensure data is treated accordingly.

If, after an appeal has been filed, MPAC receives a request for the release of actual income and expense information, or other sensitive commercial proprietary information, the usual practice is to require the person seeking the information to bring a motion before the Assessment Review Board (ARB), with notice to the third parties, requesting that the Assessment Review Board order production of the requested information. The release of such information is at the discretion of the Assessment Review Board.

The Assessment Act outlines in Section 53(2) that disclosed information may be released in limited circumstances “(a) to the assessment corporation or any authorized employee of the corporation; or (b) by any person being examined as a witness in an assessment appeal or in a proceeding in court involving an assessment matter.”

2.4 Data Analysis

Having carried out the data collection outlined previously, the assessor needs to analyze it and reach a conclusion regarding the appropriate valuation method to use and how it should be applied.

The following steps will be taken for data analysis:

1) Stratify long-term care properties based on age, condition, design classification, quality and amenities.

2) Determine the design classes assigned by the Ministry of Health and Long-Term Care for all long-term care home properties.

3) Determine the basic, semi-private and private bed types for each long-term care home.

4) Determine the funding rates established by the Ministry of Health and Long-Term Care applicable as of the valuation date.

5) Determine ranges of potential gross income (PGI) for each class of long-term care home.

6) Establish typical market vacancy rates based on the location and physical attributes of properties within the market.

7) Establish typical operating expenses

8) Establish an appropriate reserve for replacement

9) Establish appropriate capitalization rates.

10) Establish effective tax rates (ETR) used to represent property taxes.

11) Establish adjustments for personal property.

12) Summarize the valuation parameters derived from the data analysis.

2.5 Valuation

Having undertaken the necessary steps outlined above, the assessor should now be in a position to apply the appropriate valuation model.

2.6 Validating the Results

Once the assessor has completed the valuation, it is necessary to carry out a series of checks to ensure that all relevant parts of the property have been included in the valuation, there has been no double-counting of any adjustments made for depreciation, the resulting valuation has been compared with any market evidence that may be available in relation to similar properties and the final valuation is in line with the valuation of other similar properties in Ontario.

3.0 The Valuation

Long-Term Care Home Renewal and Redevelopment

In order to encourage the renewal and redevelopment of long-term care homes in Ontario, the Ministry of Health and Long-Term Care provides additional funding to properties that qualify. Properties that meet the design standards of the *Long-Term Care Facility Design Manual, May 1999* or the more current design standards established by the Ministry of Health and Long-Term Care are eligible to receive additional construction funding.

The additional revenue is received in the form of a construction funding per diem for each eligible bed. The additional construction funding commences when the redeveloped beds are operational and is received in equal installments over a set term. Since the funding is received in equal payments over a set time period, this portion of revenue is considered a level annuity. Due to the level payments and known term of this income stream, the *yield capitalization method* can be the most appropriate method to establish a value for the construction funding component.

Yield capitalization converts future benefits into an indication of present value by applying a yield rate. The yield capitalization method applied to the long-term care home construction funding component (for eligible properties) involves the following steps:

1) Determine the remaining term of the construction funding as of the valuation date.

2) Determine the future cash flow based on the established funding agreement.

3) Choose an appropriate yield rate.

4) Convert the future benefits into present value by discounting the future benefits (construction funding revenue) to be received over the remaining term of the funding agreement.

Income Approach – Application Summary

Long-term care homes that do not meet the design standards of the *Long-Term Care Facility Design Manual, May 1999* or the more current design standards established by the Ministry of Health and Long-Term Care are not eligible to receive additional construction funding. MPAC uses the direct capitalization method to value these properties, and the yield capitalization method does not apply.

For long-term care homes that do qualify for additional construction funding, and when the assessor determines that it is appropriate to incorporate the use of the yield capitalization method, the income approach MPAC applies is a two-method process. First, the direct capitalization approach is used to determine an estimate of value for the stabilized net operating income. Secondly, the yield capitalization method is applied to determine an estimate of value for the construction funding revenue stream, which is received over a set term. The two valuations are then added together to determine the current value assessment. This guide will explain these steps in more detail below.

