

The Land Economist

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Professional Journal of the



ASSOCIATION of
ONTARIO LAND
ECONOMISTS

1235 Bay Street, Suite 400
Toronto, Ontario M5R 3K4

Tel: (416) 934-5166

Fax: (416) 969-8916

Website: www.aole.org

E-mail: aole@interactive-ca.com

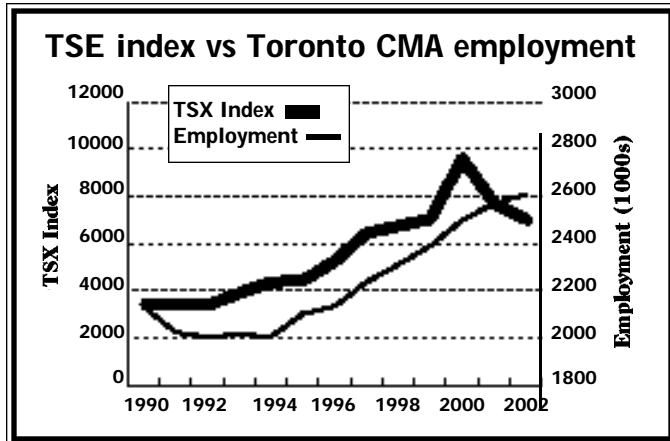


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A tale of three markets

by Will Dunning PLE

Chart 1



SOURCE: STATISTICS CANADA/WILL DUNNING INC.

During the 1990s, the Toronto housing market was loosely correlated with the stock market. During 2000 to 2002, however, there has been a disconnection between these two major markets. While the stock market has declined sharply, with the TSX down by about 40% from its August 2000 peak, the GTA housing market has strengthened. Records for new home sales were set each year from 2000 to 2002.

One interpretation might be “asset substitution” – the idea that as the stock market has weakened, investors have shifted resources to a different asset class – their homes. On closer examination, it seems that another market – the job market – is intervening between the two.

The TSX started a strong upward movement in late 1995; employment began to increase strongly about a year later. Similarly, about a year after the stock market peaked in August 2000, employment growth almost halved (Chart 1).

Chart 2 - Two bubbles and two busts

Causes of employment growth in Toronto CMA

Impacting Variable	Jun 84-Jun 89		Sep 89-Sep 94		Aug 94-Aug 01		Aug 01-Nov 02	
	1,000s of Jobs	% of Total	1,000s of Jobs	% of Total	1,000s of Jobs	% of Total	1,000s of Jobs	% of Total
TSX	87	25%	-36	25%	300	52%	12	22%
\$ CDN	38	11%	-11	7%	212	37%	-10	-18%
Raw Materials Price Index	-74	-21%	-21	15%	17	3%	13	24%
Mortgage Rate	90	26%	41	-28%	30	5%	1	2%
Real House Prices	191	54%	-94	65%	-14	-2%	28	50%
Unexplained	20	6%	-24	16%	32	6%	12	21%
Total Change in Employment	351	100%	-145	100%	577	100%	56	100%

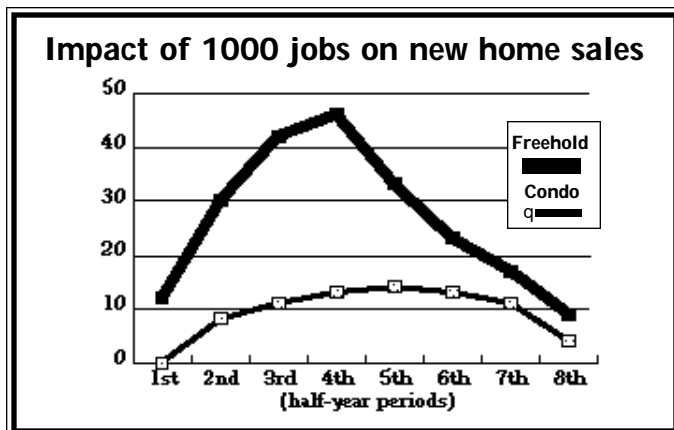
SOURCE: WILL DUNNING INC.

