



Property Taxes in Canada

By: Jason Wight - HVS Canada

Property taxes are an inevitable expense that a hotel's management cannot directly control, but they nevertheless affect the market value of a property. The following provides a general overview of how hotel assessments are calculated in Canada, how tax rates are established and applied, other special assessments that may apply, and what hotel owners or developers can look for when analyzing property taxes.

Property (or ad valorem) taxes are a primary source of revenue for municipalities. Based on the concept that the tax burden should be distributed in proportion to the value of all properties within a taxing jurisdiction, a system of assessment is established. Theoretically, the assessed value placed on each parcel bears a definite relationship to market value. As such, properties of equal market values will have similar assessments, and properties of higher and lower values will have proportionately larger and smaller assessments.¹

Depending on the taxing policy of the municipality, property taxes can be based on the value of the real property and the personal property. In Canada, it is more common to see property taxes based solely on the real property. Real property refers to the land and the building (or improvements), whereas personal property refers to items that one needs to do business but which are not permanently

attached to either the land or the building, such as furniture, fixtures, and equipment, commonly referred to as FF&E.

Value Approaches

The most common approach used throughout Canada for assessing hotels is the income approach. In this methodology, the net operating income (NOI) is divided by a cap rate to calculate the value. Before this calculation can be made, the assessor has to determine an appropriate cap rate and derive the hotel's NOI.

Cap rates are directly related to risk and inversely related to value. Therefore, the riskier the property, the higher the cap rate will be. The particular market and the type of asset both have an impact on what cap rate is used for a hotel's assessment. Large cities like Vancouver and Toronto are using cap rates between 7.5% and 8.5% for better properties, whereas Regina and Winnipeg are currently using between 9.5% and 10%. Municipalities can determine appropriate rates through a review of hotel sales, published capitalization rates, and external capitalization rate studies.

The method for determining the assessed hotel's NOI varies depending on the jurisdiction. In most jurisdictions, the hotel's operating history is used to determine the NOI that is used in calculating the assessment. The subject

property's operating history is compared to the performance of other similar hotels, and adjustments are made when necessary. Common adjustments include a management fee deduction of 3% to 5% of total income and a deduction for a reserve for replacement, which may range from 3% to 5%. Since the assessment is usually aimed at valuing only the real estate component of the hotel and not the personal property, many assessors deduct 15% from the NOI to account for the FF&E.

Once the cap rate is determined and the NOI derived, the assessed value can be established. The assessed value is then used to determine the amount of tax due.

The use of the cost approach to determine the assessed value of a hotel is becoming rare across the country. The cost approach entails estimating how much it would cost to construct the hotel as new and then making subjective adjustments to account for the age and condition of the building as well as other factors.²

Once the assessed value is determined, the total property tax payable can be calculated using the tax rate. Each jurisdiction sets the tax rate to raise the revenue required for its budget. The services that the municipality funds include but are not limited to fire and emergency services, police service, public

transit, infrastructure and maintenance, and education. It is hard to compare tax rates from jurisdiction to jurisdiction because each area employs a different methodology in determining the rate.

Special Assessments/Levies

Municipalities sometimes tax business value. This value is defined as a value enhancement that results from items of intangible personal property, such as marketing and management skill, an assembled workforce, working capital, trade names, franchises, patents, trademarks, contracts, leases, and operating agreements. Business assessments are only used in a few jurisdictions across the country, and the way they are calculated varies. It is important to understand how the assessment is calculated, the applicable tax rate, how the business assessment compares to those of other similar hotels, and how the additional tax impacts the bottom line.

Frontage levies are becoming more common across Canada. They are typically used to cover the expected costs of municipal services, such as water and sewage or street improvements. A frontage levy is calculated by multiplying the established rate by the frontage of the specific property.

If a hotel is located in an "Improvement Zone", the property might be subject to a special levy. These levies are charged to businesses in the given area to help fund the revitalization of the district's infrastructure and appearance.