3.1 Determining Potential Gross Income

The approach taken to determine potential gross income (PGI) can be influenced by the type, quality and quantity of information available.

Where Actual Revenues Are Available

In the valuation process, actual income and expenses form the starting point in the process. This data is compared to, and adjusted as appropriate, to reflect the performance of similar long-term care homes in order to establish the appropriate valuation parameters.

In order to deal with short-term fluctuations, stabilized income and expenses are used in the valuation of long-term care homes.

Sources of Revenue

Long-term care homes in Ontario are funded through a well-defined model. The Ministry of Health and Long-Term Care issues licences for long-term care beds and places long-term care homes into one of four design classes: A, B, C or D. Operators receive operational funding through the provincial government and directly charge residents for accommodation.

All long-term care homes receive flow-through funding through funding envelopes. The funding covers expenses associated with each envelope. The envelopes are identified as “nursing and personal care,” “program and support services” and “accommodation.” The flow-through component of accommodation is “raw food.” Co-payments are charged to residents to cover other items identified within the accommodation envelope.

Individual long-term care homes may receive additional flow-through funding for initiatives or operations not covered through the envelopes.

Other sources of operational funding and revenue include preferred accommodation, realty tax allowance, structural compliance premiums and accreditation.

Capital funding (construction funding) is also available to operators through two programs: capital cost funding for new beds and new capital cost funding for class B and class C beds.

Other income can be generated by a long-term care home through ancillary activities, such as rent for a hair salon.

Flow-through funding and accommodation funding are historically increased annually. Stabilized revenue as of the valuation date is established for each type of accommodation (basic, semi-private and private beds) and for each design class (A, B, C, or D) of a long- term care home (A, B, C, or D). There will be differences in the revenues for long-term care homes based on the accommodation mix and the design class of the facility.

Where Financial Data Is Not Available or Is Non-Market

For long-term care homes where information is incomplete, revenue and expense levels are determined by analyzing and applying typical market levels of comparable long-term care homes. Income and expense statements received from comparable properties are reviewed to complete this analysis.

Figure 3.1: Analysis of Revenues by Accommodation Type

Potential Bed Revenue											
Licensed Bed Type	**Classification**						**Total Licensed Beds**	**Daily Rate**	**Total**	**GPBR %**	**Per Bed**
	AAA	**AA**	**A**	**B**	**C**	**D**					
Basic Beds	--	12	--	--	32	--	44	58.35	$937,101	36%	$21,297
Semi-Private Beds	--	--	--	--	36	--	36	66.35	$871,839	33%	$24,217
Private Beds	--	20	--	--	7	--	27	81.54	$803,576	31%	$29,762
Other	--	--	--	--	--	--	--	--			
Total Licensed Beds		**32**			**75**		**107**	**$66.89**	**$2,612,516**	**100%**	**$24,416**
Rate		7.50%			9.00%		Blended Rate	10.00%			
Expense Ratio	--	0.264	--	--	0.644	--	Total Ratio	0.908			

Figure 3.2: Example of PGI Calculation

Potential Bed Revenue											
Licensed Bed Type	**Classification**						**Total Licensed Beds**	**Daily Rate**	**Total**	**GPBR %**	**Per Bed**
	AAA	**AA**	**A**	**B**	**C**	**D**					
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Rate		7.50%			9.00%		Blended Rate	10.00%			
Expense Ratio	--	0.264	--	--	0.644	--	Total Ratio	0.908			

Basic Provincial Subsidy										
	Projection:					**Build Proforma:**				
	Select					**2016B Base year CVA**				
	Rate		**Total**	**PGI%**	**Per Bed**	**Rate**		**Total**	**PGI%**	**Per Bed**
Nursing & Personal Care		CMI:				$92.52	CMI: 100	$3,613,369	52.06%	$33,769
Program & Support Services						$9.23		$360,477	5.19%	$3,368
Raw Food						$8.03		$313,611	4.52%	$2,930
CCHSA						$0.33		$12,888	0.19%	$120
Equalization Adjust-ment						--				
Aggregate LTC Subsidies						--				
Structural Compli-ance Funding		Bed:				$1.00	Bed: 75	$27,375	0.39%	$255
Municipal Tax Allowance						--				
Additional Con-struction Funding		Bed:				--	Bed: --	--		
Other						--				
Total Basic Provincial Subsidy						$111.11		$4,327,720	62.36%	$40,442

