

Government Land Rental Policy— is it fair?

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This article concerns itself with land only rather than improved properties. In addition it relates to government lands administered by government or quasi government agencies. It is incumbent upon these administrators to maximize the use of such lands and obtain the best possible rent.

The processes of land alienation is apparent in the Provincial level through such agencies as the Ministry of Lands, Parks and Housing Provincial Railways, etc. It is also apparent in the provinces at the federal level through such agencies as the National Harbours Board, Department of Indian Affairs, etc.

The availability of lands so administered by these agencies is critical to the well being of the nation as a whole and to the local level of governments. The lands are made available on a lease basis with variable terms, conditions and rental rates. More often than not the lessee has no viable alternative to land use. During the past several years the determination of lease term and rental by the lessor has created an unfavourable situation to the lessee. This article will explore these situations and examine the present method of rental determination, the philosophy of leasing government lands, the problems now arising and a possible alternative to the present method of rental determination. It must be recognized that the objectives of the various Provincial Agencies and Federal Agencies responsible for administering Crown lands are varied. The remarks and observations made in this article are of a general nature. They may apply to some agencies but not others. In all probability the reader can apply his own knowledge of government agencies to the observations advanced in this discussion and form his own conclusions.

At the outset it is necessary to examine the very basic issue which is *to determine the reason for leasing government lands*. If the primary reason is to encourage and

accommodate land use then the policy concerning rental structure will be considerably different than if the primary reason is to maximize rental income from land. Originally it would seem that the former thinking applied, but more recently the latter has become a dominant consideration. In reality the probable objective now is to achieve both. If this is so then friction is inevitable. Both objectives should be tempered so that a leasing and rental policy can be developed which will establish a framework for the future which will not change and which will be beneficial to both parties.

Perhaps some thoughts and observations concerning leasing would be appropriate.

Most criticism relating to Crown or quasi Crown tenancies are related to purported abuses that sometimes creep in to the tenancy system. The landlord's bargaining power *is often close to being monopolistic*. This is a most critical factor. This makes it possible for the lessor to conclude a one sided arrangement to the disadvantage of the lessee or to claim a disproportionate share of the economic returns from the property. Problems also arise due to the vagaries of human nature involved when drawing up the lease document. It would seem that the lessee is, at times, not fully cognizant of the implications contained in a lease. If he is, he chooses to ignore them on the assumption that possible problems will not arise. For example, a lessee assumes that the rental structure will never be so punitive that a crisis will occur in 5, 10 or 15 years. He would also assume that a 20 year lease will be renewed. Otherwise it would be difficult to justify spending large sums of money on capital improvements which should logically be amortized over a period of 40 to 50 years. Virtually no one would enter into a lease with a 30 day cancellation clause unless he was reasonably assured that it would not be invoked

and yet such leases exist and for specific reasons.

In effect, when a lease is issued for say 20 years, only one thing is reasonably certain—that is that the lease will continue for 20 years (with a 30 day cancellation clause, even this is not certain). The rental for this term, however, is anything but certain. The base for establishing the term is year one. The base for establishing the rental *shifts forward each five years* to a new base. This negates any possibility of the lessee ever acquiring anything but a nominal leasehold interest. It is counter productive in that it discourages the investment of capital to improvements in the latter part of a lease term. It discourages the sale of a leasehold interest. It provides the security of a 20 year lease, but only the economic advantage of a five year lease. With a cancellation clause in effect, even the security of tenure is lost.

In preparing a lease document it is critical to anticipate all future problems and make provisions to solve them before the document is finalized. This is seldom done.

The most critical aspect of any lease is that both parties should enter into the contract with the belief that both are being dealt with in a fair manner at the outset, during the term of the lease, and at the conclusion of the lease. Changes in the economic climate, changes in land use, changes in social behaviour, changes in environmental attitudes should be anticipated and provisions made to cope with them. Quite often this is not done.

The accepted criterion at this time followed by virtually all government or quasi government agencies is to charge a lessee a market rent which equates to an economic rent. This rent would apply for the first five year period and be subject to a review at following five year intervals. At each five year interval, the rent would be adjusted upward to reflect the then current market value of the land.

Market rent or economic rent is therefore the result of two components—one being the market value of the land and the other being the economic rate of return to land. Market value is assumed to be the value of the fee simple interest. The economic rate of return is considered to reflect the prime bank rate or perhaps bond rate plus say 1%, the latter to reflect the risk associated with land alienation. The rate is applied for five years which does not reflect the vagaries in the money market. In the long run, however, the rate would tend to average out. At the present time the rate of return, as measured in the market place, is considerably less than bank rates. The above observations would apply to a less volatile money market.

Very critical to the establishment of market rent is the value of the land as *though held in fee simple*. This, of course, does not reflect the true facts as the land is only held under leasehold tenure.

In effect, a lease divides the "bundle of rights" and transfers only some rights to the tenant. The lessor keeps:

- The right to capital appreciation to the land (most significant).
- The right to the reversionary interests of improvements upon expiration of tenure (unless otherwise provided).
- The right to increase rents at periodic intervals and, in effect, shift the base year forward for economic considerations.

The right to obligate the lessee to develop the lands and possibly to a certain value level.

- The right to obligate the lessee to use Crown owned facilities to some degree.
- The right to refuse to allow an assignment or subletting.
- The right to limit the use of the leased land to a specific use.
- Plus others.

The lessee's interest is therefore something considerably less than fee interest. This factor is generally not recognized when computing lease rentals but it should be. The single most critical right which a lessee does not have is the right to capital appreciation. It is this factor which has and will continue to cause the very real problems encountered when renegotiating lease rentals. The problems intensify during a period of rapidly rising land values.

Perhaps a comparison can be made to the private sector. At first glance the observation can be made that many businesses rent office accommodation and suffer rent increases with time. However, the situations are different. A lessee under this situation has the freedom of movement. If rents rise beyond his ability to pay then he moves to more affordable premises. He is not tied to a site by virtue of large capital investments or by virtue of the fact that there is no real alternative site (emphasizes the monopolistic situation re-

lating to Government lands i.e. waterfront lands owned by the National Harbours Board or Provincial Governments).

A comparison case can also be made to renting vacant land from the private sector. Again the situation is not similar. In the private sector there is room for competition. There is certainly a different motivation behind the objectives in renting land. The private sector would probably have one objective only in mind and that is to maximize income. Large landowners are scarce and lands which are leased tend to be for temporary periods of time pending some future development of the lands by the owner. When the private sector does develop land expressly for the purpose of leasing, the rates and terms tend to encourage land use and development.

Considerable further observations could be made concerning leasing and effects in other areas of importance (mortgages, terms, reversionary rights, etc.) but they are beyond the scope of this essay.

Some observations should be made however, relative to the benefits which accrue to a lessee.

The lessee has the distinct advantage of not having to tie up a large amount of capital in land acquisition. This money can then be used for capital improvements or for other uses. In any event, the economic return to this money at prevailing interest rates is a benefit to the lessee. The lessee also has the opportunity to "write off"

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