



**THE ISLAND REGULATORY AND
APPEALS COMMISSION**

Prince Edward Island
Île-du-Prince-Édouard
CANADA

**Docket LR13023
Order LR14-02**

IN THE MATTER of an appeal under Section 25 of the Rental of Residential Property Act (the Act), by Hambly Enterprises Ltd. against Order LD13-325 dated October 18, 2013 issued by the Director of Residential Rental Property.

BEFORE THE COMMISSION
on Monday, the 20th day of January, 2014.

John Broderick, Commissioner
Ferne MacPhail, Commissioner
Peter McCloskey, Commissioner

Order

IN THE MATTER of an appeal under Section 25 of the Rental of Residential Property Act (the Act), by Hambly Enterprises Ltd. against Order LD13-325 dated October 18, 2013 issued by the Director of Residential Rental Property.

Order

BACKGROUND

On November 6, 2013 the Commission received a Notice of Appeal dated the same date from a lessor, Hambly Enterprises Ltd. (the Appellant) requesting an appeal of Order LD13-325 dated October 18, 2013 and issued by the Director of Residential Rental Property (the Director).

By way of background, on May 1, 2013 the Appellant filed with the Director a Form 12 - Application by Lessor for Approval of Rent Increase Exceeding Percentage Allowed by Regulation dated April 30, 2013 pursuant to Section 23.(3) of the **Rental of Residential Property Act** (the Act). The 2013 allowable percentage increase for a mobile home site in a mobile home park is 1.50% as prescribed by the Commission.

A hearing was held by the Director on June 4, 2013 and on October 18, 2013 the Director issued Order LD13-325 which states in part:

***“...The rental increase must be limited to the allowable 1.5 per cent increase approved by the Island Regulatory and Appeals Commission for 2013.*”**

IT IS THEREFORE ORDERED THAT

- 1. The rent increase applied for shall be varied in conformity with the following schedule....***
- 2. The approved rates are effective as of August 1, 2013.”***

The appeal was heard before the Commission on December 9, 2013. The Appellant was represented by legal counsel, Pamela Williams, Q.C. Wayne Hambly, Michael Fitzpatrick and Peter Waddell testified on behalf of Appellant. The residents of Riverview Estates (the Respondent) were represented by Delbert Reeves (Mr. Reeves) who was accompanied by Barb Carroll (Ms. Carroll) who testified on behalf of the Respondent.

Preliminary Matter

Mr. Reeves raised a preliminary matter, seeking to strike out the Appellant's appeal, on the basis that the Appellant no longer owns the Riverview Estates mobile home park.

Ms. Williams, on behalf of the Appellant, submitted that the Appellant is a party to the Director's Order, appeared at the hearing before the Director and has a material interest in the outcome of the appeal as the proceeds of sale of the mobile home park are tied to income and not land value.

Following a brief recess to consider the preliminary matter, the Commission informed the parties that it would hear the appeal, having determined that the Appellant does have standing pursuant to subsection 25(1) of the **Act** which reads:

25. (1) Any party to a decision or order of the Director, if the party has appeared or been represented at the hearing before the Director, may appeal therefrom by serving on the Commission, within twenty days after receipt of the decision or order of the Director, a notice of appeal in the form prescribed by regulation.

Emphasis added.

EVIDENCE

Wayne Hambly testified that the mobile home park is now owned by CAPREIT Limited Partnership (CAPREIT), the sale which took place after the Director had heard the Appellant's application for a rental increase greater than the 2013 allowable increase. Mr. Hambly explained that he is the President of the Appellant. In recent years, the Appellant was experiencing difficulties with its sewage treatment facility and was ordered to connect to the City of Charlottetown (the City) water and sewer system. In order to connect to the City's water and sewer system, the Appellant had to spend \$525,000.00 in engineering and construction costs. Upon completion of this project, the Appellant "signed an easement [for the water and sewer infrastructure] over to the City".

Mr. Hambly explained that as a result of succession planning, the Appellant considered selling off its real estate division, which includes the mobile home park. The Appellant engaged Altus Group to do an appraisal of all properties in the real estate division, including the mobile home park. Following the preparation of the appraisal report, the Appellant went to market to find a suitable buyer.

Mr. Hambly referred the Commission to Exhibit E-35, the appraisal report prepared by the Altus Group. Mr. Hambly noted that the Altus Group selected the income approach for the valuation of the mobile home park and determined that the value of the park was \$2,480,000.00. Mr. Hambly explained that the Appellant, having just spent \$525,000.00 on necessary infrastructure upgrades, would "never sell" the park for its property tax assessment value of \$625,000.00.

