



# Arbitration and appraisal:

## RENT RESET ISSUES

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### PART 2

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#### Characteristics of a lease renewal and lease extension

A resetting of rent during the term of an existing space lease (i.e., part or all of a building) always takes into consideration the lease itself, and typically all of the subsisting terms remain intact in fixing the new rent. The same holds true when resetting rent for a stated term under an *option to extend*<sup>1</sup> an existing lease.

An *option to renew* constitutes a new lease, and resetting of the rent for the term covered by the renewal option may or may not take into account the subsisting terms of the original lease.

There is a technical distinction between a [lease] *renewal* and [lease] *extension*.

An extension is a stretching or spreading out of the term of the lease. A renewal, on the other hand, creates a new and distinct tenancy and is not merely a perpetuation of the old tenancy. It contemplates the execution of a new lease document.<sup>2</sup>

In *Fire Productions Ltd. v. Lauro*,<sup>3</sup> the British Columbia appellate court addressed the interpretation of the term 'fair market rent' in the renewal clause of the lease:

"... provided that the rental payable under the [renewal] of the lease will be the fair market rent for the Premises as mutually agreed upon by the parties hereto within one (1) month after the giving of such notice, provided that upon failure of such agreement, the

same will be determined by a single arbitrator acting in accordance with the *Commercial Arbitration Act (British Columbia)*, whose decision will be binding on the parties hereto."

The tenant exercised a second *renewal* option for a term of five years commencing May 1, 2003. The dispute was whether the tenant's leasehold improvements should be considered in the rent reset analysis upon 'renewal' of the lease. The court treated the renewal option as if the premises were available for lease in 'as is' condition (i.e., as finished space) on the open market to any potential third party, commenting as follows:

"The tenant has not been disadvantaged if on exercising his right of renewal he

is required to pay the rent the landlord would be able to obtain if the lease was not renewed. The tenant may in one sense be paying interest on the improvements he made, but he has the continued use of the improvements, which have become the property of the landlord, to the end of the renewal period. It is all a matter of the bargain driven when the parties enter into the lease and it is then essential that effect be given to the wording the parties actually employed to express their bargain in any given instance. In this case, the bargain made in terms of the renewal rent to be paid favoured the landlord.”

### Nature of rent to be determined

In exchange for the right of a tenant to occupy space on specified terms and conditions, a landlord is entitled to receive *rent*. The nature of the *rent* to be determined for the demised premises (or leased space) is defined and dictated by the language of the lease, and may deviate from Market Rent, which, according to *The Dictionary of Real Estate Appraisal*, 7th edition, is defined as follows:

“The most probable rent that a property should bring in a competitive and open market under all conditions requisite to a fair lease transaction, the lessee and lessor each acting prudently and knowledgeably, and assuming the rent is not affected by undue stimulus.” Implicit in this definition is the execution of a lease as of a specified date under conditions whereby:

- Lessee and lessor are typically motivated;
- Both parties are well informed or well advised, and acting in what they consider their best interests;
- Payment is made in terms of cash or in terms of financial arrangements comparable thereto; and
- The rent reflects specified terms and conditions found in that market, such as permitted uses, use restrictions, expense obligations, duration, concessions, rental adjustments and revaluations, renewal and purchase options, frequency of payments (annual, monthly, etc.), and tenant improvements (TIs) [p. 117].”

### Existing use or (unrestricted) highest and best use

A *use clause* in a space lease dictates the type of use(s) to which the demised premises can be put during the term of the lease or during the period of a lease extension. However, the formula or mechanism for resetting the rent during the term of the lease or during the period of a lease extension may have no connection to what is actually permitted under the use clause. Unless the language of the lease has a contrary intention, the appraiser should estimate rent on the basis of the use(s) permitted under the use clause in the existing lease.

If a rent reset clause in a space lease stipulates that market rent be based on the highest and best use<sup>4</sup> of the space (demised premises), all relevant factors, including the following, should be taken into account by the appraiser as of the valuation date stipulated in the lease:

- The years remaining on the existing lease<sup>5</sup> and any lease extensions unilaterally exercisable by the lessee (tenant) at the time of the rent reset or the period of time stipulated in the rent reset clause.<sup>6</sup>
- The location of the space within the building or complex.
- The type of access to the space (e.g., stairs, elevator, street grade, etc.).
- The amount of space and its utility.
- The condition of the space (i.e., finished or unfinished).
- The age and condition of the building or complex housing the space.
- The uses permitted under the prevailing land use controls, and not prohibited by any restrictive covenants registered against title or by covenants in other tenant leases.
- The market support and level of demand for each permitted (viable) use.

