CALGARY
ASSESSMENT REVIEW BOARD
DECISION WITH REASONS

In the matter of a complaint against the Property assessment as provided by the *Municipal Government Act* being Chapter M-26, Section 460(4).

between:

Altus Group Ltd. - Complainant

and

The City of Calgary - Respondent

before:

J. Schmidt, PRESIDING OFFICER
K. Kelly, MEMBER
J. Massey, MEMBER

This is a complaint to the Calgary Composite Assessment Review Board in respect of a Property assessment prepared by the Assessor of The City of Calgary and entered in the 2010 Assessment Roll as follows:

ROLL NUMBER: **068108794**

LEGAL DESCRIPTION: **Plan A Block 54 Lots 21-23**

FILE NUMBER: **58757**

ASSESSMENT: **$886,640,000**

This complaint was heard on June 17, 2010 at the office of the Assessment Review Board located at 1212 – 31 Avenue NE, Calgary, Alberta.

Appeared on behalf of the Complainant:
Doug Hamilton, Altus Group Ltd.

Appeared on behalf of the Respondent:
Roy Fegan, Assessor, City of Calgary

Property Description and Background

The subject property is known as Bankers Hall and is located at 855 – 2 Street SW in downtown Calgary. This property was developed, starting in 1987, as a two tower high-rise office complex having some 1.6 million square feet of office space and 190,000 square feet of retail space on four floor levels. For purposes of property assessment the building was classified as an "AA" office. The estimate of market value was determined by the application of the direct capitalization method of the income approach to value.

Issues:

In considering the complaint as filed, together with the representation and documents presented by the parties, the specific issues which are addressed in this case are as follows:

1. Office rental rate
2. Office vacancy rate
3. Overall capitalization rate
4. Leasable office area.

Board's Findings respecting each issue:

1. The typical market office rental rate for the subject "AA" class office space is $34.00 per square foot.

2. The typical stabilized vacancy rate for the subject "AA" class office space is 2.0%.

3. The overall capitalization rate for the subject "AA" class property is 6.75%.

4. Both parties are in agreement that the leasable office space is overstated and the final assessment should be adjusted.

Reasons:

1. Office Rental Rates

The Complainant submitted in evidence eleven 2009 lease transactions taken from lease deal documents showing various occupancy dates ranging from 2009 to 2012. These lease deals indicate a weighted average rental rate at $28.18 for "AA" office space. It was argued these lease deals were a clear indication of present date rental rates based on future expectations of a declining market due to, in particular, supply and demand of office space in Calgary. While the evidence supports an approximate $28.00 rate, it was requested that a reasonable typical market rent rate should be $30.00 to determine the assessment.

The Respondent countered that for purposes of completing the annual assessment the various property managers are requested to provide leasing information based on new leases during the year leading up to the July 1, 2009 assessment valuation date. That information indicates a weighted average at $38.49 for "AA" office space. Third party companies who track office net annual rent show second quarter 2009 lease rates ranging from $32.00 to $42.00. Even the Complainant's Insite report shows $35.19 as being typical for "A" office space. It was argued that lease deals, as presented by the Complainant, for post 2009 occupancy dates do not represent 2009 market. They may represent market rent for the future date of occupancy, however that is only speculation.

Rather than base an assessment on future rental contracts, actual new leases with occupancy start dates leading up to the July 1, 2009 assessment valuation date should be considered as the best indication of typical market rental rates. New leases which were reported show lease rates have dropped from the 2008 assessment year by approximately 15%. There is therefore agreement with the Complainant that the market was declining with respect to lease rates. The evidence supports a lease rate at $34.00 which was used in determining the subject property assessed value for the 2009 assessment in place of $38.00 which was used for the 2008 assessment.

The lease deals which were presented by the Complainant, in the Board's view, may have been simply transacted as a hedge against what may or may not happen in the future market place. As such, those contracts will not be considered as typical transactions for the 2009 "AA" office rental rates. There can be no doubt that large project leasing managers are confronted with and consider all the market forces which affect market rental rates. In this case, those managers reported lease rates, for the effective assessment year, having a weighted average of $38.49. As well, third party companies directly involved in the subject type leasing sales etc. report a second quarter 2009 rental rate for "AA" class office space ranging from $32.00 to $42.00. Placing the most weight on the property manager's reported 2009 lease start contracts the Board is convinced that the $34.00 lease rate used to establish typical market value in this case is reasonable.