A number of mechanisms link a rising stock market with job creation:

- q Stock transactions and profits influence employment in the financial services industry.
- q With the substantial amount of invested wealth in the Toronto area, increased stock values lead people to spend more, which generates jobs.
- q Increased funds are available to start new businesses and expand existing businesses.

The statistical analysis in Chart 2 decomposes the impact of a number of key variables on employment in the Toronto area:

Chart 3



SOURCE: WILL DUNNING INC.

- q During the late 1980s ‘Boom’, increased wealth caused by the growth in real house prices had the most significant impact on employment. Significant amounts of stimulus were provided by other variables. The only negative factor was the rising prices of raw materials (RMPI).
- q During the subsequent recession, the biggest negative factor was falling house prices.
- q During the late 1990s, the rapidly inflating TSX stock index generated more than one-half of job growth in the Toronto CMA. The steady depreciation of the Canadian dollar provided additional stimulus. The only negative factor for employment was that house prices declined modestly in real terms.
- q Since August 2001, the greatest support for Toronto CMA employment has again been from rising house

prices. Falling prices for raw materials have also been positive. On the other hand, the Canadian dollar has been a negative factor.

Changes in employment do not affect sales in the housing market instantly. As an output from my forecasting models, I have estimated the lag effect between employment growth and sales of new homes in the GTA (Chart3).

In the first half year after 1000 new jobs are created, the result is only about nine new home sales. That rises until the fourth half year, when about 46 freehold sales and 13 condominium sales are generated – then the effect begins to decline.

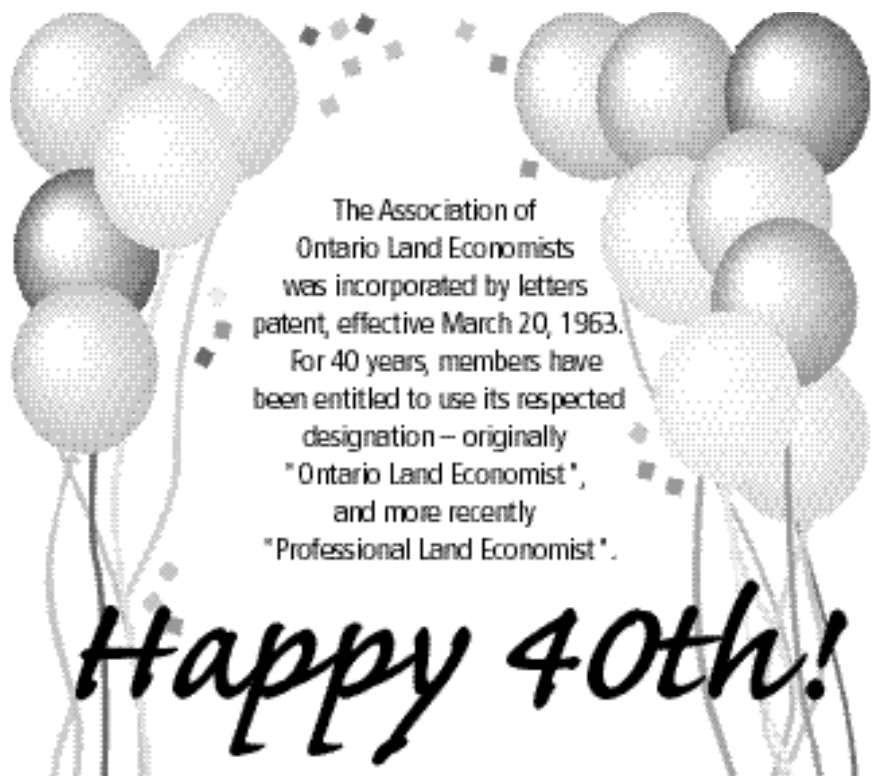
Conclusion

An excessive amount of employment was generated by the stock market bubble of the late 1990s. So far, the falling TSX has not had a very negative impact on employment, as there is still a slightly positive equity wealth effect.

