MUNICIPAL
PROPERTY
ASSESSMENT
CORPORATION

METHODOLOGY GUIDE

ASSESSING MULTI-RESIDENTIAL PROPERTIES IN ONTARIO

Valuation Date: January 1, 2016

OCTOBER 2016

MUNICIPAL PROPERTY ASSESSMENT CORPORATION

October 31, 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 multi-residential properties 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 tax years.

The last Assessment Update was based on a January 1, 2012, valuation date. Increases between the 2012 assessed value and 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 multi-residential properties in Ontario. Multi-Residential properties range from bachelorettes and row houses to low, medium and high-rise apartments all with seven or more self-contained units. To be considered a self-contained unit, a unit must include a kitchen, a bathroom and a separate entrance. The following MPAC property codes are used to categorize the various types of multi-residential properties with seven or more self-contained units in Ontario:

- 340 – Multi-residential with seven or more self-contained units (excludes row housing)

- 341 – Multi-residential with seven or more self-contained residential units and with small commercial unit(s)
- 352 – Row housing with seven or more self-contained units under single ownership
- 361 – Bachelorette (converted single-family dwelling with seven or more self-contained units)
- 374 – Non-equity co-operative (with seven or more self-contained units)

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. An example is of a mixed-use property containing seven or more residential units and a place of worship. This guide would cover the multi-residential portion and the place of worship would be valued following the replacement cost method.

1.2 Legislation

The main legislation governing the assessment of properties in Ontario for property tax purposes is contained in the Assessment Act.[1]

The Act contains important definitions and states what property is assessable, taxable and how it should be valued. 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.”

The Minister of Finance filed Ontario Regulation 430/15 on December 18, 2015, which added additional rules affecting the valuation and classification of properties on which a third-party sign (billboard) is located. To comply with the regulation, the income attributable to a third-party sign will not be included in the valuation of any property for assessment purposes.

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

[1] Assessment Act, R.S.O 1990, c A.31: https://www.ontario.ca/laws/statute/90a31.

taxing authority. All properties are classified according to their use, and Ontario Regulation 282/98 sets out how various property uses are classified.

Multi-residential properties are included in the “Multi-Residential Property Class” in accordance with Section 4(1).1 of Ontario Regulation 282/98 of the Act as “land used for residential purposes that has seven or more self-contained units other than land included in the residential property class under paragraph 1 of subsection 3(1).” The Multi-Residential Property Class also includes “vacant land principally zoned for multi-residential development.”

Multi-residential properties may also be classified in the “new multi-residential property class” with the appropriate municipal bylaw if “the units on the land have been built or converted from a non-residential use pursuant to a building permit after the by-law adopting the new multi-residential class was passed.” The inclusion in the new multi-residential property class is time-limited to either 8 years or 35 years, depending on when the class was adopted. Refer to Section 10 of O.Reg.282/98 for additional information.

If a portion of the property is used for multiple purposes, it may be necessary to value those components separately and sum the component values to achieve the correct total current value. It may also be necessary to apportion the total value of the property 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 the Assessment Review Board, municipalities, property owners and other parties.
- 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.

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 multi-residential property.

Assessors determine the value of a property using one or a combination 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 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, 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 improvements of the land (including buildings, structures and other assessable 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 multi-residential properties. This approach looks at the annual market rental income and also considers other income that can be generated by the multi-residential property. A market analysis is completed to determine the capitalization rate, which is then applied to the net income to create a current value for the property.

MPAC uses the direct capitalization method of converting an expected stream of income into a *current value*.

The direct capitalization method involves the following steps:

1. Determine potential gross income.
2. Establish effective gross income.
3. Establish normalized expense ratio
4. Establish net operating income.
5. Capitalize the net operating income into value.

2.2 Approach

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

- data collection
- analysis of the data collected
- valuation

2.3 Data Collection

The data required for multi-residential property valuations come from a number of sources:

- MPAC conducts periodic inspections of multi-residential properties.
- MPAC may send a written request for information regarding property to property owners as per *The Assessment Act*, section 11(1).
- MPAC also collects information about sales and transfers of multi-residential properties.
- There are a number of guides and other published information about multi-residential properties.