A space lease (demised premises) that makes no provision for parking (either onsite or offsite) eliminates permitted uses dependent on parking, and permitted uses that cannot be accommodated within the space or within the unexpired term of the lease and any lease extensions are also eliminated from further consideration. Likewise, any permitted use that is not financially feasible given the remaining term of the lease, coupled with any lease extensions, is also eliminated from further consideration in the highest and best use analysis.

In *McDonald's Corporation v. 1552 Broadway Retail Owner, LLC*,<sup>7</sup> a dispute arose as to whether resetting of the rent during the first five years of a 10-year Lease Extension<sup>8</sup> should be based on the existing restaurant use or the (unrestricted) highest and best use of the 'demised premises' defined as follows:

“The demised premises consist of a ground floor space [2,200 square feet], basement [315 square feet] and mezzanine [3,700 square feet]... ”  
ng of rent for the five-year period of June 1, 2014 to May 31, 2019 is pursuant to the following formula as set out in valuation clause 4(b)(1):

“Ninety percent (90%) of the fair market rent (the 'FMV') for the demised premises determined as of the date occurring six (6) months prior to June 1, 2014 [the 'Determination Date']... The FMV shall be determined on the basis of the highest and best use of the demised premises and considering all relevant factors.”<sup>9</sup>

According to Article 9 of the lease, the only permitted use of the demised premises is as a McDonald's restaurant or another restaurant that McDonald's operates.

In this example, the *use clause* is in conflict with the rent reset (valuation) clause, and to suggest restaurant use is the only permitted use of the demised premises would render the valuation clause and the concept of highest and best use meaningless. At the tenant's insistence, the court was persuaded to intervene on a threshold issue of 'highest and best use,' arguing that the arbitration would be impracticable if the parties' competing valuations were premised on different concepts of value. '*Highest and best use*' is not a term typically found in rent reset clauses associated with space leases in a building. Also, reference in the rent reset clause to *fair market rent* as *FMV* is confusing on its face, as *FMR* is the common initialism for *fair market rent*. A poorly drafted rent reset clause can make it difficult for an appraiser to determine appropriate uses of the demised premises, define the type of value, and apply appropriate appraisal methods and techniques, and can be a challenge for an arbitrator to interpret.

As noted by the court, 'highest and best use' is a phrase used often in the real estate industry. Determining highest and best use

is within the jurisdiction of the arbitrators (unless the use is stipulated in the lease or agreed upon by the parties). However, the court ruled that the arbitrators could not limit their valuation analysis to the use of the demised premises as a *McDonald's* restaurant without determining whether there are more valuable uses for the demised premises pursuant to the language of the rent reset clause.

'Highest and best use' analysis can prove challenging in a rent reset of a leasehold defined only as part of a building or complex and with a fixed term under single tenant occupancy. *McDonald's* space lease, with a remaining term of 10 years,<sup>10</sup> consists of 5,900 square feet on two levels, street frontage of 37.75 feet (midblock location), and benefits from exposure to pedestrian and vehicular traffic (high volume in Times Square). The potential proxy tenant pool for the space occupied by *McDonald's* is limited, as space requirements vary from tenant to tenant depending on the nature of the business and intended use.

### Appraisal suggestions and content

A lease that calls for the exchange of appraisal reports by a specified date requires that each party give its appraiser sufficient lead time to complete the appraisal in a credible and timely manner. Conversely, it is equally important that an appraiser retained on behalf of a party involved in a rental dispute be aware of and comply with contractual obligations involving compliance with recognized appraisal principles and standards such as the *Uniform Standards of Professional Appraisal Practice (USPAP)*, *Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP)*, or *International Valuation Standards (IVS)*,<sup>11</sup> and timely completion and delivery of an appraisal report. If the appraisal is to be independently reviewed,<sup>12</sup> more lead time should be set aside to commission the appraisal. A lease clause or provision that imposes unrealistic timeframes for the preparation and exchange of appraisal reports should, if possible, be renegotiated or temporarily relaxed for the mutual benefit of the parties before proceeding to arbitration.