However, in the near future, the TSX declines will likely begin to exert a significant negative influence on employment. It is possible that in the near future there will be outright reductions of employment in the Toronto CMA. That downturn should be gradual, as the recent increases in house prices, the depreciation of the dollar, and reduced interest rates will act to support employment.

Despite the economic slowdown, housing market activity so far has been exceptional. Previous employment growth has generated a very large pool of people who are getting into position to buy a home. During 2003 and 2004, that pool of buyers will be depleted gradually. In consequence, the outlook is for a gradual winding-down of housing market activity. After setting a new record in 2002 (expected to be 55,500 sales), new home sales are forecast to be in a range of 37,500 to 45,500 in 2003.

Will Dunning, an economic consultant who specializes in analysis of the housing market of the Greater Toronto Area, spoke at the November dinner meeting. Samples of his subscription "Forecast Report" on the Toronto economic and housing market outlook, and other recent reports are available at www.wdunning.com.



Welcome New Members!

Gregory Bell PLE

Royal LePage Commercial Inc.
Toronto
416-359-2638
gbell@royallepage.com

Gus Dal Colle PLE

Altus Group, Toronto
416-221-1200 ext 208
gdalcolle@thealtusgroup.com

Winson Chan FRI, MCFI, MBA, PLE

Del Realty Inc., Unionville
416-230-1681
winsonchan@rogers.com

Thomas Davis P.Eng, PE, PLE

Green-Tech Environmental
Engineering Ltd., Toronto
416-364-1760
tdavis@green-tech.com

George Lysenko MA, MCIP, CMM, PLE

Forhan Rogers, Newmarket
905-895-0011
glysenko@forhanrogers.com

William Nichols MSc, PQS, MCIQB, PLE

Mutual Gain Inc.,
Toronto
416-491-1711 ext 23
nicholsb@mutualgain.com

Sue Perella AIMA, PLE

Derbyshire Viceroy Consultants
Limited, Toronto
416-232-9999 ext 271
sperrella@derbytax.com

J. Douglas Shenton PLE

Wendy's Restaurants of Canada Inc.
Oakville
905-337-4645
doug_shenton@wendys.com

Tony Volpentesta MCIP, RPP, PLE

Bousfield, Dale-Harris, Culter &
Smith Inc.,
Toronto
416-947-9744
tvolpentesta@plannerbdhcs.com

The following analysis compares the costs for a typical industrial building of 100,000 square feet on 5.1 acres of land in four municipalities: the City of Toronto (represented by North York), Mississauga, Vaughan, and Pickering. Three options are considered: leasing an existing building, purchasing a building, and purchasing land and building a new facility.

While the market decides how much it will cost to build a new factory or lease an existing factory, the Province and local Government determine the taxes and development charges on new construction. The analysis considers those comparative factors due to market conditions (i.e. land costs, lease costs building purchase costs) and those due to municipal conditions (i.e. annual taxes, development charges).

Chart 1 Taxes, Maintenance & Insurance

	Toronto	Mississauga	Vaughan	Pickering
Tax rate	7.14%	4.06%	3.61%	3.58%
Assessed value	\$4,000,000	\$4,000,000	\$4,000,000	\$4,000,000
Total	\$285,600	\$162,400	\$144,400	\$143,200
Tax (\$/sf)	2.86	1.62	1.44	1.43
Maintenance/insce	1.50	1.50	1.50	1.50
TMI (\$sf)	\$4.36	\$3.12	\$2.94	\$2.93
Total TMI	\$435,600	\$312,400	\$294,400	\$293,200

Chart 2 Development Charges

	Toronto	Mississauga	Vaughan	Pickering
City (\$/sf)	0	1.83	1.25	1.15
Region (\$/sf)	0	2.60	2.5	1.39
School Boards (\$/sf)	0.23	0.48	0.36	0.18
Unit Total (\$/sf)	0.23	4.91	4.11	2.72
Total for Building	\$23,000	\$490,900	\$411,000	\$272,000
Other (\$/acre)	-	\$13,933	-	-
Total for Land	-	\$71,058	-	-
Total Dev't Charge	\$23,000	\$561,958	\$411,000	\$272,000