Mr. Hambly took issue with the Director's determination of a reasonable rate of return. He noted that the Director had referred to the S & P 500 index for making that determination. Mr. Hambly felt that real estate investments on Prince Edward Island could not be compared to "blue chip" investments and the top 500 companies in the USA.

Michael Fitzpatrick, a chartered accountant and partner with a local accounting firm, testified on behalf of the Appellant. Mr. Fitzpatrick explained that his firm provides operational business financial advice to the Appellant. Mr. Fitzpatrick reviewed the Altus Group appraisal report. He noted that a property tax assessment value is very rarely used to value an income driven business. He also referred to a Form 15 filed by the Appellant in June 2013 and an updated Form 15 filed shortly before the appeal hearing. Mr. Fitzpatrick noted that the Form 15 is a specific purpose form authorized under the **Act** and the Form 15 does not comply with generally accepted accounting principles.

Mr. Fitzpatrick submitted that with a \$41.00 per month per site rental increase and using the \$2,480,000.00 valuation provided by the Altus Group, the Appellant's shareholders would receive about a 7% return on their investment. Mr. Fitzpatrick echoed Mr. Hambly's comments that the S & P 500 index is not an accurate way to compare the Appellant. He also commented that there was "no way I'd advise him [the Appellant] to sell for \$625,000.00".

During the Respondent's cross examination of Mr. Fitzpatrick, Peter Waddell, Controller for the Appellant, provided details and clarifications with respect to various items noted on financial forms and statements filed by the Appellant.

Ms. Carroll testified for the Respondent. She stated that an additional \$46.14 per month per site is a huge increase for residents to pay. She stated that this provides over \$93,000.00 in additional revenue for the Appellant. She noted that the projected sewer and water charges presented to the Director were estimated at \$68,000.00 while the latest Form 15 shows such charges as only \$38,000.00. She noted that the costs incurred to connect to the City's utility system are a one-time cost which could be paid over 5 or 6 years, yet the proposed rental increase would mean residents would be paying "forever". She stated that garbage services were once provided by the Appellant but these services are no longer provided by the Appellant once the Waste Watch program was implemented, resulting in a cost saving for the Appellant and an additional financial burden for residents of the mobile home park.

Ms. Carroll also expressed concerns about greatly increased professional fees, emphasizing that professional fees incurred by the Appellant in preparing for a hearing to seek a rent increase should not be included in the calculations set out to attempt to justify such increase.

Ms. Carroll expressed concern that it took the Director 130 days to reach a decision. She submitted that the uncertainty created stress for residents and resulted in a decrease in mini-home sales within the park as prospective purchasers were "holding off" on purchasing a mini-home due to the uncertainty associated with a possible large increase in site rent.

SUBMISSIONS

Ms. Williams referred the Commission to the factors set out under section 23 of the **Act**. She submitted that as a result of the necessary infrastructure expenditures, the Appellant's costs have increased and this has decreased the Appellant's profitability.

Ms. Williams noted that financial loss is defined in the Act and a financial loss can occur where there is a decrease in profitability. She expressed concern over the information sought by the Form 15. She submitted that the property tax assessment of the mobile home park is not appropriate for valuation purposes and urged the Commission to accept the valuation provided by the Altus Group appraisal report. She referred the Commission to Orders LR08-09 and LR12-32 and submitted that any financial hardship which may be experienced by a lessee is not a factor set out under section 23 of the Act.

Mr. Reeves submitted that even if some site rent increase is warranted, the increase sought by the Appellant, over \$90,000.00 per year, is too much. He noted that the park has been well kept by the residents and their efforts in this regard has enhanced the value of the park. He also noted that many of the residents had purchased their homes from a mini-home dealer owned by the Appellant. He noted that any increase will ultimately be of benefit to the park's new owner while leaving residents with a permanent increased financial burden.

DECISION

The Commission allows the appeal in part, awarding the Appellant an increase in site rent of 6%. The Commission's reasons follow.

Subsection 26(1) of the **Act** establishes that an appeal to the Commission shall be heard by way of a *hearing de novo*, that is to say, that the Commission holds a new hearing of the matters giving rise to the appeal:

26. (1) An appeal to the Commission shall be by way of a re-hearing, and the Commission may receive and accept such evidence and information on oath or affidavit as in its discretion it considers fit and make such decision or order as the Director is authorized to make under this Act.

It is worthy of note that subsection 26(1) gives the Commission discretion to accept new evidence and information that is appropriate to a determination of the appeal.