Property Tax and Owners

Hotel owners should understand the impact of property taxes on their hotel. The property tax expense is frequently between 5% and 10% of total revenue, which is similar to other line items, such as the marketing expense and the property operations and maintenance expense. It is important to be familiar with how the hotel's assessment is derived and how the hotel's assessment compares to those of

other similar properties. If the income approach is used, the assessment is likely to increase in a strong market, as the NOI will increase. Following tax rate trends can help an owner be more precise in forecasting future property tax expenses. A hotel owner should monitor the activities of the municipality to be aware of any proposed levies or special assessments that may be implemented. Property taxes are a part of real estate ownership, and they ultimately have a negative impact on the value of a hotel; therefore, an owner should be engaged to ensure that the amount being paid is reasonable and in line with what is happening in the local market. If the owner feels that the assessment does not fairly reflect the value of the property, it is best to consult a professional who can help evaluate the situation and determine whether an appeal is in order.

Property Tax and Investors

It is also important for hotel developers and investors to understand the property taxes of the area in which they will potentially purchase or build a hotel. Familiarity with local taxation standards allows the investor or the developer to better forecast the property taxes for the pro-forma and better compare potential markets with respect to how local taxation will impact the value of the project.

Developers may also find that there are tax incentives to build in a certain market. Some municipalities offer property tax discounts, in which the property's taxes are ramped up over a specified time period. These discounts can ultimately add value to a project by bringing more to the bottom line. When analyzing these incentives, it is important to understand the specific terms of the property tax incentive. Some good questions to ask: How many years is the discount valid? What is the discount per year? Does the discount apply to the land or the improvements or both? Is the incentive applied to all tax categories or only specific portions (e.g., only the municipal portion or only the education portion)?

Conclusion

This article was intended to provide an overview of the most general aspects of hotel assessments and property taxation. If you have questions or concerns about your assessment, it is best to contact your local assessment authority or consult a professional who can evaluate your position. While many of the larger municipalities employ assessors that focus solely on hotels, others do not have specialists for every type of property they value.



Special thanks to all the city assessors who kindly shared their time and information with us. Although we have made every effort to ensure the accuracy of the information presented, use of this information without verification from original sources is at the user's own risk.

Footnote:

1. Stephen Rushmore, MAI, and Erich Baum, *Hotels & Motels Valuations and Market Studies (Illinois: Appraisal Institute)*, 282-283.
2. Miguel Rivera, "Property Taxes in Canada," *The HVS - Canada Hotel Valuation Newsletter*, Summer 1996.