Assumptions

- q Building size 100,000 sf
 - Offices 10%
 - Industrial space 90%
- q Land 5.1 acres (45% coverage)
- q Construction costs \$40/sf
- q Annual financial carrying cost 6% (applied to full capital cost)
- q Assessed value for taxes \$4 million
- q Owner maintenance and insurance \$1.50/sf
- q Maintenance refers to outside maintenance such as snow removal and grass cutting and does not include building repairs and upkeep
- q Lease/sales data current as of 2002

Taxes, Maintenance & Insurance (Chart 1)

Whether you lease a building, buy an existing building or build a new facility; taxes, maintenance and insurance costs have to be paid.

Toronto's reputation for having a high municipal tax rate is justified, as industrial real estate taxes are more than double those of the other municipalities in our survey.

The tax rate is for property used specifically for manufacturing or processing.

Development Charges (Chart 2)

Regions and Municipalities assess all new construction a one time Development Charge. Our survey indicates that what Toronto receives on municipal taxes, it gives back (at least in part) in Development Charges. In fact,

Industrial report The Economi Industrial Bu

by Alastair H. Strachan

the City of Toronto is the only Municipality between Burlington and Pickering and north to Newmarket that does not levy a Development Charge. (There is an Education Development Charge in all Municipalities).

Leasing an Existing Building (Chart 3)

When it comes to leasing on an equivalent net rent per square foot comparison, Toronto is, surprisingly, the least expensive. The huge demand for facilities in the booming 905-area north and west of Toronto has pushed up the lease costs outside the city substantially.

Lease costs, however, account for only about half the occupancy costs; taxes, maintenance, and insurance may add another 50% to the occupancy cost and this is where Toronto falls back to the rest of the pack. The combination of municipal taxes, maintenance and insurance cost are almost 30% higher in Toronto than in the other Municipalities in our survey. Consequently, total occupancy costs for leasing are virtually the same across the GTA.

We have assumed that leasehold improvements are not required and that the leased space would be immediately available for occupancy.

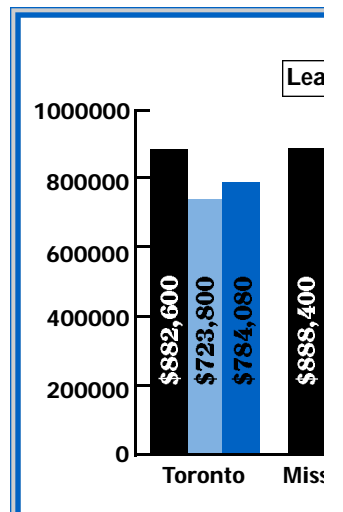
Purchasing an Existing Building (Chart 4)

The cost to purchase an existing building is remarkably similar across the GTA. However, the owner of a building has to pay the taxes, maintenance, insurance and utilities.

Once again, Toronto's taxes add significantly to the annual occupancy costs.

Note that frequently the industrial stock in Toronto is older and hence additional maintenance costs may be incurred. We have assumed that any building purchased is

Chart 6 — Annual Cost C



Cost of Selecting an Option for Building in the GTA

John Morrison, B.A. Hon, PLE

ready for occupancy and does not require renovating or upgrading. Note also that carrying costs and variable costs do not include additional administrative and overhead costs associated with owning a building.

Lease Construction (Chart 5)

Lease construction costs are essentially equivalent across the GTA (we have assumed \$40 psf). Land costs, on the other hand, vary considerably not just between municipalities but also within the municipalities themselves.

Toronto, contrary to popular belief, is not the highest cost municipality when it comes to industrial land for continuing industrial use in the former suburban areas of the City. The price, however, for industrial lands for redevelopment closer to downtown will be considerably higher. Pickering, where demand is lower, has the lowest land costs in our sample.

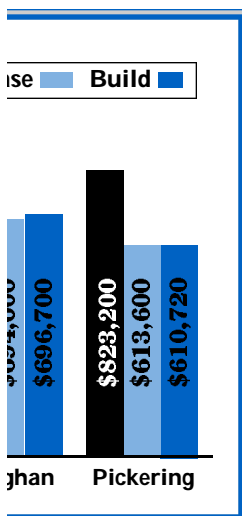
When all the components are considered (building, land and Development Charges), the total costs are surprisingly close across the GTA.