Subsection 23(8) of the **Act** sets out the factors to be considered at a hearing of an application for a rental increase greater than the annual prescribed percentage rent increase:

23(8) At the hearing both parties are entitled to appear and be heard and the Director shall consider the following factors:

- (a) whether the increase in rent is necessary in order to prevent the lessor sustaining a financial loss in the operation of the building in which the premises are situate;*
- (b) increased operating costs or capital expenditures as advised by the lessor;*
- (c) the expectation of the lessor to have a reasonable return on his capital investment;*
- (d) such other matters as may be prescribed by the regulations.*

The above factors shall also be considered by the Commission at an appeal of the Director's decision.

Sections 18 and 19 of the *Rental of Residential Property Act Regulations* (the *Regulations*) read as follows:

18. For the purposes of subsection 23(8) of the **Act**, the following definitions shall apply:

- (a) "capital expenditures" includes replacement of plumbing, electrical or heating systems or appliances, and major structural repairs;
- (b) "financial loss" means the difference between the total income from the building less operating costs;
- (c) "income" means the rental fee assigned to each unit and revenue from facilities such as coin operated laundry machines and parking;
- (d) "maintenance" includes repairs to plumbing, electrical or heating systems, or to appliances, or minor structural repairs, but does not include capital expenditures or replacement of capital assets;
- (e) "management fee" means the actual cost thereof or 5 per cent of the gross rental income for the previous year, whichever is the lesser;
- (f) "operating costs" excludes depreciation costs, but includes the basic expenses necessary for the operation of the building such as fuel, water, electricity, insurance, taxes, maintenance, management fees, staff wages or value of rental unit made available in lieu thereof, and financing costs of principal and interest on mortgages registered against the property. EC10/89.

Section 17 of the Regulations reads as follows:

17. At least five days prior to a hearing pursuant to subsection 23(8) of the **Act**, the lessor shall serve on the Director and the lessees who are parties a statement of income and expenses in Form 15. EC10/89.

The Commission is mindful that the Form 15, under the heading of "Other Information", seeks the value of "property" as per Provincial assessment, the amount of outstanding mortgages and loans – principal portion only, and from those two figures determines the owner's equity in "property". Applying this "formula", the owner's equity in the property is only \$101,000.00.

The Commission is of the view that the above "formula" should be considered as it is contained within a form set out in the Regulations. However, there is an important distinction between considering such specified information and deciding that such information shall exclude other evidence pertaining to the same issue. The Commission does not accept the view that such a "formula" was ever intended to exclude other germane evidence presented to the Commission that would assist the Commission in determining the owner's equity of a lessor's rental business, in this case the Appellant's mini-home park. If the legislature intended that the "formula" bind the Director and bind the Commission on appeal, surely the calculation of "owner's equity in property" would have been included in section 18, the definition section, of the Regulations, or elsewhere in the Regulations or in the **Act** itself.

In the present appeal, the Appellant introduced Exhibit E-35, a report prepared by the Altus Group. The Commission notes that the Altus Group report was not in evidence before the Director when she issued Order LD13-325. The Altus Group report established the then current [June 2012] market value of the park at \$2,480,000.00, using the income approach and based on a capitalization rate of 7%.

The Commission finds that there is a major discrepancy between the current Provincial property tax assessment, stated by the Appellant on the December 9, 2013 Form 15 [Exhibit E-33] as \$626,000.00 and the 2012 market value of the park assessed by the Altus Group. In a nutshell, the Altus Group has assessed the market value of the park at approximately four times the value assessed by the Province for property tax purposes.

In addition, the Commission is of the view that a rigid adherence to the “owner’s equity in property” “formula” set out in Form 15 would ignore the value of water and sewer infrastructure expenditures recently incurred by the Appellant. While this infrastructure was transferred to the City, the net effect is that now the City is responsible for water and sewer service to the park, significantly reducing risk for the Appellant and, going forward, the park’s new owner. Gone is the expense and risks associated with obtaining and treating water and treating sewage. When the park is viewed, not as a piece of raw land but as a business enterprise that is a going concern, the expenditure of \$525,000.00 would, in the Commission’s opinion, significantly enhance the value of the Appellant’s park.

The Commission finds that the owner’s equity for the Appellant’s park shall be determined in the following manner:

The average of:

Provincial Property Tax Assessment plus cost of infrastructure improvements: $\$626,000.00 + \$525,000.00 = \$1,151,000.00$

and

2012 market value as assessed by the Altus Group = $\$2,480,000.00$

Value of Appellant’s mobile home park [average of above] = $\$1,815,500$

Minus principle value of outstanding mortgage = $\$525,000$

Owner’s Equity = $\$1,290,500.00$

Referring to page 1 of the December 9, 2013 Form 15, the Commission adjusts the existing rental income of \$310,806.00 on line one, which is carried over to lines 3 and 5, by adding \$7,000.00 which had been previously attributed to CAPREIT, for a total of \$317,806.00. The Commission adjusts line 17(c) professional fees from \$19,035.00 to \$1,000.00 in accordance with prior years, recognizing that the bulk of the professionals fees claimed for “Period A” [fiscal year ending October 31, 2013] were attributable to professional fees incurred as a result of the Appellant pursuing the rental increase application and perhaps preparing for the sale of the park. The Commission also adjusts the mortgage payments, principle and interest, of \$39,687.00 to \$22,947.00 in interest only. Accepting the other figures for “Period A”, the Commission finds the line 19 net profit to be \$146,102.00. Assuming a tax rate of 30%, the Appellant’s net income after taxes would be \$102,271.40. Based on the previously calculated owner’s equity of \$1,290,500.00, the existing site rates would provide an after tax return on equity of 7.9%.