Hotel Municipal Property Taxes

Location	Tax Rate (by Category)		Methodology of Value	Source	
	Use	2008			2009
Calgary, Alberta	City Property Tax	8.0929	8.2132	Income Approach The City of Calgary uses the income approach to value hotels. Actual income and expense information is requested from all hotels. The assessors use three years of information and stabilize the three years by applying weighted averages. Then the actual income and expense ratios are compared to industry norms, and further adjustments are made where needed. This provides a stabilized and normalized net operating income. Adjustments are made to remove the non-assessable components of the hotel; this includes deductions for FF&E. A deduction between 3% and 5% is made from the total income for management, a 3% deduction of total income is made for a reserve for replacement, and a deduction between 1.0% and 1.5% from the NOI is made for other intangibles. The resulting NOI is attributable to the real estate. A cap rate is then applied (10.5% for downtown locations and 11.5% for all other hotels).	Steve Cook (403) 268-4475
	Provincial Property Tax	3.2161	3.2282		
	Total	11.309	11.4414		
Charlottetown, P.E.I.	Provincial Commercial	1.50	1.50	Income Approach/Cost Approach The City is switching to the income approach, but most properties are still valued using the cost approach. For the cost approach, the base year for buildings is 2000, whereas current values are used for land. Depreciation and locational adjustments are made. For the income approach, a base cap rate of about 9.5% is used, to which an effective tax rate of about 2.5% to 3.5% is added. A 15% deduction from the total value is taken for FF&E. A reserve for replacement of approximately 3% of gross revenue is considered when calculating the NOI. Other adjustments are made based on other factors. Hotel cap rates are roughly in the range of 12% to 15%.	Walter White (902) 368-4070
	Municipal Commercial	2.36	2.36		
		3.86	3.86		
Edmonton, Alberta	Municipal	11.298	10.4512	Income Approach Value is based on reported information and what is typical for the market. All revenues and expenses, including municipal taxes, are ideally based on three years of stabilized financials. The stabilized expenses are compared to hotels in a similar class to find the typical market expense. The actual stabilized expense is used to a maximum of ±10%. Intangibles and FF&E are then deducted after the stabilized expenses. The intangible and FF&E rate used is based on the hotel class. The cap rate also varies depending on the hotel class. In 2009, cap rates ranged from 7.5% to 10%.	Mark Sandul (780) 496-6661
	Education	3.3294	2.6784		
	Provincial Education Allowance	0.057	0.031		
	Total	14.6844	13.1606		
Regina, Saskatchewan	Municipal	18.913	13.442	Income Approach Regina uses the income approach to determine assessed value. The City derives the typical Potential Net Income per room by averaging the net income per room divided by the actual occupancy of comparable hotels. The group average net income per room is multiplied by the group average occupancy rate to provide the Effective Net Income per room. A cap rate between 9.5% and 12.0% is used to determine the capitalized value. A 15% deduction is made for FF&E, and no separate replacement reserve is deducted. After this deduction, the result is the hotel value. The mill rate is subject to a mill rate factor that was 1.22945 in 2009. The school boards have the option to use the mill rate factor. There is also a tax phase in mill factor, which is used to phase in the tax change from the re-assessment. The listed rates do not account for these mill factor adjustments.	Mike Schulowsky (306) 777-7807
	School	19.7393	12.25 -18.55*		
	Library	2.1059	1.4967		
	Total	40.7582	27.1887		
		*Rate varies depending on Assessed Value			
	Business Improvement District Areas**				
	Regina Downtown	1.3107	0.8205		
	Regina Old Warehouse District	1.3107	0.8809		
	**Only applies to commercial properties located in the Business Improvement District Areas				