Building a facility has an advantage over purchasing or leasing an existing building in that the building can be designed to fit the Purchaser's needs. However, purchasing land and arranging and supervising construction is a time-consuming job that might divert considerable attention from operating the business.

Note that we have not allocated any costs for the time and effort needed to acquire permits, discuss with the architect and the builder.

Making the Comparison (Chart 6)

Based on our survey, building a new facility in Pickering is the least expensive. However when you consider that costs for various types of property can vary considerably, even within a municipality, there is little difference between various options.



After using the result of a market analysis to determine where to locate, you still have to decide whether to build, lease, purchase or build new. It is not an easy decision.

In fact, companies concerned about the high cost of real estate (typically the third largest business cost) often fail to ask the right question. The question is not "How can I minimize my real estate costs?" The question should be "How can I use real estate to enhance my business?"

There are other important questions to be answered, such as:

- q Where is the best labour pool?
- q How will transportation affect logistics costs?
- q Do I need to be near my suppliers?

- q How will financing affect the balance sheet?
- q Do I have the flexibility if I want to expand?
- q If I have to pay a premium to be in a particular Municipality, is the premium worth paying?

Alastair H. Strachan, Vice President & Sales Manager for Toronto Industrial & Land, at Royal LePage Commercial Inc., manages the suburban industrial sales force in Toronto. John Morrison, the company's Associate Vice President, Land Sales & Investments, specializes in commercial land sales in the GTA and surrounding municipalities. John is also Vice President of this Association, and its Membership Chair.

Chart 3 — Leasing an Existing Building

	Toronto	Mississauga	Vaughan	Pickering
Lease (\$/sf) 4.47	5.76	5.98	5.30	
TMI	4.36	3.12	2.94	2.93
Total (\$/sf)	8.83	8.88	8.92	8.23
Total Annual Cost	\$882,600	\$888,400	\$892,400	\$823,200

Chart 4 — Purchasing an Existing Building

	Toronto	Mississauga	Vaughan	Pickering
Cost of Building	\$4,970,000	\$5,830,000	\$6,660,000	\$5,340,000
Interest Rate	6.00%	6.00%	6.00%	6.00%
Carrying Cost/yr	\$298,200	\$349,800	\$399,600	\$320,400
TMI	\$435,600	\$312,400	\$294,400	\$293,200
Total Annual Cost	\$733,800	\$662,200	\$694,000	\$613,600

Chart 5 — New Construction

	Toronto	Mississauga	Vaughan	Pickering
Land cost/acre				
Low	\$250,000	\$300,000	\$400,000	\$150,000
High	\$450,000	\$450,000	\$500,000	\$250,000
Average	\$350,000	\$375,000	\$450,000	\$200,000
Building	\$4,000,000	\$4,000,000	\$4,000,000	\$4,000,000
Land	1,785,000	1,912,500	2,295,000	1,020,000
Dev't charge	23,000	561,958	411,000	272,000
Total	\$5,808,000	\$6,474,458	\$6,706,000	\$5,282,000
Interest Rate	6.00%	6.00%	6.00%	6.00%
Carrying Cost/yr	\$348,480	\$388,467	\$402,360	\$317,520
TMI	\$435,600	\$312,400	\$294,400	\$293,200
Total Annual Cost	\$784,080	\$700,867	\$696,760	\$610,720

There are disturbing signs that the world is on the verge of a global depression. If so, the challenges to the current structure of our society, Confederation, urbanism, and rural life, will be very demanding.

At the same time, there are always possibilities, even in a depression, and I am sure that Land Economists will rise to the occasion!

The emerging global depression

In essence, the problem is very simple: surplus capacity and a shortage of customers.

New markets such as China are growing rapidly. As a main focus for foreign investment, they are poised to increase global capacity and strip wealth from Europe and North America.