The Appellant has applied for rent increases varying from 24.14% to 35.51% for some 169 mini-home sites, as specifically set out in a three page attachment to the Appellant’s Form 12 application (Exhibit E-1).

Provided the applicable notice requirements of the **Act** are followed, the Appellant is entitled to the allowable rental increase which for 2013 is 1.5%. Taking this into account, the Appellant's rental income would increase from \$317,806.00 to \$322,573.09. Net profit before tax would rise to \$150,869.09 with a net income after taxes [again, assuming taxes of 30%] of \$105,608.36 yielding an after tax return on equity of approximately 8.2%.

The Commission is of the opinion that a suitable after tax rate of return on equity for the park, or in the language of the **Act**, a return on capital investment, would be between 8% and 9%. While this is a little higher than the 7% to 8% rate of return considered fair and equitable by the Director, the Commission has had the benefit of evidence not available to the Director and finds that a slightly higher rate of return is necessary to address a level of risk somewhat higher than safe, blue chip stocks.

Applying a rental increase of 6% would increase the parks rental income from \$317,806.00 to \$336,874.36. Net profit before tax would rise to \$165,170.36 with a net income, after taxes [assuming 30% tax rate] of \$115,619.25 yielding an after tax return on equity of approximately 9%. In the Commission's view, a 9% after tax return on equity is sufficiently high to make the continued operation of the park an attractive investment.

In Order LD13-325, the Director set out a schedule of existing rates for the various mini-home sites in the park. This schedule accurately summarizes the very lengthy listing of existing rates set out in the Appellant's Form 12, yet preserves the privacy of residents. The Commission's lauds the Director's efforts to ensure accuracy and yet maintain the privacy of the residents.

The Commission adopts the Director's schedule of existing mini-home site rates in the park but varies the approved rent increase, ordering a 6% increase, **effective August 1, 2013**, which will increase site rents in the park as follows:

Existing Rent	Approved Rent Increase 6%
\$129.93	\$137.72
\$137.81	\$146.07
\$143.08	\$151.66
\$148.72	\$157.64
\$150.95	\$160.00
\$154.89	\$164.18
\$154.90	\$164.19
\$155.18	\$164.49
\$155.52	\$164.85
\$156.13	\$165.49
\$159.26	\$168.81
\$160.34	\$169.96
\$162.29	\$172.02
\$163.58	\$173.39
\$164.85	\$174.74
\$168.76	\$178.88
\$170.23	\$180.44
\$172.42	\$182.76
\$173.62	\$184.03
\$173.63	\$184.04
\$190.99	\$202.44
\$191.10	\$202.56
\$191.11	\$202.57
\$191.75	\$203.25

NOW THEREFORE, pursuant to the *Island Regulatory and Appeals Commission Act* and the *Rental of Residential Property Act*

IT IS ORDERED THAT

1. The appeal is allowed in part.
2. The Commission hereby orders a 6% increase in site rent for mini-home lots within Riverview Estates, said increase effective August 1, 2013.

DATED at Charlottetown, Prince Edward Island, this **20th** day of **January**, 2014.

BY THE COMMISSION:

John Broderick, Commissioner

Ferne MacPhail, Commissioner

Peter McCloskey, Commissioner

NOTICE

Sections 26.(2), 26.(3), 26.(4) and 26.(5) of the **Rental of Residential Property Act** provide as follows:

26.(2) A lessor or lessee may, within fifteen days of the decision of the Commission, appeal to the court on a question of law only.

(3) The rules of court governing appeals apply to an appeal under subsection (2).

(4) Where the Commission has confirmed, reversed or varied an order of the Director and no appeal has been taken within the time specified in subsection (2), the lessor or lessee may file the order in the court.

(5) Where an order is filed pursuant to subsection (4), it may be enforced as if it were an order of the court.

NOTICE: IRAC File Retention

In accordance with the Commission's Records Retention and Disposition Schedule, the material contained in the official file regarding this matter will be retained by the Commission for a period of 2 years.

IRAC141y-SFN(2009/11)