Revenue										
	Rate		**Total**	**PGI%**	**Per Bed**	**Rate**		**Total**	**PGI%**	**Per Bed**
Total Licensed Beds								$2,612,516	37.64%	$24,416
Total Basic Provin-cial Subsidy								$4,327,720	62.36%	$40,445
Respite & Guest Fees								--		
Retirement Home Income								--		
Comm Rental								--		
Other Funding		Bed:				--	Bed: --	--		
Other Income		Bed:				--	Bed: --	--		

Revenue										
	Rate		Total	PGI%	Per Bed	Rate		Total	PGI%	Per Bed
Potential Gross Income								**$6,940,236**	**100%**	**$64,862**
Less Vacancy & Collection								$69,402	1.00%	$648
Effective Gross Income								**$6,870,834**		**$64,214**

It should be noted that rates and other information shown are for illustrative purposes only.

Income and Expense Stabilization

The income and expense data is compared to industry norms to ensure realistic future estimates are made. "Per bed" calculations can be used to compare similar long-term care homes.

Long-term care home income and expenses can vary from one year to the next. Abnormal supply and demand conditions or transitory or non-recurring conditions can result in unusual revenues or expenses to the property. These types of conditions should be removed from the analysis.

Long-term care homes may have a number of sources of revenue in addition to the typical resident funding received. Ancillary income may include items such as guest meals, respite stays and commercial rentals.

3.2 Establishing Effective Gross Income

Once the PGI from a property has been established, the next step is to determine the effective gross income (EGI). EGI is the amount of income that an owner expects to receive over the long term; this is the PGI reduced as a result of expected vacancy and bad debt.

Market Vacancy

The revenue generated from a long-term care home relies on market demographics and is sensitive to changes in the supply of long-term care beds.

As such, the operating income a long-term care home is able to achieve is highly correlated to its value. A short-term change in either supply or demand may produce an immediate and corresponding fall or rise in income.

Market vacancy reflects the amount of space that is typically vacant for a given type of longterm care home property. A number of issues arise when considering vacancies:

- A vacancy estimate is intended to reflect the likely average for a property type over a typical holding period and recognizes that, because of economic cycles, there will be periods when demand is good and times when demand softens.

- The Ministry of Health and Long-Term Care currently provides full funding levels to long-term care homes operating at 97% occupancy or better. This limits the potential revenue loss due to vacancy.

- Annual vacancy rates at individual long-term care homes can differ from the norm.

- Not all categories of units experience the same vacancy conditions. The assessor may have to incorporate more than one vacancy rate: a rate for the long-term care home units; and a rate for short-term care spaces.

Establishing the Typical Market Vacancy Rate

The market vacancy rate can be calculated in one of two ways:

- as the percentage of beds that are vacant

- as the percentage of lost income as a result of vacant beds

MPAC assessors determine vacancy rates for long-term care homes by calculating the number of actual bed days divided by the number of available bed days over a defined period, usually a year. When calculating vacancy based on lost income, the assessor applies typical market rental rates and calculates as a percentage of the total income. The vacancy rate percentage is the ratio of total income forgone as of the valuation date as a percentage of the total potential income.

Bad Debt

Bad debt represents payments that the owner cannot collect from the occupants. It is typical to include vacancy and bad debt as a single blended rate.

Determining EGI

The approach used to determine the EGI is as follows:

1) Start with the PGI.

2) Deduct the vacancy allowance. When differentiating the vacancy rate for accommodation revenue and other revenues, the assessor will deduct the appropriate amount from the income generated by that class of accommodation.

3) The result is the EGI.

Note that unless there are extenuating circumstances, which will be noted by the assessor, market vacancy rates should be used as opposed to actual vacancy rates in order to derive the appropriate deduction for vacancy.

