

INTERNATIONAL COUNCIL OF SHOPPING CENTERS

CANADIAN LAW CONFERENCE

TORONTO, ONTARIO

MARCH 4, 1999

CURRENT ISSUES IN QUEBEC PROPERTY TAXATION

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INTRODUCTION

In 1978, the Quebec Government entered into an agreement with the municipalities to restructure property taxation on the basis of municipal autonomy. Legislatively, this resulted in important amendments to *la Loi sur la fiscalité municipale*¹ ("LFM") that gave most of the property taxation powers to the municipalities and instituted a system that everyone involved felt was just, equitable and transparent. The taxation system was based on a market value approach to real estate and with respect to business taxes, the rental values of the place of business.

1998 UDI/ICSC Memorandum

In September 1998, the Urban Development Institute of Quebec ("UDI") and the International Council of Shopping Centers ("ICSC") jointly presented a memorandum to La Commission nationale sur les finances et les fiscalités locales (hereinafter "UDI/ICSC Memorandum"), that focused upon the problems inherent in the local taxation system, in large part brought on by a series of modifications to the LFM since 1988. These modifications may be summarized as follows:

- 1988:** introduction of the triennial role;²
- 1991:** introduction of the surtax on non-residential immovables ("Surtax");³
- 1992:** introduction of the "bundle of rights" notion in valuing a unit of assessment, with respect to owners and to tenants;⁴
- 1994:** introduction of the tax on non-residential immovables ("TNRI") in response to the constitutional challenge to the surtax;⁵

¹ RSQ (1977) c F-2.1.

² Section 14 LFM.

³ Sections 244.11 et seq LFM.

⁴ Section 45.1 LFM: "*For the purposes of section 43 to 45, the vendor is deemed to hold all of the rights of the lessee in respect of the unit of assessment.*"

⁵ Sections 244.23 et seq LFM.

- 1996:** dysynchronization of the 29 MUC roles, by which 10 municipalities must deposit biennial roles and the City of Montreal plus 18 Montreal Urban Community ("MUC") municipalities are entitled to freeze their triennial role, increasing the disparity in the market value of the reference year in respect of which the valuation was first established and the market value of the current taxation year for which the imposition is being made;
- 1997:** the Quebec Government's decision to download five hundred million dollars of expenditures to the municipalities who are already struggling with the need to balance their balance their budgets and distribute the tax burden between residential and non-residential components;
- 1998:** the passage of Bill 440,⁶ permitting role freezes in the City of Montreal and in 18 municipalities in the MUC, and introducing to the LFM, via Sections 253.51 to 253.53, the notion of stratified mill rates for classes of non-residential properties fitting within a median, higher and lower ranges of the valuation spectrum.

Contestation Matters

In addition, significant changes have been made to the property tax contestation system. On December 16, 1996, the Quebec National Assembly enacted an *Act Respecting Administrative Justice*⁷ which, according to Section 1, is intended to "affirm the specific character of administrative justice, to ensure its quality, promptness and accessibility and to safeguard the fundamental rights of citizens".

Section 14 of this act also established what is now known as the Administrative Tribunal of Quebec (or in French *Tribunal administratif du Québec* and hereinafter in this paper referred to as the "TAQ"). Section 17 of this act created four divisions, one of which is for immovable property.

⁶ L.Q. 1998 c. 43.

⁷ L.Q. 1996 c. 54.

On June 19, 1997, the Quebec National Assembly enacted the *Act Respecting the Implementation of the Act Respecting Administrative Justice*⁸, by which the TAQ replaced the Board of Revision as the initial forum of property tax contestation.

General Themes

This paper will focus upon the Surtax and TNRI, innovations to tax contestations and their implications for shopping centre leases, the effects of the triennial role system and subsequent role freezes upon the market approach objective, minimum and maximum tax increases and decreases, and the stratified mill rate system. Finally, in the course of discussing various problem areas, the writer will highlight the specific recommendations made by the UDI/ICSC Memorandum.

SURTAX AND TNRI REVISITED

Stabilizing Problems

Understandably, one of the Provincial Government's objectives through the property tax system is to maintain stability of municipal revenues from one year to the next. Not only must the municipalities continue to defray the cost of the services which they provide, but they must find new and innovative methods to combat their respective shares of the provincial government downloading.