Hotel Municipal Property Taxes

Tax Rate (by Category)				Methodology of Value	Source		
Location	Use	2008	2009				
St. John's, Newfoundland	Property Tax			Income Approach Hotels are assessed in St. John's using a correlated income/market approach with the income approach being the primary calculation. 10% is the basic cap rate for the re-assessment of major hotels. A 15% deduction from the total value is made for FF&E. Re-assessments are conducted every three years. The latest re-assessment was completed using a market valuation date of January 1, 2008, and an effective date for taxation of January 1, 2010. The taxation rates applicable for an upcoming year are determined by December 15th of the current year as directed by legislative authority.	Ron Cadigan (709) 576-8233		
	Property Tax	17.2	17.2				
	Business Occupancy Tax	19.7	19.7				
	Total	36.9	36.9				
Toronto, Ontario	1st Million			Income Approach Property taxes for 2009 and 2010 are calculated based on the 2008 Current Value Assessment (CVA). If a property increased in value over the previous CVA, that increase is phased in over the next four years. The CVA is determined through the use of the income approach. A stabilized NOI from a pro-forma is used in the calculation along with a cap rate of 7.5% for good-quality assets. For the management fee, 5% of total revenue is deducted, and a 15% deduction is made for FF&E to account for personal property, which is a regulated by the Ontario Assessment Act. For the reserve for replacement, 4% of total revenue is deducted.	Peter Thachuk* (905) 837-6934 * Provided assistance exclusively with the methodology of value.		
	Municipal	2.0926255	1.9776151				
	Education	1.9683050	1.80306				
	Total	4.0609305	3.7806751				
	Above 1 million						
	Municipal	2.1514381	2.0431761				
	Education	1.968305	1.80306				
	Total	4.1197431	3.8462361				
	Note: Toronto tax rates provided by the City of Toronto						
	Vancouver, British Columbia	Market Value				Vancouver uses the income approach as the primary valuation method and direct comparison as a check on value. Typically, the cost approach would only be used if the hotel was no longer economic, meaning the land value exceeded the capitalized income value (the improvements would then be fully depreciated). The income approach is essentially the going concern value determined using market-derived cap rates. Cap rates are currently between 7.5% and 8.5% for better products. Revenues and expenses are stabilized, and deductions are made for both management (3% of revenue) and reserve for replacement (4% of revenue) prior to establishing the estimated NOI. An FF&E allowance (15%) is deducted from the capitalized hotel value to remove personal property and any other non-realty amounts as required under the assessment act. Hotels are assessed on an annual basis.	Grant McDonald (604) 739-8588
Municipal General		10.8161	10.34798				
School		7.75987	7.29402				
Assessment Authority		0.22185	0.21113				
Municipal Finance		0.00011	0.00052				
Regional District		0.17951	0.16652				
Total		20.89121	19.82256				
Winnipeg, Manitoba	Income Approach			The City of Winnipeg uses the income approach to value hotels. The assessed value is the full market value of the fee simple interest. The hotel's actual operating history is used as a base, and the data are then compared to similar hotels in order to establish a typical performance. A stabilized net operating income is used in the calculation. The deduction is 4% of total revenue for the management fee, 3% for the reserve for replacement, and 10% to 15% for FF&E. Cap rates range between 9.5% and 11%.	Alan Payjack (204) 986 7162		
	Municipal General	25.448	25.448				
	Education Support	16.088	16.049				
	School Division*	27.879	28.337				
	Total	69.415	69.834				
* Varies depending on the school division							

STR and HVS are pleased to provide you with this month's issue of the Canadian Lodging Outlook. Each report includes occupancy (Occ), average daily rate (ADR), and revenue per available room (RevPAR) for three major markets and the Provinces.

If you would like a detailed hotel performance data for all of Canada, STR offers their Canadian Hotel Review. The Canadian Hotel Review is available by annual subscription which includes both monthly and weekly issues. Each monthly issue of the Canadian Hotel Review also includes an analysis provided by HVS. Please contact Erin Hannigan, Canada Sales Executive, at erin@str.com or 615-824-8664 ext. 3313. You may also contact any of their other sales executives at info@str.com or 615-824-8664 ext. 3504.

March 2010	Number of Rooms	Occupancy Rate (%)		Average Room Rates (in \$CAD)		RevPAR (in \$CAD)		Room Supply % chg	Room Demand % chg
		2010	2009	2010	2009	2010	2009		
Montreal	16,481	54.2%	50.6%	\$120.81	\$120.77	\$65.48	\$61.11	0.9%	8.0%
Toronto	28,775	63.4%	58.5%	\$133.02	\$133.77	\$84.33	\$78.26	0.5%	9.0%
Vancouver	17,616	60.4%	61.3%	\$136.72	\$127.04	\$82.58	\$77.88	5.0%	3.5%
Provinces									
Alberta	33,484	58.6%	59.8%	\$128.25	\$133.10	\$75.15	\$79.59	2.7%	0.7%
British Columbia	32,584	57.4%	57.9%	\$136.78	\$129.22	\$78.51	\$74.82	2.3%	1.4%
Manitoba	4,041	65.2%	63.4%	\$108.20	\$106.79	\$70.55	\$67.70	0.3%	3.2%
New Brunswick	4,855	51.5%	49.8%	\$107.84	\$107.95	\$55.54	\$53.76	0.0%	3.4%
Newfoundland	1,834	58.2%	57.1%	\$114.34	\$112.00	\$66.55	\$63.95	0.0%	2.0%
Nova Scotia	5,611	60.5%	57.0%	\$113.06	\$108.39	\$68.40	\$61.78	1.8%	8.1%
Northwest Territories	204	INS	INS	INS	INS	INS	INS	INS	INS
Ontario	79,007	54.9%	52.5%	\$119.10	\$120.98	\$65.39	\$63.51	1.2%	5.8%
Prince Edward Island	949	39.5%	35.1%	\$86.46	\$88.97	\$34.15	\$31.23	0.0%	12.5%
Quebec	26,971	53.4%	50.1%	\$121.86	\$121.50	\$65.07	\$60.87	0.5%	7.2%
Saskatchewan	6,600	70.6%	69.6%	\$118.82	\$116.69	\$83.89	\$81.22	1.7%	3.2%
Yukon Territory	416	67.7%	55.2%	\$98.06	\$96.95	\$66.39	\$53.52	0.0%	22.7%
Canada	196,556	56.5%	55.1%	\$123.17	\$123.27	\$69.59	\$67.92	1.4%	4.0%