When trade barriers dropped, it was assumed that capitalism, market economies and democracy would spread almost automatically. This did not occur. Instead, huge areas of the globe (Russia, Africa, much of Latin America, parts of Asia, and most of the Islamic nations except Turkey) are full of people stuck in feudal, authoritarian and often corrupt regimes, with no capacity to learn how to create wealth. The domestic product of the entire Russian Federation, for example, is the same as the State of Illinois.

Until we solve this dilemma, we are stalled.

Long wave theory

We may, in fact, be at the end of the 65-75 year Kondratieff "long wave" – a time when war and depression are forecast to last several years until new technologies and economic activities replace the old and outmoded.

Judging by the history of major economic depressions, we might face the following:

- ❑ Numerous wars, possibly triggering upheavals in the Middle East and S.E.Africa
- ❑ New lows in the stock market and great destruction of wealth in a climate of deflation
- ❑ Increasing energy prices
- ❑ Weakening US dollars as Middle-Easterners dump the currency

Into depression & beyond

by Norman Pearson PhD, FISA, FRTPI, PLE, AICP, MCLP

- ❑ Impossibility of the US Federal Reserve propping up the economy
- ❑ A bursting real estate bubble and falling house prices

Beyond the upheaval, Kondratieff predicted a 30-year boom. The problem is getting there!

Implications for Canada

While the Canadian economy has performed better than the other G-7 nations (+3.6% in 2002), note that inflation was 4%. Since we are heavily dependent on trade, global depression could have significant implications, including:

- ❑ Great difficulty sustaining the hugely popular welfare state (an aging population, reduced revenues). That likely means increased tax burdens on younger taxpayers — a recipe for social unrest.
- ❑ Growing turbulence within Confederation, as demands for more support for the "have not" Provinces meet increasing resistance from Ontario, Alberta and British Columbia.
- ❑ International competition, driving down labour costs, and fuelling a need for younger immigrants. Unions will find themselves under pressure as plants close.
- ❑ Widening economic and social gaps, as deflation allows the cash-rich to pick up goods at ten cents on the dollar, while those in debt get poorer.
- ❑ Ongoing neglect of urban infrastructure. Today, despite special funding, we're not even keeping up with the past two decades of neglect. And we're still trying to build roads

considered crucial in the regional plans on which I worked 40 years ago! This will contribute to economic and competitive problems in the major cities and urban regions. On the other hand, electronic commerce and education may help allow new responses such as "planned scatteration" of growth among smaller urban centres with good infrastructure.

- ❑ Great struggles over the empowerment of local and regional governments, and the waste of passing tax monies up and down the Federal structure. Canada is no longer a rural country where tax resources have to be centralized in Ottawa to preserve stability and build a welfare state. Today, it is highly urbanized with dramatic variations in regional needs.
- ❑ Much concern over the survival of small rural municipalities. Rural populations will age rapidly and drop sharply, and we may discover that there is great difficulty in re-starting urban places effectively stifled by earlier, revenue-pushed amalgamations.

With everyone's attention on survival, the biggest challenge may be to remember – and plan for – the coming mid-century long-term economic boom, so as to avoid the "crash programs" of the 1950s and 1960s.

Challenges for Land Economists

There is an urgent need for theoretical development, based on thorough research, to understand and help society evolve into a new era. We also need to change our educational system to a new paradigm, which teaches people to create wealth for themselves, rather than be dependent on government.

Land Economists are an integrative profession. I suspect we have a huge role to play in the 21st Century, both in the depression and in the boom time beyond!

Dr. Norman Pearson is an international planning management consultant, and Dean of the College of Business and Political Studies, Greenwich University (Australia, Hawaii and California).

Add the aole.org website to your marketing plan!

by Konrad Koenig

One of the benefits of being a member of our Association is the exposure you get on internet search engines.

Search engine submissions for the Land Economists are done every 90 days to maintain a reasonable ranking with majors like Google, Yahoo, Altavista, Metacrawler, Dogpile etc. etc.

It makes sense for members to have their contact information and their personal descriptions current, so they can benefit when potential clients type in specific search terms or names, and visit our website.

The entire Membership list can be sorted by Last Name, Designations, Company, City, or Primary Practice Area (click on the headers).