As an example, Westmount, an affluent suburb within the MUC has just reported that it has reduced expenses by asking its employees to agree to a variety of cuts in labour costs, notably by decreasing in the City's contribution to the employee pension fund, a one year salary freeze, controlling expenses and continuing with a "pay-as-you-go policy" adopted in 1994, by which capital expenditures such as roads, vehicles and most buildings are paid out of the current revenue. To keep residential taxes stable, the Surtax was increased on an average of approximately 4.9% but even with this, the

⁸ L.Q. 1997 c. 43 ("Implementation Act").

commercial contribution is 30% of the overall Westmount tax burden while in 1980, the commercial sector bore 38% of the burden.⁹

However, commercial property owners still bear the financial risk of tenants not paying the Surtax or the TNRI (as the case may be), whereas if the tenants were charged business taxes directly by the municipality, the matter would be totally transparent and neutral to the owner.

In a very recent decision in the case of *Omniplast Inc. v. Nordic Development Corp.*,¹⁰ the Quebec Court of Appeal was faced with a gross lease for commercial premises requiring the tenant to pay:

TAXES: All municipal taxes normally paid by a lessee, such as water tax, business tax, etc., are to be paid by the lessee.

The municipality replaced the business taxes with the Surtax. Given that the Supreme Court of Canada had already ruled the Surtax to be a real estate tax and not, so to speak, a reincarnation of the business tax,¹¹ is the Surtax a tax for which the tenant should normally be responsible within the context of the clause? The Court of Appeal, reversing the Superior Court decision, ruled in favour of the landlord, concluding that the Surtax is a tax that "normally" could be paid by tenants.

Softening the Impact

The LFM provides the municipalities with some tools to mitigate some, if not all, of the adverse effects the Surtax and the TNRI create for property owners. Yet as the UDI/ICSC Memorandum points out, the experience has been less than satisfying.

⁹ This information is taken from a January 8, 1999 letter from Peter F. Trent, Mayor of Westmount, accompanying the 1999 residential tax bills.

¹⁰ CAM 500-09-001036-953 (JE 99-31), December 2, 1998.

¹¹ *Daniel Germain et al. v. The Attorney General of Quebec*, [1997] 1 S.C.R.1144.

Optional Aspects of the Surtax and The TNRI

Both the Surtax and the TNRI are optional, it being available to any municipality to charge business taxes alone,¹² or business taxes in combination with either the Surtax¹³ or the TNRI.¹⁴ As the UDI/ICSC Memorandum points out, over the last few years, municipalities have progressively abandoned their reliance on the business tax as a revenue source, necessarily forcing the owners of non-residential property to assume the role of tax collectors for the municipalities. They receive no reward for collecting but suffer the consequences of non-collection, as the owners must pay the deficiencies or risk losing their properties at a tax sale.

Vacancy Adjustments

Section 244.15 LFM permits a municipality imposing the Surtax to grant an abatement for vacant space. It is determined by the period of the actual vacancy. The owner is required to advise the municipality within 30 days of any change of status, failing which the owner is guilty of an offence and liable to a fine of \$500.00 and loses the abatement.¹⁵ Finally, there must be an annex to the role to determine the value attributable to vacant space, which, as the writer pointed out in the paper given to the 1998 ICSC Canadian Law Conference suffers from chronic inaccuracy. However, as the UDI/ICSC Memorandum points out, this is only optional and is used very infrequently by municipalities imposing the Surtax. The City of Montreal, being the one major municipality granting the abatement, has abolished it for 1999.¹⁶

Where the municipality imposes the TNRI, Section 244.27 LFM entitles the municipality to permit a reduction where the vacancy rate of the unit assessment exceeds 20%. As the UDI/ICSC Memorandum reports, this reduction is rarely given.

¹² Section 232 LFM.

¹³ Sections 233 and 244.11 LFM.

¹⁴ Sections 233 and 244.23.

¹⁵ Section 244.17 LFM.

¹⁶ In a February 2, 1999 communiqué to members, UDI finds this action deplorable, given the precarious financial position in which owners with vacancies find themselves.

UDI/ICSC Recommendation

The UDI/ICSC Memorandum strongly recommends that in the interest of equity and transparency, the government scrap the Surtax and the TNRI and return to the business tax system. This will once again establish a direct link between the municipality and the business occupant, who is the end user of the services the taxes support.