Credible appraisal evidence is crucial in a rent reset dispute, and each party (or their legal counsel) should exercise due diligence in overseeing the appraisal process to provide for the following:

- The appraiser's overriding duty is to assist the trier of fact (i.e., arbitrator, arbitral panel, or court) and to provide evidence that is objective and non-partisan, and a statement to that effect should be attached to the appraisal report.
- The appraisal report must identify the intended user, the intended use (i.e., arbitration), type of value (e.g., market value, market rental value) and sourced definitions, effective date of opinions and conclusions, and any assignment conditions.<sup>13</sup>
- The appraisal report should include detailed a curriculum vitae disclosing professional qualifications and emphasizing knowledge and experience relevant to the valuation issue(s) in dispute.
- The *Scope of Work*<sup>14</sup> undertaken and presented in the appraisal must be consistent with the intended use, outlining the nature and extent of the research conducted in connection with the rent reset assignment, and reliance on reports prepared by other professionals must be disclosed. The appraisal report should be proofread for typographical errors, mathematical errors, factual omissions, inconsistent statements, and inclusion of privileged documents or information inadmissible in a court of law such as protected client-lawyer communications or work product.<sup>15</sup>
- The appraisal report should be independently reviewed before reports are exchanged, and prior to submitting the report to the arbitrator or arbitral panel. If necessary, the appraisal report should be amended to shore up any weaknesses, reconcile inconsistencies, and correct errors of commission or omission, all to ensure compliance with professional appraisal standards,<sup>16</sup> and applicable legal requirements.
- The appraisal report should include sketches (or architectural drawings, if available) and confirmed measurements

of the demised premises<sup>17</sup> or premises in dispute if not explicitly defined in the lease or agreed to by the parties. It is preferable for the parties to jointly retain a qualified third-party to conduct measurements of demised premises in dispute prior to commencing the arbitration. If the demised premises include improvements or structures, a building permit history and analysis should be provided, if readily available.

- Ideally, the appraisal report should include an abstract of title or parcel register for each comparable sale or comparable lease relied on in the rent reset analysis.
- The appraisal should disclose and analyze recent leasing activity or listings of the subject and all of the comparable market data relied on in the rent reset analysis extending for a period of time prior to the effective date of the rent reset considered appropriate by the appraiser.
- The appraisal should disclose the address or legal description of each comparable lease/rental and the extent of documentation and verification of each comparable lease/rental relied on in the rent reset analysis.
- The appraisal should disclose whether and when a sale or lease/rental comparable has been inspected, and, ideally, by whom. All photographs and aerial views should be date-stamped.
- The reliance on published surveys (e.g., land prices, rental rates, rates of return, etc.) should reflect an understanding as to how they were conducted, for what purpose, and by whom.
- The reliance on any *assignment conditions*<sup>18</sup> must not limit the scope of work to such a degree that the assignment results are not credible in the context of the intended use, and the assignment conditions must be disclosed in the appraisal report.
- The appraisal methods and techniques relied on must be appropriate and properly applied, consistent with the intended use of the appraisal, and reflect the current body of appraisal knowledge.<sup>19</sup>

## Case study –

### Review of a rent reset arbitration award

In a rent reset involving a landlord and *Best Buy Canada Ltd.* as the lessee (tenant), the dispute was confined to determining 'market rent' of a space lease for five years, consisting of a 37,000 sq. ft. store (occupied by Best Buy) on two levels (17,385 sq. ft. on the 1<sup>st</sup> floor, and 19,598 sq. ft. on the 2<sup>nd</sup> floor) and 109 surface parking spaces, argued before a "single" arbitrator:

"Fixed Rent for the sixteenth (16th) through twentieth (20th) Lease Years [June 1, 2014 – May 31, 2019] (i.e., the second option period) shall equal the greater of (i)...\$1,095,030.00 per annum; or (ii) the market rental value for the Premises but excluding from consideration, the Tenant's signs, trade fixtures, furnishings and interior finishes. Should the Landlord and Tenant not be able to agree on the market rental value in respect of the Premises, the issue shall be arbitrated in accordance with the *Arbitration Act* (Ontario)."

"In the event of any bona fide dispute arising between Tenant and Landlord under this Lease, the dispute, at the option of Landlord or Tenant will immediately be referred to a single arbitrator to be agreed upon by Tenant and Landlord... Such arbitrator, whether agreed on or appointed, will have access to such records of the parties as are reasonably necessary and the decision of such arbitrator will be final and binding upon the parties. The cost of the arbitration will follow the award, unless otherwise determined by the arbitrator."