It should also be noted that rates and other information shown are for illustrative purposes only.

3.3 Establishing Net Operating Income

The objective of the income approach is to determine the net operating income (NOI) to the owner that is attributable to the real estate. The process begins by establishing the expected potential income, then determining the effective income by making a deduction for typical vacancy. The final step is to adjust the income by deducting the expenses necessary to maintain the income stream.

Net Operating Income = Effective Gross Income – Operating & Fixed Expenses

Operating Expenses

As already indicated, long-term care home income and expenses can vary from one year to the next. The assessor excludes abnormal expenses from the analysis.

MPAC reviews several years of data to stabilize the income and expenses. This produces a more reliable picture of a long-term care home's performance as the basis of a transaction between vendor and purchaser.

In a long-term care home, the expenses necessary to operate the facility are paid by the property owner.

It is possible to express operating expenses by individual expense category or as an aggregate deduction. The deduction for operating expenses is expressed as a percentage of the EGI. It is also necessary to deduct a management fee as a percentage of EGI within the operating expense category.

In addition to operating expenses, fixed expenses are also deducted. The fixed expense category includes insurance and a reserve for replacement.

Fixed Expenses – Reserve for Replacement

Furniture, fixtures and equipment (FF&E) are required for the operation of a long-term care home and need to be replaced regularly. These expenditures take the form of a capital expense (as opposed to a regular annual maintenance expense). A deduction, called the *reserve for* *replacement*, to account for the periodic replacement of FF&E is applied. This deduction is recognized as a return of the capital necessary to acquire the personal property.

Structural Repairs

Structural repairs (not regular building maintenance) to long-term care homes are occasionally required. The determination of NOI should not be unduly distorted by large, one-time or infrequent expense items, such as major structural repairs. Instead of accounting for these items as an expense, the valuation approach includes this influence on value as part of the determination of the overall capitalization rate. The rationale for this is that long-term care facilities are purchased with the knowledge that repairs are required from time to time and, therefore, the purchase price takes into account these expected future expenditures.

Calculating NOI

Analysis of income and expense returns will provide some insight as to the typical level of operating expenses. Once complete, the assessor deducts the operating expenses and fixed expenses, including the reserve for replacement.

3.4 Capitalizing the Net Operating Income into Value

Once the NOI has been established, it is necessary to select an appropriate capitalization rate to convert the income into a present value.

The assessor will establish the capitalization rate by studying sales of properties that present similar investment opportunities and, therefore, similar income profiles. An income profile is the degree of risk, as well as the potential for growth, associated with the income stream.

Selecting the Appropriate Capitalization Rate

Selection of an appropriate capitalization rate is essential to the production of a proper estimate of value for the property. Selecting a rate considers such factors as age, design, quality, state of repair and location of the property, in comparison to the average or typical property.

Capitalization rates reflect the overall relationship between a long-term care home's net income and its sale price. The long-term care home sale price and income information are therefore analyzed to ascertain the capitalization rate for each transaction.

When capitalization rates are derived from comparable sales, the assessor will apply the capitalization rate in the same manner to the property that is being valued. For example, if a reserve for replacement is used to determine NOI within the capitalization rate calculation, it is also necessary to use a reserve for replacement allowance when calculating NOI for the longterm care home that is being valued.

Effective Tax Rate

As mentioned earlier, property taxes are not added as an expense line deduction in a long-term care home valuation. An effective tax rate is applied as part of the overall capitalization rate to reflect the burden of property taxes. The effective tax rate expresses the relationship between the assessed value of a property and the level of taxation within the municipality where the property is located.

The effective tax rate calculation for long-term care home properties is as follows:

Municipal Commercial Tax Rate X 15% Property Tax Allowance Adjustment X

90% Personal Property Adjustment

An explanation of the personal property adjustment within the effective tax rate follows:

The income stream of a long-term care home includes income derived from real property and income derived from personal property. As a result, the total capitalized value derived from an income approach valuation includes real property (which is subject to municipal taxation) and personal property (which is not subject to municipal taxation).