TRIENNIAL ROLES AND ROLE FREEZING

As mentioned in the Introduction, the philosophy behind the triennial role is to stabilize values over a three-year period, with a view to achieving commensurate stability of municipal revenues. Administratively, the triennial role eases the work load on the local assessors and reduces assessment preparation costs.

In an era of economic stability and prosperity, one might argue this would appear to generate a type of "win-win" result for all concerned. However, in a period of economic downturn such as we experienced through much of the current decade, the disparity between market value and assessed value has widened demonstrably. The disparity has been further compounded by a succession of role freezes, the most recent one being in 1999, for Montreal and 18 MUC municipalities,¹⁷ causing values in force in January 1, 1995 to remain in force until the end of 1999¹⁸. Among the list of 18

¹⁷ The 18 MUC municipalities are Anjou, Baie d'Urfé, Côte Saint-Luc, Dorval, Lachine, Lasalle, Montreal East, Montreal North, Town of Mount Royal, Outremount, Pointe Claire, Saint-Anne-de-Bellevue, Saint-Laurent, Saint-Leonard, Ville Saint-Pierre, Senneville, Verdun and Westmount.

¹⁸ Section 19 of Bill 440 states as follows:

The Communauté urbaine de Montréal may order that the real estate assessment roll and the roll of rental values of Ville de Montréal, in force since 1 January 1995, remain in force until the end of 1999. It may make the same decision in respect of all of the municipalities mentioned in Schedule B to chapter 67 of the statutes of 1996.

If the Community avails itself of the first paragraph in respect of Ville de Montréal, the next real estate assessment roll of the city and, where applicable, its next roll of rental values shall be drawn up for the fiscal years 2000 and 2001 and shall apply thereto. The fiscal year 2001 shall, in respect of those biennial rolls, be considered to be the third fiscal year for which a roll applies.

If the Community avails itself of the first paragraph in respect of all of the municipalities mentioned in Schedule B to chapter 67 of the statutes of 1996, the next real estate assessment roll for each municipality and, where applicable, its next roll of rental values, shall be drawn up for the fiscal year 2000 and shall apply thereto. The fiscal year 2000 shall, in respect of the annual rolls, be considered to be the third year for which a roll applies.

For the purpose of determining for which fiscal years the rolls subsequent to the biennial and annual rolls referred to in the second and third paragraphs must, in accordance with sections 14 and 14.1 of the Act respecting municipal taxation, be drawn up, the former are deemed to have been drawn up for the fiscal years 1999, 2000 and 2001, and the latter for the fiscal years 1998, 1999 and 2000.

The Community shall act through its executive committee.

municipalities is home to the largest regional malls within the MUC, such as Les Galeries d'Anjou (Anjou), Fairview Pointe Claire (Pointe Claire), Centre Rockland (Town of Mount Royal) and Place Vertu (Saint-Laurent).

Those who successfully convinced the government to extend the role freeze through 1999 argued that the substantial decrease in the value of non-residential real estate (particularly office buildings in the downtown core of Montreal which have been the most dramatically affected), the effects of provincial downloading upon municipal finances and the need to stabilize fiscal planning at the municipal level justify a further postponement of the inevitable.

The commercial real estate community views matters differently. Returning to basics, we find that Section 42 LFM states in part:

The role must indicate the value of each unit of assessment, on the basis of its actual value.

and that Section 43 LFM states:

The actual value of a unit of assessment is its exchange value in the free and open market, that is, the price most likely to be paid at a sale by agreement made in the following conditions:

- (1) the vendor and the purchaser are willing, respectively to sell and to purchase the unit of assessment, and they are not compelled to do so; and*
- (2) the vendor and the purchaser are reasonably informed of the condition of the unit of assessment, of the use that can most likely be made of it and of conditions in the real estate market.*

Section 45 of the LFM then continues on:

To establish the actual value of a unit of assessment, particular account must be taken of the incidence that the realization of the benefits or losses it may bring, considered objectively, may have on its most likely sale price.

The same principles, converted to a landlord-tenant type scenario, apply to the role of rental values used to assess the business taxes under Section 69.5 to 69.6 LFM.

Yet with the reference date to establish the market value for the 1995 role being July 1, 1993,¹⁹ the gap between the assessed value on the 1999 tax bills and the real value of the real estate in 1999 continue to widen.