At the outset of the arbitration, the Landlord's appraisal estimated the annual market rental value at \$1,653,140, while the Tenant's appraisal estimated the annual market rental value as a range of \$662,771 to \$983,232, with both appraisers relying on comparable lease/rental data. Subsequent settlement offers made by each party were rejected. The divergence in the parties' market rental value estimates is an astonishing 68% to 150%. A brief review of the arbitrator's award, which in this

rental dispute required a reasoned award,<sup>20</sup> reveals the following:

- 'Sales volumes,'<sup>21</sup> a fundamental metric of a 'big box'<sup>22</sup> retail operation, and the typical parking ratio required to support a retail operation<sup>23</sup> are not mentioned in the arbitral award, but it is unknown whether this information was contained in either party's appraisal report.
- One of the appraisals treated the store and parking as two discrete components, contrary to the language of the lease,<sup>24</sup> to derive a market rental rate for the Premises (consisting of the property as a whole), an approach which is inconsistent with recognized appraisal theory.
- In the presentation of comparable lease/rental data, the reported per square foot rates are 'net,' but it is unknown whether either party's appraisal report included a cost of occupancy analysis<sup>25</sup> to account for differences in operating expenses between the subject Premises and each comparable lease/rental.
- As for the corresponding parking ratios of the comparables, it is unknown whether that information was provided in either party's appraisal report.
- Although the arbitrator accepted that the "amended use provision [in the Lease] is broad enough to encompass a wide variety of uses," there is no reference in the decision as to the zoning of the subject property (Premises) and the Permitted Uses. It is unknown whether either party's appraisal report contains a zoning analysis of the demised premises.
- There is no indication which, if any, of the *uses* reflected in the comparable lease/rental data would be permitted in, or suitable for the subject Premises (37,000 square feet over two levels), and available for the five years remaining on the term of the Lease. It is unknown whether this information is contained in either party's appraisal report.
- Only one of the rental comparables (an available sublease) presented in one of the party's appraisal report is for a term of five years, consistent with the five-year period for which the rent was to be fixed, and is on two levels (13,400 sq. ft. on the 1st floor, and 14,500 sq. ft. on the

2nd floor), as is the subject space, but it was dismissed by the arbitrator as "not an accurate reflection of the market." There may be no reasonable basis for the large divergence in the opinions of market rental value, and why the arbitration should have taken 'some 10 days' to complete is not entirely clear. Neither party's opinion of market rental value was accepted by the arbitrator, who fixed the rent for the Premises at \$1,279,260. Based on the entirety of the evidence presented by the parties, the arbitrator identified the Landlord as 'the prevailing party,' leaving the Tenant to bear the cost of the arbitration, including the Landlord's Costs Award of \$383,000. On appeal, the Tenant argued unsuccessfully against the Costs Award claiming that the Awarded Rent of \$1,279,260 was closer to the minimum 'Base Rent' of \$1,095,030 than the Landlord's settlement Offer of \$1,550,000. As noted by the court,

"The Arbitrator was entitled to exercise his discretion in weighing the relevant factors he considered in making the Costs Award."

The arbitration lasted 10 days at an approximate cost of \$1,000,000. Both parties would likely have benefited had each party undertaken an independent review of their own appraisal prior to relying on it for the purpose of the rent reset arbitration, assuming no such review was undertaken.

Ensuring an appraisal report has addressed the disputed rent reset valuations issue(s) in a thorough and credible manner should be of assistance to each party in understanding the relative merits and strength of its case and assist the arbitrator or arbitral panel in deciding the dispute and would reduce the cost of the arbitration to both parties. Arbitrators make decisions on the basis of the appraisal evidence presented to them, and the decisions they make are guided by the completeness, accuracy, adequacy, relevance, and reasonableness of the appraisal reports.