For 2016 current value assessments of long-term care homes, the amount allotted for personal property is 10% of the total capitalized income value (including personal property). Since the personal property value deducted after capitalization is not subject to property taxes, it is necessary to adjust the effective tax rate used in the overall capitalization rate by a corresponding amount. As a result, a 10% adjustment is applied (90% of the commercial tax rate for long-term care homes) in order to account for the subsequent 10% deduction of personal property value.

Figure 3.5: Direct Capitalization of Net Income into Value

Capitalization					
Blended Basic Cap Rate				10.00%	
	CT: 3.64% X Tax Adjustment: 15.00% X (100% – Personal Property: 10.00%)			0.49%	
Overall Rate				10.49%	
Indicated Value				$5,374,928	$50,232
Less Personal Property				$537,493	$5,023
Net to Land & Building				$4,837,435	$45,209
Annuity / Other Amount	Amount: $120,876.00	Rate: 4.50%	Periods: 6	$623,463	$5,826
Total Value				$5,460,898	$51,036
Rounded Value				$5,460,000	$51,028

It should be noted that rates and other information shown are for illustrative purposes only.

Yield Capitalization

As mentioned earlier in this guide, a two-method process is used for long-term care homes that qualify for additional construction funding. First, the direct capitalization method is used to determine an estimate of value for the stabilized net NOI (Figure 3.5). Secondly, the yield capitalization method is applied to determine an estimate of value for the construction funding revenue stream, which is received over a set term, not to exceed 10 years. The two value components are then added together, resulting in the current value assessment.

The following example assumes the long-term care home has a construction funding income stream with a remaining term of six years.

Figure 3.6: Yield Capitalization of Construction Funding Revenue

Yield Capitalization		Comments
Per Diem	$10.35	Construction Funding Rate
Beds	32	
Monthly	$10,073	Used 30.416 Month Days
Annual	$120,876	
Opening Date	2002	
Effective Date	2016	
Date Difference	14	years
# Years Left	6	Annuity Term is 20 years
Discount Rate	4.50%	
		Using HP 10bII Financial Calculator
	¬–$120,876	Annual Payment
	1 p/yr	1 Payment per Year
	4.50%	Discount Rate
	6	Number of Payments
	0	Future Value
Present Value	$623,463	Present Value
Rounded	$623,000	

It should be noted that rates and other information shown are for illustrative purposes only.

Capitalization Summary

Figure 3.6 provides a valuation example for a long-term care home that receives construction funding from the Ministry of Health and Long-Term Care. For facilities that do not receive the additional construction funding, only the direct capitalization method is applied.

3.5 Current Value Assessment

The final step in the process is to consolidate a current value assessment for the property. Once the determination of value by the income approach has been completed, MPAC's assessor will consider whether there is any other value in the real estate that has not been captured by the analysis of income.

Adding Other Components of Value

There may be properties where the value is not entirely captured by the application of the income approach. An adjustment to the income value may be required in some cases.

Excess Land

Excess land is land that is surplus to current needs. This land is not captured by the income approach, as the rents and other payments made go to support all of the real estate elements needed to operate the long-term care home. Land that is not required to operate the long-term care home is surplus, or excess, to current needs. The value of excess land depends on its location within the site and how well it suits future developments.

Such surplus land would have to be valued separately and added to the current value assessment arrived at for the long-term care home.

Before arriving at an excess land conclusion, MPAC's assessor will usually carry out a site inspection to ensure that additional development would be possible.

The determination of excess land involves a review of current zoning by-laws as well as the current density and configuration of the property. The rate to be applied to value excess land is typically derived using market sales studies of vacant land sites.

3.6 Quality Control

Having arrived at the value of the long-term care home through the above process, MPAC assessors will check the outcome of the valuation to ensure no errors have been made and that the value is in line with the valuation of similar long-term care homes.

3.7 Conclusion

This guide sets out how MPAC assessors approach the valuation of long-term care homes for property assessment purposes.

Although it outlines the general approach adopted, it does not replace the assessor's judgment and there may be some cases where the assessor adopts a different approach for justifiable reasons.