The individual pages are even more useful. You can craft your own description of professional services to include terms or phrases that will attract clients' attention.

Members can upload their information 24 hours a day, seven days a week from ANY computer with an internet connection. On the Members page, click "update your record". If you have forgotten your Username and Password,



email webmaster@aole.org to request it. When you have updated your record the way you want it, be sure to click the SUBMIT button.

It makes sense to market your services economically. The web is an excellent vehicle and the business exposure from our Association will benefit you.

Konrad Koenig is 2002-2003 President of the Association of Ontario Land Economists.

The Legislative Beat *continued from page 8*

safety, consumer protection and nuisance control. Section 160 of the Act, however, enables the Minister of Municipal Affairs and Housing to exempt self-regulating businesses from all or any part of a municipal business licensing by-law.

On November 25, 2002, the *Municipal Statute Law Amendment Act, 2002* was passed by the Ontario legislature in order to improve the financial accountability for candidates in municipal and school board elections.

Alternative Energy and Fuels

While the handling of the hydro file remains a contentious issue, there is a concerted effort by the Tories to become 'greener'. Alternative Energy Commissioner Steve Gilchrist provided a year-end progress report on numerous government initiatives:

- q tax incentives for producers of clean power (e.g., 10-year corporate income tax break for new electricity generation from renewable energy sources)
- q tax credits for individuals purchasing solar panels

- q retail sales tax rebates for high-efficiency appliances
- q emission caps for power stations burning fossil fuel
- q proposed 10 per cent reduction in electricity consumption by the province's own operations, with a target of 20 per cent of electricity usage from renewable sources

Sustainable Water and Sewage Systems Act

On December 13, 2002, Royal Assent was given to Bill 175 following committee hearings at Queen's Park, Ottawa and Walkerton.

Spurred by Justice Dennis O'Connor's Part Two report of the Walkerton Inquiry, it requires municipalities ("regulated entities") to prepare Full Cost Reports and Cost Recovery Plans for the provision of water and sewer services. A late amendment enables municipalities to finance activities related to watershed-based source protection as long as the costs are linked to the delivery of water and wastewater services.

The province will retain the authority to cap water and sewer

rates but the Minister of the Environment can permit a municipality to exceed that cap in special circumstances. Accompanying Regulations must still be drafted.

Under the umbrella of the Clean Water Strategy, the government has also passed the *Safe Drinking Water Act, 2002* – which provides legislative authority to implement 50 of the 93 recommendations in Justice O'Connor's Part Two report.

There will be requirements for: licensing and accreditation of laboratories that test drinking water; certification and training of operators; an owner's licence, and a statutory standard of care for municipal water systems.

Andy Manahan is Development Promotion Representative, Universal Workers Union, Local 183, and this Association's Legislative Chair.



House in Recess

The Ontario Legislature starts sitting again on March 17.

New Minister of Municipal Affairs and Housing

Hon. Helen Johns, MPP for Huron-Bruce, has been named Interim Minister of Municipal Affairs and Housing following Hon. Chris Hodgson's announcement on Jan. 8 that he would step down to spend more time with his family. He will continue to represent the riding of Haliburton-Victoria-Brock until the end of the current mandate. Johns will retain her position as Minister of Agriculture and Food.