### Arbitrator rejects non-compliant appraisal report

Presenting appraisal evidence that falls short of the professional standards

expected of a 'reasonable appraiser'<sup>26</sup> and that does not follow 'applicable appraisal principles' can cause a party to sustain significant financial losses, and in turn, could have unintended consequences for an appraiser whose client has received an unfavourable decision in an arbitration as occurred in the dispute between two parties over the value of an unserviced 84-acre parcel to be developed some six to eight years in the future as a residential subdivision.<sup>27</sup>

A retired judge presided over an 18-day hearing as the sole arbitrator, and based on a very detailed analysis referencing an authoritative appraisal text and generally accepted appraisal standards, he rejected the appraisal prepared on behalf of one of the parties. In effect, one party was left without any appraisal evidence on which to rely in support of its position. The reasoning in support of the arbitrator's decision to reject the appraisal is reproduced, in part, as follows:

"In his analysis, [the] Arbitrator... imported and, with rigour, applied a number of professional standards from the *Canadian Uniform Standards of Professional Appraisal Practice [CUSPAP]* and the text *The Appraisal of Real Estate, 3rd Edition, Canadian Edition*, published by the Appraisal Institute of Canada [AIC]. He reasoned that the latter part of Article 9 [of the Co-Tenancy Agreement] was intended to make the AIC Standards and principles in its text applicable to the appraisals called for under the CTA.<sup>28</sup>

...[T]he...Report did not qualify as an appraisal under Article 9 of the CTA [Co-Tenancy Agreement]; on the evidence there was no factual basis for estimating the value of the land using the appraisal method [Land Residual Approach] chosen by... [the appraiser]; and, there were errors in the inputs and/or calculations... [the appraiser] had made, as reflected in the detailed reasons given between pages 15 and 40 of his decision.

...[The] Arbitrator examined the 'Land Residual Approach' said by... [the appraiser] to have been used to determine the fair market value<sup>[29]</sup> of the subject property. This approach

was described in the AIC text as one technique of giving effect to the income approach. In contradiction, notes the Arbitrator, the income approach was said by the appraisal not to be relevant. He rejected... [the appraiser's] insistence that the Land Residual Approach was the same as the Subdivision Development Approach, as being inconsistent with the authoritative text... In comparing... [the appraiser's] report and evidence to specific A.I.C. standards, [the] Arbitrator said they "... did not begin to comply."<sup>29</sup>

The arbitrator informed himself as to the body of knowledge articulated in *The Appraisal of Real Estate*, and the *Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP)*, standards to which all members of the Appraisal Institute of Canada must comply.

It is apparent that the 'Land Residual Approach' is not the same as the 'Subdivision Development Approach',<sup>30</sup> and one is not a substitute for the other. The financial losses sustained by the party left without an acceptable appraisal, including a reported \$800,000 payment of costs levied by the arbitrator, could possibly have been avoided had the appraisal report been independently reviewed prior to the arbitration, assuming no such review was undertaken. The party's trust in the appraisal proved fatal. In some jurisdictions, an appraiser retained as an expert witness may be liable for negligence in their report or testimony,<sup>31</sup> and could be held liable if the retainer agreement (contract) with the client is breached and results in financial losses. The appraiser's work product might also lead to an investigation by the umbrella organization of which the appraiser is a Member. Of course, before an assignment is accepted, an appraiser has an obligation to satisfy the competency provision as set out in *CUSPAP*, *USPAP*, or *IVS*, depending on the governing Standards.<sup>32</sup>

### Conclusion

Arbitration may be preferable to court proceedings as a mechanism to resolve disputes over private contracts such as leases, especially valuation issues

involving rent resets. While still adversarial, arbitration is a consensual and typically less formal procedure, and resolution of a dispute is timely. Arbitrators experienced as valuers understand the appraisal process and the governing appraisal standards (e.g., *USPAP*, *CUSPAP*, *IVS*), making appraisers suitably qualified to act as arbitrators in rent reset disputes. An arbitrator whose rent reset decision rests on appraisal evidence has an expectation of being able to rely on credible appraisals, as does each party on whose behalf the appraisal has been prepared.

An arbitrator retained for their subject matter expertise should be capable of identifying both the strengths and weaknesses of each party's appraisal evidence, while performing the arbitral duties in a neutral manner and in accordance with the arbitration agreement and arbitration act governing the geographic location of the demised premises. Depending on the jurisdiction in which the property is located, the complexity of the valuation issue(s), or the amount of rent in dispute, it may be appropriate for each party to have its own appraisal report independently reviewed by a qualified appraiser prior to the arbitration, and address any shortcomings warranting revisions to the appraisal report. A party's failure to have its own appraisal independently reviewed prior to acting upon it could prove to be a costly oversight.