UDI/ICSC Recommendation

Undeniably, the farther out the reference date is from the year to which the assessment applies, the greater the chances are that the assessment value will fail to reflect current market value. The UDI/ICSC Memorandum recommends reinstating annual valuations, both for real estate taxes and for business tax.

In the absence of political will to do so, the UDI/ICSC Memorandum recommends amending Section 174 LFM.²⁰ to oblige the assessor to modify the role to reflect both increases or decreases in the unit of assessment based upon substantial occupancy changes. For example, if a major tenant was to go bankrupt in the middle of a triennial role period, this could be reflected in both an immediate and an ongoing basis to parallel the almost instantaneous adverse effect that the vacancy creates upon the economic

¹⁹ Section 46 LFM, first paragraph states:

For the purposes of establishing the actual value used as a basis for the value entered on the roll, the condition of the unit of assessment on 1 July of the second fiscal year preceding the first of the fiscal years for which the roll is made, the real estate market conditions on that date and the most likely use made of the unit on that date are taken into account.

²⁰ Section 174 LFM **obliges** the assessor to adjust the real estate assessment in a variety of circumstances, both administrative, such as to reflect ownership changes and substantive, such as to account for "fire, destruction, demolition or disappearance" of immovables comprised in the unit of assessment.

value of the property, the ability to lease space and to renew leases upon economically viable conditions and the synergy the retailers bring to one another.

The effects of the 1997 Eaton's filing under the *Companies and Creditors Arrangements Act*²¹ provide an excellent practical example. Eaton's obtained court authorization to "abandon" any leased premises which Eaton's elected to abandon, in its effort to shed unprofitable locations and attempt to make the company once again economically viable. While the process may have been for the overall benefit of Eaton's creditors generally (many of whom had discounted their claims to vulture funds), the operational and economic effects upon those shopping centres losing Eaton's as a major anchor are still being felt and will continue to be felt until the vacant space, often in excess of 100,000 square feet, is once again absorbed and revitalized.

Unlike the abatement for vacant space in the case of the Surtax and the reduction for vacant space in the case of the TNRI which are both discretionary on the part of the municipalities, Section 174 LFM is mandatory. The UDI/ICSC suggested amendment would make possible reactions to dramatic changes created by situations such as the Eaton's abandonments.

THE NEW CONTESTATION PROCESS

Appeals

Prior to 1998, contestations were made before the Board of Revision,²² were appealable to the Court of Quebec²³ and final judgments of the Court of Quebec could be appealed to the Quebec Court of Appeal²⁴. The *Implementation Act* eliminated the Board of Revision, made the TAQ the court of first instance in property tax to contestation and to be consistent with Section 164 of the *Administrative Justice Act* which states that:

²¹ 1985 R.S.C. c C-36.

²² Section 138.5 LFM.

²³ Section 160 LFM.

²⁴ Section 170 LFM.

The Court of Quebec hears the appeal according to the evidence presented before the tribunal without further appeal lies from the decision of the Court of Quebec...

Section 170 LFM, which permitted appeals to the Quebec Court of Appeal, has been repealed.

Transitionally, proceedings before the Board of Revision filed before April 1, 1998 will still follow the old rules, while subsequently filed proceedings may not go beyond the level of the Court of Quebec.

What practical impact may this have in the future? First, unlike decisions which emanate from the various judges of the Superior Court, the Court of Appeal (and then perhaps ultimately upon leave, the Supreme Court of Canada), has the final say on matters of legal controversy. In property tax matters, this will be impossible without recourse to the Court of Appeal and quite possibly will result in principles previously established by Quebec's highest court being overruled by a lower court.

For example, while the Court of Appeal in the case of *Ville de Québec et al. v. Corporation d'assurance de personnes La Laurentienne*²⁵ considered that an automatic banking machine lodged in a metal casing that did not touch the wall was not an immovable for property tax purposes, a Quebec Court judge in the case of *Ville de Sillery et al. v. Communauté urbaine du Québec et al.*²⁶ considered counters and a refrigeration room used in the exploitation of an immovable to be immovable for taxation purposes. The supermarket industry will no doubt confront similar problems with its refrigeration and similar equipment.

²⁵ [1995] R.J.Q. 731.

²⁶ 200-02-005874-955.