MPAC generally collects the following types of data for multi-residential properties:

- sales and market information
- registered sales information
- listing information where available
- trade publications and third-party market information.

The assessor collects data relating to each property, including:

- physical data relating to each property
- location
- building design, age, type and quality of construction
- number of units and suite mix
- amenities (elevators, security, lobbies, communal space, fitness areas, storage)
- type and number of parking spaces (surface or covered)
- other uses (retail, office or miscellaneous)
- market rents
- vacancy and collection loss
- income and expense statements

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 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 proprietary information, the usual practice is to require the person seeking the information to bring a motion before the Assessment Review Board, 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 steps to valuation and their application. This process includes the following steps:

1. Categorize the multi-residential properties by design type.
2. Determine the quality or class of each multi-residential property.
3. Group the units according to suite type.
4. Analyze data and establish valuation parameters, such as by neighbourhood type, and/or building type.
5. Establish typical range of rents by suite type for multi-residential category or class.
6. Establish typical market vacancy rates for each type of property.
7. Establish other income.
8. Establish a typical unrecovered operating expense allowance.
9. Establish capitalization rates.
10. Develop tables of valuation parameters, such as capitalization rates by structure type and economic neighbourhood,

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, 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

3.1 Multi-Residential Building Stratification

MPAC stratifies multi-residential buildings into four building types:

- row housing
- low-rise (less than five storeys, typically without an elevator)
- medium/high-rise (typically five or more storeys)
- bachelorettes

The defining feature is that they contain seven or more self-contained residential units.

Multi-residential properties may also contain other uses, such as retail or office space. The methodology to value these separate portions are contained within their respective Methodology Guides. Current values of multi-residential and other uses are partitioned according to use to ensure the correct tax rate will be applied to each relevant portion of the property.

3.2 Determining Potential Gross Income

Potential gross income (PGI) represents the amount of annual income a multi-residential property would be capable of producing if it is at full occupation and at market rents as of the valuation date of January 1, 2016. As a result, MPAC requires the following residential rental unit information to calculate a PGI:

- quantity and type (e.g., bachelor, one bedroom, two bedroom, etc.) of every residential rental unit at the subject property
- the utilities, amenities and services included in the rental fees paid
- the utilities, amenities and services not included in the rental fees paid but for which an additional fee was paid (i.e. parking)
- market rent for each type of suite

Further information is required for properties capable of producing income from other types of rental units, such as retail or office.

The income approach in the determination of PGI can be influenced by the type, amount and quality of information available.

Where Rental Data Is Available

Where current rental information is available and believed to be a good indicator of market, the approach is to establish the market rents from this data. That is, the multi-residential building should be at market rents within a geographic area, negotiated close to the base date and based on unit types at stabilized occupancy. The best evidence of market rent is from real property managed competently and not exposed to external obsolescence.

Adjustments should be made to rents to correct for non-market leases. These adjustments will reflect any individual terms and conditions in actual leases (e.g., rent-free periods, service provisions, etc.) that may impact value. Typical market rents are to be applied to any vacant units.

Current market rents should be established for standard unit types for each quality or class of multi-residential as well as any non-residential tenancies.

Where Rental Data Is Not Available or Is Non-Market

Multi-residential buildings will have values derived by using typical market rents as determined by comparable multi-residential buildings in the vicinity.

Figure 3.2.1 – Example of the Analysis of Rents by Residential Unit Type

Rent as of:		2016-01-01	
Rent by Unit Type	**No. of Units**	**Rent per Month**	**Potential Annual Rent / Unit Type**
Bachelor/Studio	4	$575	$27,600
One bedroom	88	$775	$818,400
Two bedroom	45	$915	$494,100
Three bedroom	23	$1,050	$289,800
Other residential rent			$ 0
Residential totals	160		$1,629,900
Commercial (SF)	0		0
Total Rent			**$1,629,900**