Arbitrators exercise wide discretion as to how they weigh appraisal evidence, and appraisal evidence that is credible will carry more weight. Valuations at the extremes do little to enhance the credibility of the appraisal profession. Arbitration awards are final and binding,<sup>33</sup> absent any extremely limited irregularities. Accordingly, each party should exercise due diligence in formulating an appropriate appraisal strategy in anticipation of a rent reset arbitration. Rent reset arbitrations can be costly, but an effective pre-arbitration appraisal strategy will shorten the duration of the arbitration and likely result in substantial cost savings to both parties.

## End notes

- <sup>1</sup> According to *The Dictionary of Real Estate Appraisal, 7th ed.*, an option to extend a lease is synonymous with the term 'renewal option,' defined as "an agreement entered into at the time of the original lease providing the tenant with the right, but not the obligation, to extend the lease term for a specified time at a rent specified in the option agreement or at the market rate at the time of renewal."
- <sup>2</sup> See 10 Miller & Starr, *Cal. Real Estate (4th ed. 2020)*. Landlord and Tenant, 'Renewal' and 'extension' distinguished §34.73 (Miller & Starr)
- <sup>3</sup> *Fire Productions Ltd. v. Laura*, 2006 BCCA 497 (CanLII), <<http://canlii.ca/t/1q1r7>>, retrieved on 22 November 2023.
- <sup>4</sup> 'Highest and best use' is "The reasonably probable use of property that results in the highest value [and] [t]he four criteria that...must be met [are] legal permissibility, physical possibility, financial feasibility, and maximum productivity," *The Dictionary of Real Estate Appraisal, 7th ed.*, p. 88. For a discussion of 'highest and best use' involving ground leases see 'Ground Leases: Rent Reset Valuation Issues,' *The Appraisal Journal*, (Fall 2011), p. 316-317.
- <sup>5</sup> An early termination clause exercisable at the discretion of the owner (landlord) effectively reduces the remaining term of the lease for the purpose of a rent reset, and has an impact on highest and best use analysis, resulting in a lower rent for the rent reset period. To achieve a higher rent, it is in the best interest of the owner (landlord) to waive the early termination clause for the purpose of resetting the rent for the period covered by the rent reset.
- <sup>6</sup> In *Galvano Enterprises Limited v. Orionvink BV*, [1999] NICA 11, at each rent reset date of the 25-year term of the space lease rent is to be fixed "for a term equal to, whichever is the greater of, the period of 15 years or the remainder of the Term."
- <sup>7</sup> *McDonald's Corporation v. 1552 Broadway Retail Owner, LLC*, 2017 NY Slip Op 50011(U) – NY: Supreme Court, 2017, <https://static.schlamstone.com/docs/1552-Broadway-Retail-Owner-LLC-v-McDonalds-Corporation-2017-NY-Slip-Op-50011U.pdf> retrieved on 11 November 2023.
- <sup>8</sup> Pursuant to the Lease, the rent in years 6-10 is to be 115% of the rent fixed during years 1-5 of the 10-year Lease Extension.
- <sup>9</sup> Highest and best use in the context of estimating market rent of a *space* lease should consider reasonably probable uses permitted under the prevailing land use controls supported by an investment horizon or holding period of 10 years, consistent with the term of the lease extension and lease expiry, as of the valuation or rent reset date stipulated in the lease. In other words, prospective retail/commercial tenants requiring more than 10 years recouping their investment in the business and leasehold improvements should be disregarded in the highest and best use analysis. Certainly, the remaining term of the lease, i.e., the 10-year lease extension and lease expiry of May 31, 2024, is a 'relevant factor' in the highest and best use analysis.
- <sup>10</sup> In *United Equities, Inc. v. Mardordic Co.*, 8 AD 2d 398 (1st Dept. 1959), *affd* 7 N.Y. 2d 911 (1960), the court ruled that consideration must be given to the term of the rent reset (21 years) and the renewal option (21 years), or 42 years in total, in determining "the best use to which the land can be put and not limited to improvement as a garage," para. 405. With rent fixed for only 21 years, redevelopment options may be impacted by mortgage financing constraints.
- <sup>11</sup> In *Westnay Container Services Ltd. v. Freeport Properties Ltd.*, 2009 BCSC 184 (CanLII), the arbitrator rejected a two-step procedure (i.e., estimated property value times estimated rate of return) in favour of an estimated lease rate applied directly to the demised premises in resetting the rent. The rationale for resorting to indirect methods of estimating rent should be adequately explained in the appraisal report.
- <sup>12</sup> Appraisal Review requirements are covered under Standard 3 and Reporting Standard 4 of *USPAP*; Standards Rule 10 and 11, and Reporting Standards 6 and 7 of *CUSPAP*; and Section 6 under Professional Standard 2 of the *RICS Valuation – Global Standards*, effective January 31, 2022.
- <sup>13</sup> See 'Identification of the Appraisal Problem,' *The Appraisal of Real Estate, 15th ed.*, p. 30.
- <sup>14</sup> *CUSPAP* (effective January 1, 2024) 3.72 defines *Scope of Work* as "[t]he type of Inspection, the type and extent of research and analysis required, any limitations, or other terms to fulfill the Authorized Assignment. The Scope of Work for an Assignment is determined by the Member's compliance to *CUSPAP* and applicable legislation. [see 6.2.4, 7.5, 7.6]
- <sup>15</sup> The rules of privilege are matters of public policy that are to be enforced in arbitration just as they would be in litigation, p. 4; 'Best Practices Regarding Evidence in Arbitrations,' *American College of Trial Lawyers, Alternative Dispute Resolution Committee*, February 2018, [https://www.actl.com/docs/default-source/alternative-dispute-resolution-committee/adr\\_best\\_practices\\_regarding\\_evidence\\_in\\_arbitrations.pdf?sfvrsn=2](https://www.actl.com/docs/default-source/alternative-dispute-resolution-committee/adr_best_practices_regarding_evidence_in_arbitrations.pdf?sfvrsn=2).
- <sup>16</sup> Compliance with *CUSPAP*, *USPAP*, or *IVS*, depending on the laws in the jurisdiction in which the property is located, and, if a member of a professional organization, compliance with their rules and regulations.
- <sup>17</sup> *Demised premises* are defined as "[p]roperty that is leased to a person or entity for a specific period of time..." *The Dictionary of Real Estate Appraisal, 7th ed.* (Chicago: Appraisal Institute, 2022), 51.
- <sup>18</sup> *USPAP* defines Assignment Conditions as "assumptions, extraordinary assumptions, hypothetical conditions, laws and regulations, jurisdictional exceptions, and other conditions that affect the scope of work. Laws include constitutions, legislative and court-made law, administrative rules, and ordinances. Regulations include rules or orders, having legal force, issued by an administrative agency."
- <sup>19</sup> References to outdated appraisal texts should be avoided. Quoting from outdated appraisal texts may be a sign of indifference to the profession expanding its body of knowledge or his or her own knowledge, especially if the appraiser's curriculum vitae fails to demonstrate the knowledge and experience necessary to complete an assignment for its intended use.