Access to Documentation

The first paragraph of Section 18 LFM states:

Every owner or occupant of a property or his mandatary must produce or make available to the assessor or his representative, any information respecting the property that he requires for the performance of his duties, according as he requests him to produce it by means of a questionnaire, or otherwise, or to make it available.

This generally includes a rental role which includes the terms and conditions of leases, a summary of revenues and expenses and a statement of current operating expenses, which may be done on a normalized basis.

Who has a right to examine these documents? According to the second paragraph of Section 79 LFM, not only the owner but the occupant of a place of business may examine documents which are used for entries on the roll. This is very helpful for anchor tenants who are often involved in the decision as to whether or not the property taxes of a shopping centre are going to be contested, or are seeking to establish the value to be attributed to their premises for the purposes of determining their respective shares of property taxes.

If the assessor refuses the tenant access to the documentation, recourse may be had to the *Act respecting Access to Documents held by Public Bodies* (sometimes known as the *Access to Information Act*).²⁷, which will usually convince the assessor to be more forthcoming.

²⁷ R.S. Q. (1977) chapter A-2.1. See particularly Section 9, first paragraph:

"Any person making a request has the right of access to public documents."

Consultation

The application for revision must state the grounds the applicant intends to allege before the TAQ, if the debate gets that far. Thus appraisers and other experts that will be needed should be consulted immediately.

There is a form of consultative process which in most cases is optional and in the case of single-unit or institutional non-residential immovables is mandatory. According to Section 138.4 LFM, the window of opportunity is September 1st for contestations which must be filed by May 1st and in other cases, the later of September 1st following the date the roll first comes into force or four months after the filing of the application for review. This is a useful process in that it enables the taxpayer to discuss with the assessor a possible settlement of the dispute and a consequential adjustment to the roll.

Who May Contest?

Section 124 LFM grants contestation rights to "anyone having an interest in contesting the correctness, existence or absence of an entry on the roll relating to property owned by himself or another person (...)". Theoretically, any tenant that is required to contribute to property taxes would appear to have a statutory right to contest the valuation. In response, most form shopping centre leases require that the CRU tenants waive their contestation rights to avoid the adverse overall effects upon values that proliferations of tax contestation are likely to create.

Anchor tenants generally do not agree to waive their contestation rights. More often than not, the anchors do not pay a proportionate share of the real estate taxes, arguing that certainly on an income to value approach, and to a lesser or greater degree, even on a cost approach, the relative per square foot value of the anchor's premises is considerably less than the relative per square foot value of the CRU spaces.

Sometimes supermarkets, who often find themselves betwixt and between the low values of the department stores and junior department stores on the one hand and the high values of the CRU spaces on the other, may agree to pay a proportionate share,

but may have their own reasons for wishing to reserve certain contestation rights where specific principles (such as the taxation of refrigeration equipment) may impact many more stores within the chain.

Practical Considerations for Landlord and Anchor

As between the landlord and the anchor tenant, there are a series of concerns which should be raised:

1. Who will do the contestation, the landlord or the tenant?
2. Will there be other tenants involved in the contestation process?
3. If more than one of the "major players" (that is, landlord and one or more of the anchors) wish to contest, should the landlord take the lead and to what extent should the cost of the contestation be shared?
4. Section 147 LFM permits the tribunal to fix *"a lower or higher value than those proposed by the parties"*. If the valuation is increased, then who is responsible for what? Landlords often say to an anchor: *"If you cause the valuation of the unit of assessment to increase, then you should bear the risk of the entire increase in the taxes"*. The anchor may say: *"If I disagree with the contestation" and/or the value is increased as a result of someone else's doing (be it the landlord or another major), then I shouldn't have to support any of the consequences"*.

Given all of these concerns, it is the writer's view that the anchor should be invited into the consultative and contestation process from the moment that the developer receives its tax bills. Given the serious difficulties which many Quebec landlords have encountered in carving out of the overall valuation a portion to the anchor building and the land underneath, and then account for the taxes on the common areas, this may result in more efficient and timely resolutions of the problems.

Anchor With Ownership-Type Rights

The definition of "owner" in Section 1 LFM includes, in addition to a property owner, a usufructuary, an institute under a substitution and an *emphytéote* under an emphyteusis. Occupants under these arrangements will have a unit of assessment that is distinct from the remainder of the shopping centre and will be treated as the owner for tax contestation purposes.