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

Figure 3.2.2 – Example of PGI Calculation

Rent as of:		2016-01-01		
Rent by Unit Type	**No. of Units**	**Monthly**	**Total**	**Annualized**
Bachelor/Studio	4	$575	$2,300	$27,600
One Bedroom	88	$775	$68,200	$818,400
Two Bedroom	45	$915	$41,175	$494,100
Three Bedroom	23	$1,050	$24,150	$289,800
Other	$–	$–	$–	$–
Residential Totals	**160**		**$135,825**	**$1,629,900**
Commercial	0	0	$–	$–
Total Rent			**$135,825**	**$1,629,900**
Other Income				
Parking – Indoor Spaces	150	$12	$1,800	$21,600
Parking – Outdoor Spaces	100	$4	$400	$4,800
Laundry Income				$23,085
Other Income		$–	$–	$–
Total Other Income				**$49,485**
Expense Recoveries				**$-**
Potential Gross Income				**$1,679,385**

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

Other Income

Other income may include rent and payments made to property owners not accounted for in the determination of residential market rents (e.g., laundry income, rent for storage lockers, parking, retail or office spaces).

Other income may be added and can be extracted from the actual income (apart from the rent) indicated on each individual income and expense statement. Alternatively, these amounts can be analysed from comparable circumstances in similar properties. Examples are market rent per parking stall or rentable retail or office space per square foot valued as per their respective methodology guide.

3.3 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 less than the PGI because of expected vacancy and bad debt.

EGI = PGI – (Vacancy and Bad Debt %)

Market Vacancy

Market vacancy reflects the amount of space that is typically vacant for a given type of multi-residential property. Three 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 periods when demand softens.
- Vacancy rates at individual multi-residential properties often differ from the norm.
- Not all categories of units experience the same vacancy conditions. The assessor may have to apply more than one vacancy rate: a rate for non-residential space and a rate for the multi-residential units.

Establishing the Typical Market Vacancy Rate

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

- as the percentage of units that are vacant versus full occupancy as of a given period or date
- as a percentage of lost income due to the vacancies

MPAC may calculate the vacancy rate using the percentage of gross income typically lost due to vacant units or may calculate vacancy as a percentage of total units typically listed as vacant for all buildings within a category. When calculating vacancy based on lost income, the assessor will apply a market rental rate to the vacant unit and calculate as a percentage of the total income rather than applying actual income that was collected before the unit was vacant.

Vacancy rate percentage is the ratio of total income lost as of the valuation date as a percentage of the total income.

MPAC may rely on third-party opinions or data in establishing consistent vacancy rates.

Bad Debt/Collection Loss

Bad debt, often referred to as collection loss, represents rental and other payments that the property owner cannot collect from the tenants. It is typical to include vacancy and bad debt as a single blended rate from an analysis of available market data.

Determining Effective Gross Income

The approach used by MPAC to determine a property's EGI is as follows:

1. Start with the PGI.

2. Deduct vacancy allowance. (When differentiating the vacancy rate between residential units and non-residential units, the appropriate amount from the income generated by that class of unit will be deducted.)

3. Add the miscellaneous or sundry income from actual income/expense statement (other than the income already accounted for in the determination of PGI).

The result is the EGI.

Figure 3.3 – Example of EGI Calculation

Potential gross income (PGI)	$1,679,385
Vacancy rate (% PGI)	2.5%
Effective gross income (EGI)	$1,637,400

Note: Unless there are extenuating circumstances, as noted by the assessor, market vacancy rates are used as opposed to actual vacancy rates in order to derive the appropriate deduction for vacancy.

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

3.4 Establishing Net Operating Income (NOI)

The objective is to determine the property's NOI so that its current value can be established using the income approach. The process begins by establishing the expected potential income, then determining the effective income by making a deduction for vacancies and bad debts and adding and miscellaneous income. The final step is to deduct the standardized operating expenses that cannot be recovered from the tenants.

Net Operating Income (NOI) = Effective Gross Income (EGI) – Operating Expenses

Operating Expenses

In a multi-residential project, the property owner pays expenditures, such as real property taxes, heating, advertising and cleaning.

Operating expenses are standardized by reviewing income and expense information requests that have been returned to MPAC. MPAC will then normalize the results and calculate the relationship between the expenses and the effective gross income and analyze for patterns. The results become the Expense Ratio and it is expressed as a percentage. Figure 3.4 illustrates the Expense Ratio.