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<sup>21</sup> In 2009, at the time of the previous rent reset, the Best Buy brand averaged sales of \$877 per sq. ft. based on 1,023 stores and an average store size of 39,000 sq. ft. In 2014, Best Buy's average store size was 27,400 sq. ft., and sales volume averaged \$770 per sq. ft. based on 1,779 stores, <https://retail-index.emarketer.com/company/data/5374f24e4d4afd2bb4446640/5374f25d4d4afd824cc1564d/lfy/false/best-buy-real-estate> [accessed 27 November 2023]. According to CBRE's July 13, 2015 *Marketflash* (Money Talks: Retail Sales Productivity Show Divergence in Performance), Best Buy Co. Inc.'s (Future Shop, Best Buy, Best Buy Mobile) sales productivity in Canada averaged \$800 per sq. ft. in 2013.

<sup>22</sup> A single-use store, typically between 10,000 and 100,000 square feet or more, such as a large bookstore, office-supply store, pet store, electronics store, or toy store (ICSC)' *Dictionary of Real Estate, 7th ed.* p. 18. The typical lease term for a 'Big Box' store is 20 years, often structured as an initial term of 10 years at fixed rental rates with two five-year lease extensions or options to renew, also at fixed rental rates.

<sup>23</sup> A typical parking ratio for a 'big box' retailer is between 4.5 and 5.5 stalls per 1,000 sq. ft. of Gross Leaseable Area (GLA). The subject Premises has a parking ratio of 2.87 stalls per 1,000 sq. ft. of GLA, which may be appropriate given that the store is located in a densely populated urban area on a subway line in midtown Toronto, Ontario.