These occupants, whether free-standing or physically integrated into the main shopping centre building, will be taxed separately and will bear the risk of unsuccessful tax contestations on their own units of assessment.

Nevertheless, it is useful for both owners, that is, of the shopping centre and the anchor premises, to require that the other owner provide receipted tax bills. This will assist in monitoring payment. It is also useful for one owner to be able to remedy the default by the other owner to pay taxes. This is particularly important where the anchor-owner is connected to the mall, as neither non-defaulter would want the city or its adjudicatee as owner of the contiguous property.

BILL 440 ISSUES

Recognizing that the rolls cannot be frozen indeterminably and that the new roles are bound to produce significantly lower values than those upon which the current roles have been based, but at the same time, recognizing the need to ensure stability of municipal revenues, and this all in the face of the provincial downloading, the Quebec Government, through Bill 440, brought certain modifications to the LFM to help municipalities absorb the financial impact.

Averaging

The first relates to averaging variations in taxable values. Since 1989, municipalities have been entitled to adjust values such that the taxable increases or decreases would be phased in over a three-year period. For example, a decrease in value from \$100,000 to \$70,000 would be phased in as follows: in year 1, the decrease would be

taken at the rate of \$10,000, in year 2, \$20,000 and 30,000 in year 3, \$30,000. The same would apply for increases so taxpayers would not have to absorb everything all at once. In reality, this has been characterized as a form of manipulating the taxes payable rather than adjusting the values themselves, despite the fact that the technique is legislatively framed in the form of adjusting value.

Prior to Bill 440, if a municipality chose to average, it had to do so both for the real estate assessment role and the role of rental values. Pursuant to the new Section 253.27, the municipality is given the choice as to whether averaging applies to either or both roles.

The Ceiling Abatement

The second technique is the abatement applicable to certain real estate taxes. This has been available since 1994 (Sections 253.36 LFM and following) and caps the amount of any increase in the real estate taxes payable at 10%. Formerly, this only applied to general real estate taxes. Section 12 of Bill 440 extends this to all real estate taxes the municipality imposes, including the Surtax and the TNRI.

One might surmise this to be convenient way of side-stepping the abatement for vacant space in the case of the Surtax and the reduction for vacant space in the case of the TNRI.

The Floor Surcharge

The third technique is found in Section 253.51 LFM, added by Section 14 of Bill 440. This entitles the municipalities to create a surcharge of the taxes payable for any particular year in order to limit the percentage of the reduction. Like the new abatement, it applies to all types of municipal property taxes and cannot be less than 10%, so that the reduction again would be phased in.

Stratified Mill Rates

Bill 440 adds Sections 253.54 to 253.62 to the LFM, entitled "*Transitional Diversification of the Rates of Certain Real Estate Taxes*".

Section 253.54 LFM permits the municipality to fix different rates for any of the taxes which it imposes. Section 254.55 LFM requires the municipality to create three classes (median, lower and higher) and Section 253.59 LFM requires the municipality to establish separate mill rates for each of the median class, a higher rate for the lower class and the lower rate for the higher class.

Once the levels are determined, they may not be changed, even if the role is changed. Thus, it is possible to successfully contest and reduce the valuation, yet if the property then falls into a lower class that is taxed at a higher rate, the taxpayer has really won the battle but lost the war!

The UDI/ICSC position on Bill 440 is very negative. Bill 440 continues to move the property valuation system further and further away from a market value approach to almost a status and capacity type of approach. It seems to favour placing the property tax burden on those who at first glance are best positioned to absorb the impact, while at the same time, certainly in the case of the Surtax and the TNRI, burden the owners with the credit risk.

A FINAL THOUGHT

In its numerous briefs and communiqués with the Quebec Government over the past decade, UDI has been arguing the case for more consultation and involvement of the business community in all property tax matters which affect their business interests.

The cover letter accompanying the UDI/ICSC Memorandum sincerely thanks the members of the commission for affording them the opportunity to present their views. The writer is advised by Mr. Cameron Charlebois, the President and Director-General of UDI Quebec, that aside from the memorandum, UDI and ICSC were given the

opportunity to explain their views before the Commission and were fairly and openly received.

Perhaps this in itself will signal a new chapter in the degree to which the government will solicit and seriously consider the interests and the concerns of the real estate industry, who are such a much a major contribution to the municipal coffers which are funded by property taxes.