Figure 3.4

Expense	**Effective Gross Income**	**Expense Ratio**	**Expense Amount**
Fixed Charges	50,000	13%	6,300
Management	50,000	5%	2,500
Administration	50,000	3%	1,500
Utilities	50,000	14%	7,200
Repairs and Maintenance	50,000	15%	7,500
	Expense Ratio	**50%**	

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

It is possible to express operating expenses as a percentage of the EGI, especially in situations where the terms and conditions expressed in the lease arrangements are reasonably uniform. If this difference is consistent, then it can be applied as a one-time deduction or overall expense ratio, much like the vacancy deduction.

Capital Expenditures

Expenses for structural repairs (not regular building maintenance) are also necessary for the long-term operation of a multi-residential investment.

Large one-time or infrequent expense items (such as major structural repairs) should not distort the determination of NOI. When making deductions for such expenses and other extraordinary items, the assessor will stabilize these amounts over a reasonable period of years. The assessor may also reflect these expenditures in the determination of the overall capitalization rate.

Reserve for Replacement

Major structural repairs are required periodically, whereas refrigerators and stoves must also be replaced from time to time. These expenditures take the form of a capital expense (as opposed to regular annual maintenance expense). Instead of accounting for these items as they arise, the valuation approach includes this influence on value as part of the determination of the overall capitalization rate (the rationale being that all apartment buildings 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 Net Operating Income

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. Figure 3.5 shows the approach for converting EGI into NOI.

Figure 3.5: Example of NOI Calculation

Potential gross income		$1,679,385
Vacancy and bad debt rate	2.5%	$41,985
Effective gross income		$1,637,400
Miscellaneous income		$0
Total effective gross income		$1,637,400
Operating expenses including Realty Tax Estimate (% EGI)	50.0%	$818,700
Total Operating Expenses		$818,700
Net Operating Income		**$818,700**

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

3.5 Capitalizing the Net Operating Income into Value

Once the NOI has been established, the final step for MPAC is to select the appropriate capitalization rate to convert the income into a present value.

Capitalization rates are established by the market through an analysis of transactions reflective of market conditions, adjusted to the base date and the corresponding net incomes as calculated. The net operating income is divided by the adjusted transaction values to arrive at a percentage (see Figure 3.6).

Figure 3.6: Example of Capitalization Rate Calculation

Address	**1 Example Rd**	**22 Illustration Ave**	**525 Description Blvd**
Adjusted Sale Amount	$6,850,000	$7,584,000	$7,439,000
Number of Units	150	165	172
Net Operating Income	$753,525	$853,256	$855,571
Indicated Cap Rate	11.00%	11.25%	11.50%

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

Selecting the Appropriate Capitalization Rate

Selection of an appropriate capitalization rate is essential to the production of an equitable and accurate value for the property. Using the data from Figure 3.5, the median or middle percentage of net income to transaction of similar real property is selected at 11.25% for illustration in Figure 3.6.

Figure 3.7 – Capitalization of Net Income into Value

Net operating income	**$818,700**
Market value estimation	
Overall capitalization rate	11.25%
Market value ($818,700 / 11.25%)	$7,277,333
Market value rounded	**$7,277,000**

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

3.6 Current Value Assessment

CVA= Net Operating Income / Overall Capitalization Rate

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

If a property contains other components not captured by the application of the income approach, additional value for these components may be required to reflect the total property value.

Excess Land

Excess land is land that is surplus to current use. The value of this additional land is not captured by the income approach, as the rents and other payments made relate only to the real property elements needed to operate the multi-residential property. Land that is not required to operate the multi-residential property 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 multi-residential property.

Before arriving at an excess land conclusion, MPAC may carry out a site inspection to ensure that additional development is possible.

The determination of excess land involves a review of current and potential land use controls as well as the current density and configuration of the property. The rate to be applied to value excess land is typically derived from market sales studies of vacant land sites.

3.7 Quality Control

Once the value of the multi-residential property is calculated, MPAC will examine the results for calculation and omission errors made through the process through their Assessment Roll Quality initiative. In addition to those checks, MPAC will conduct a review of the results in accordance to the standards for quality as set by the International Association of Assessing Officers (IAAO) and may use external parties to review and audit. Individual valuation reviews on a sample of the inventory will be the final step prior to values being finalized for the 2016 assessment roll for 2017 taxation.

3.8 Conclusion

This guide sets out how MPAC assessors approach the valuation of multi-residential properties 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.