<sup>24</sup> The parking component is operated by a third party on behalf of the tenant under a License Agreement with the tenant. A 'license' is not an interest in land, and *The Dictionary of Real Estate, 7th ed.*, defines 'license' as "[f]or real property, a personal, unassignable, and typically revocable privilege or permit to perform some activity on the land of another without obtaining an interest in the property." [p. 108] In *12400 Stowe Drive, LP v. Cycle Express, LLC*, Cal: Court of Appeals, 4th Appellate District, Division One, the 'Premises' consist of a 133,125 sq. ft. industrial building on a 297,505 sq. ft. site and an adjoining 112,830 sq. ft. vacant lot used for customer parking during auctions, as no off-site parking is permitted. In resetting the rent for the five-year lease extension, the court found in favor of the tenant's appraisal, which estimated the market rental value of the two components as one 'collective unit' at \$106,500 per month, based on the conditions and restrictions contained in the Lease. The landlord's appraisal valued each component separately in its highest and best use and arrived at a combined market rental value of \$138,270 per month.

<sup>25</sup> Tenants are concerned about *Occupancy Cost*, which "...constitute the rent and reimbursables (expense reimbursements to the landlord as specified in the lease), which may include items such as heat, utilities, janitor service, taxes not included in the rent, and amortization of the tenant's cost of alterations over the term of the lease." *The Dictionary of Real Estate, 7th ed.*, p. 134.

<sup>26</sup> *CUSPAP 3.64* defines 'Reasonable Appraiser' as "[a] Member providing Professional Services within an acceptable standard of care and based on rational assumptions. [see 4.2.5, 7.1.2, 9.9]

<sup>27</sup> On the facts of the case, the arbitrator concluded that the Subdivision Development Approach had no application.

<sup>28</sup> Under the CTA, the appraisals had to be prepared by designated 'AACI' members of the Appraisal Institute of Canada.

<sup>29</sup> *The Dictionary of Real Estate, 6th ed.*, 2015, defines "fair market value, in nontechnical usage, a term that is equivalent to the contemporary usage of *market value*." The *7th ed.*, 2022, defines "fair market value, in nontechnical usage, a term that is generally synonymous with the contemporary usage of *market value*."

<sup>30</sup> According to *The Appraisal of Real Estate 'Third Canadian Edition*, 2010, '[t]he land residual technique is a method of estimating land value in which the net operating income attributable to the land is isolated and capitalized to produce an indication of the land's contribution to the total property,' [p. 16.12] which differs from the steps involved in "subdivision development analysis." See *Subdivision Valuation, 2nd ed.*, © 2017, Appraisal Institute, Chapter 11 (Land Value Using the Subdivision Development Method).

<sup>31</sup> In Canada, an expert witness that "provides evidence that was useless" to the client and to the court (arbitrator or arbitral panel) is entitled to "expert witness immunity." (See *The 6th Line Mofos Limited v. Stewart* 2022 ONSC 520). In the United States, some jurisdictions do not permit a party to sue its own expert witness. In Florida, an expert in an arbitration hearing may not rely on the statutory immunity granted to arbitrators and may be sued for negligence. Fla. Stat. §682.051 (2016) created statutory immunity for arbitrators, and immunity has never been expressly expanded to include experts. (Brian C. Willis, "Resolving 'Disputes By Expert Determination: What Happens When Parties Select Appraisers, Accountants, Or Other Technical Experts To Decide Disputes,") *Florida Bar Journal*, Vol. 91, No. 7 July/Aug 2017, p. 35, <https://www.floridabar.org/the-florida-bar-journal/resolving>, accessed on 14 November 2023. In the United Kingdom, in the decision of the Supreme Court in *Jones v. Kaney*, [2011] UKSC 13, "expert witness immunity" was abolished for a party suing its own expert in a claim for negligence.

<sup>32</sup> Peter T. Christensen, 'Averting Professional Liability Claims, Essential guidelines for appraisers serving as expert witnesses,' *Right of Way* (November/December 2016): 24-27, <https://www.liability.com/publications/2016/averting-professional-liability-claims.aspx>, accessed on 20 November 2023.

<sup>33</sup> "Arbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal. As a mode of settling disputes, it should receive every encouragement from courts of equity. If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error, either in law or fact." *Burchell v. Marsh*, 58 US 344 (1854) 17 How.344.

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