Provincial Election Readiness

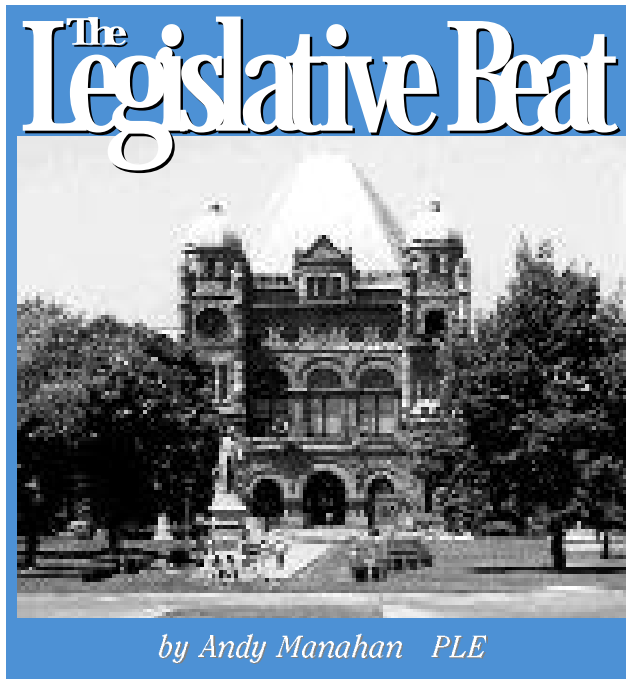
In anticipation of an election call, both the Liberal and NDP parties have released agenda documents. Liberal leader Dalton McGuinty has proposed:

q Creation of a permanent greenbelt of 600,000 acres around the Golden Horseshoe in order to curb urban sprawl. The Urban Development Institute/Ontario is critical of the establishment of urban growth boundaries as this would increase housing costs and foster leapfrog development.

q Repeal of the current *Tenant Protection Act*, which was implemented by the Tories in 1998. The reinstatement of real rent controls is contemplated in the "Growing Strong Communities" Liberal document. Rent controls would remain in place wherever vacancy rates remain below regional thresholds (e.g., three per cent).

In an open letter to McGuinty, the Fair Rental Policy Organization called the Liberal "challenge" to investors to "build your way out of rent controls" absurd, as legislative stability is paramount to encourage private rental construction.

q No new taxes. In a speech to a local chamber of commerce, McGuinty envisioned that \$3.5 billion in savings could be found by managing spending more prudently than the Tories.



NDP leader Howard Hampton also focuses on housing issues by recommending a two-year rent freeze or a rent rollback to 1998 levels (plus inflation). Local councils could opt out of this plan where the vacancy rate has exceeded three per cent for three consecutive years.

Property Assessment and Classification Review

On November 29, 2002, Ontario's Finance Minister Janet Ecker released MPP Marcel Beaubien's phase two report on property assessment and taxation issues. (The first report was delivered on April 2, 2001 to then Finance Minister Jim Flaherty.) Everything from car dealerships to floating homes to pipelines is covered in this latest document, including recommendations on:

- q treatment of small business properties
- q scope of the definition of the industrial property class
- q methodology of assessing farmland and classification of farm buildings

Beaubien also recommends combining the multi-residential property class with the residential class, and reducing municipal tax rates for multi-residential to the residential rate. With the goal of enhancing fairness, he further recommends that any property tax

savings be passed on to tenants under the provisions of the *Tenant Protection Act*. January 1, 2006, would be the deadline for full implementation of this recommendation by municipalities, except Toronto would be given another four years to fully merge the two property classes in recognition of its "unique circumstances". He also notes that the burden of this tax shift should not fall entirely on the residential class but across all property classes.

Statute of Limitations

In December, the House passed Bill 213, the three-part Justice Statute Law Amendment Act.

This allows lawyers' contingency fees, recognizes management accountants and certified general accountants, and includes long-sought changes to Ontario's limitation periods for legal actions.

It sets a standard two-year period for starting most actions, counting from when the claim is discovered. More importantly, it sets an "ultimate limitation period" of 15 years for most actions.

Today, there is no ultimate limitation – which leaves people with an open-ended potential of being dragged into lawsuits.

When proclaimed, the 15-year period will start from the time the work was actually done, so everyone will know when it has ended. Exemptions include undiscovered environmental claims.

Municipal Act/Elections

The new *Municipal Act* went into effect on January 1, 2003. A searchable electronic guidebook is now available at www.mah.gov.on.ca which will eventually cover all 18 parts of the Act. A regular review of the Act will occur every five years, beginning in 2007.

The new legislation gives municipalities broader "natural person powers", and recognizes a number of spheres of jurisdiction; however, municipal authority to impose taxes, fees, charges, incur debt or make investments is still governed by specific, more prescriptive sections of the Act.

Municipalities have authority to license businesses for purposes of health and

See Legislative Beat page 7