For further information about MPAC's role, please visit [mpac.ca.](http://mpac.ca)

Appendix A: Long-Term Care Home Valuation – Example

Potential Bed Revenue											
Licensed Bed Type	**Classification**						**Total Licensed Beds**	**Daily Rate**	**Total**	**GPBR %**	**Per Bed**
	AAA	**AA**	**A**	**B**	**C**	**D**					
Basic Beds	--	12	--	--	32	--	44	58.35	$937,101	36%	$21,297
Semi-Private Beds	--	--	--	--	36	--	36	66.35	$871,839	33%	$24,217
Private Beds	--	20	--	--	7	--	27	81.54	$803,576	31%	$29,762
Other	--	--	--	--	--	--	--	--			
Total Licensed Beds		**32**			**75**		**107**	**$66.89**	**$2,612,516**	**100%**	**$24,416**
Rate		7.50%			9.00%		Blended Rate	10.00%			
Expense Ratio	--	0.264	--	--	0.644	--	Total Ratio	0.908			

Basic Provincial Subsidy										
	Projection:					**Build Proforma:**				
	Select					**2016B Base year CVA**				
	Rate		**Total**	**PGI%**	**Per Bed**	**Rate**		**Total**	**PGI%**	**Per Bed**
Nursing & Personal Care		CMI:				$92.52	CMI: 100	$3,613,369	52.06%	$33,769
Program & Support Services						$9.23		$360,477	5.19%	$3,368
Raw Food						$8.03		$313,611	4.52%	$2,930
CCHSA						$0.33		$12,888	0.19%	$120
Equalization Adjustment						--				
Aggregate LTC Subsidies						--				
Structural Compliance Funding		Bed:				$1.00	Bed: 75	$27,375	0.39%	$255
Municipal Tax Allowance						--				
Additional Construction Funding		Bed:				--	Bed: --	--		
Other						--				
Total Basic Provincial Subsidy						$111.11		$4,327,720	62.36%	$40,442

Revenue										
	Rate		**Total**	**PGI%**	**Per Bed**	**Rate**		**Total**	**PGI%**	**Per Bed**
Total Licensed Beds								$2,612,516	37.64%	$24,416
Total Basic Provincial Subsidy								$4,327,720	62.36%	$40,445
Respite & Guest Fees								--		
Retirement Home Income								--		
Comm Rental								--		
Other Funding		Bed:				--	Bed: --	--		
Other Income		Bed:				--	Bed: --	--		
Potential Gross Income								**$6,940,236**	**100%**	**$64,862**
Less Vacancy & Collection								$69,402	1.00%	$648
Effective Gross Income								**$6,870,834**		**$64,214**

Operating Expenses										
Total Payroll & Benefits										
Medical & Nursing Supplies										
Program & Support Services										
Raw Food Costs										
Dietary Supplies & Services										
Housekeeping Supplies & Services										
Laundry & Linen Supplies & Services										
Repairs & Maintenance										
Administration & Office Supplies										
Utilities										
Management Fees & H.O. Overhead										
Consulting & Professional Fees										
Marketing										
Communication										
All Supplies										
Other 1										

Operating Expenses										
Other 2										
Other 3										
Total Operating Expenses								**$6,238,717**	**90.80%**	**$58,305**
Income Before Fixed Charges									**$632,117**	**$5,909**

Fixed Charges										
Insurance								--		
Municipal Tax								--		
Renewals								$68,201	1.00%	$637
Other								$0	--	$0
Total Fixed Charges								**$68,201**	**1.00%**	**$637**
Net Operating Income								**$563,916**	**8.13%**	**$5,270**

Capitalization					
Blended Basic Cap Rate				10.00%	
	CT: 3.64% X Tax Adjustment: 15.00% X (100% – Personal Property: 10.00%)			0.49%	
Overall Rate				10.49%	
Indicated Value				$5,374,928	$50,232
Less Personal Property				$537,493	$5,023
Net to Land & Building				$4,837,435	$45,209
Annuity / Other Amount	Amount: $120,876.00	Rate: 4.50%	Periods: 6	$623,463	$5,826
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Rounded Value				**$5,460,000**	**$51,028**