March 2010 Year-To-Date	Number of Rooms	Occupancy Rate (%)		Average Room Rates (in \$CAD)		RevPAR (in \$CAD)		Room Supply % chg	Room Demand % chg
		2010	2009	2010	2009	2010	2009		
Montreal Area	16,481	49.4%	49.5%	\$119.92	\$122.63	\$59.24	\$60.70	1.2%	1.0%
Toronto Downtown	28,775	59.5%	56.3%	\$127.07	\$131.97	\$75.61	\$74.30	0.8%	6.4%
Vancouver Downtown	17,616	65.3%	57.6%	\$178.02	\$125.12	\$116.25	\$72.07	4.4%	18.3%
Provinces									
Alberta	33,484	53.1%	57.7%	\$127.97	\$132.76	\$67.95	\$76.60	2.7%	-5.4%
British Columbia	32,584	57.4%	54.2%	\$171.06	\$131.42	\$98.19	\$71.23	1.9%	7.9%
Manitoba	4,041	59.9%	58.8%	\$107.62	\$105.71	\$64.46	\$62.16	0.3%	2.1%
New Brunswick	4,855	46.0%	45.3%	\$106.44	\$106.97	\$48.96	\$48.46	0.0%	1.6%
Newfoundland	1,834	55.1%	51.3%	\$113.78	\$111.77	\$62.69	\$57.34	0.0%	7.4%
Nova Scotia	5,611	49.7%	50.0%	\$108.59	\$107.12	\$53.97	\$53.56	1.8%	1.3%
Northwest Territories	204	59.7%	55.8%	\$144.87	\$147.32	\$86.49	\$82.20	0.0%	6.9%
Ontario	79,007	51.0%	50.5%	\$117.07	\$120.84	\$59.71	\$61.02	1.2%	2.0%
Prince Edward Island	949	37.3%	35.7%	\$86.73	\$88.30	\$32.35	\$31.52	0.0%	4.4%
Quebec	26,971	50.7%	49.8%	\$121.95	\$123.76	\$61.83	\$61.63	0.6%	2.3%
Saskatchewan	6,600	65.0%	66.4%	\$118.27	\$114.74	\$76.88	\$76.19	2.1%	0.0%
Yukon Territory	416	57.5%	52.4%	\$95.74	\$96.10	\$55.05	\$50.36	0.5%	10.3%
Canada	196,556	52.9%	52.8%	\$128.52	\$123.70	\$67.99	\$65.31	1.4%	1.6%

DEFINITIONS

Occupancy:	Rooms sold divided by rooms available.
Room Revenue:	Total room revenue generated from the sale or rental of rooms.
Average Daily Rate (ADR):	Room revenue divided by rooms sold.
Room Revenue Per Available Room (RevPAR):	Room revenue divided by rooms available (occupancy times average room rate will closely approximate RevPAR).

*If you have any questions regarding this publication please send a message to bmacdonald@hvs.com
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FAX: (604) 988-4625

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