2. Office Vacancy Rate

The Complainant submitted that historical data as supplied by CB Richard Ellis shows the downtown office vacancy rate for September 2009 at 12.6% compared to 4.10% for September 2008. In particular, the Class "AA" office vacancy inventory went from .00% to 8.4% in the same period. Approximately 90% of the subject office space is occupied by a single tenant, Encana. This tenant is developing a new office project known as "The Bow" scheduled for completion in 2011 at which time they will be vacating the subject office space. As a result the subject property will be subjected to a large vacancy in the near future. In addition to "The Bow" other major "AA" office towers are scheduled for completion which will result in a huge supply of "AA" class office space. The backfill or unleased space for these projects alone is estimated at some three million square feet. This combined with the space being vacated in existing property, will create an over supply of office space resulting in projected vacancy rates higher than 15% by 2012. In consideration of industry reported vacancy at 8.4% and the high projected vacancy in the near future, together with the fact that the major tenant in the subject property will be vacating some 500,000 square feet, this shows that the 2% vacancy rate used in the assessment calculation is too low. A reasonable stabilized vacancy rate at 10% should be applied in this case.

The Respondent took the position that for market value assessment purposes it is the actual market data that occurred during a particular assessment cycle which must be used. Each assessment year, property managers are requested to supply information respecting, in part, actual vacancy. The subject property manager's information reply, for the 2009 assessment year shows no vacancy as all of the leasable office space is leased. In fact most of the Encana space referred to by the Complainant, becoming vacant in 2011 is under lease contract until 2013 by Encana. There was a total of some 7.5 million "AA" class office space available for lease, as reported for the 2009 assessment on the information request form. Of the available space, 42,537 was reported as being vacant. This would indicate an actual vacancy rate of 0.564% for the 2009 assessment year. In addition, second quarter 2009 industry reports were reviewed. Those reports for "AA" class office space show:

Cresa	-	0.07%	second quarter, 2009
Avison Young	-	0.01%	second quarter, 2009
Colliers	-	2.29%	June 30, 2009
Barclay	-	1.60%	second quarter, 2009

Any future forecast which claims vacancy rate for "AA" office space could reach 10% to 14% is simply a forecast and has no bearing on the 2009 market condition. In consideration of the actual vacancies, as reported, as well as third party reports a reasonable stabilized vacancy rate at 2% was applied to all "AA" class office property in the direct capitalization method to market value.

There can be no doubt that a large inventory of new "AA" class office space is being developed and will be available. As a result it is true that the economic principle of supply and demand will be tested. To claim with certainty that there will be an oversupply of vacant space is highly dependant on market conditions as they unfold. While it is true that the players in the market consider the future, as the Complainant contends, that consideration is expressed in actual transaction which occurred at any particular time. In this case, the question is simply, did the market transaction which occurred during the 2009 assessment year show a vacancy rate for "AA" class office space to be greater than a stabilized 2%? To answer this question the Board looked to the evidence as presented by both parties. The Complainant's evidence shows a vacancy rate at 8.4% at the end of the third quarter 2009.

As well, a projected vacancy rate by 2012 of over 15% was argued. The Respondent's actual vacancy reported by property managers was less than 1.0% with industry reported vacancy ranging up to 2.29%.

The Board will rely on the actual market condition in 2009 which shows vacancy rates for "AA" class office space at less than 1.0%. Stabilizing the rate at 2% is reasonable and is accepted in this case. When the market shows higher vacancy rates that is the time to use the higher rate (stabilized) in the direct capitalization method of valuation.

3. Overall Capitalization Rate

The Complainant submitted firstly that the 6.75% capitalization rate used in estimating market value for the subject property was not determined in a fair and equitable manner. All class "AA" office properties in Calgary are assessed based on a 7.0% cap rate. Since the subject property is also classed as an "AA" at the very least a 7.0% cap rate should be applied in determining the final assessed value. Secondly, sales data show a cap rate of approximately 8.0% for "A" class office buildings. Since there were no "AA" class property sales available to analyze for purposes of developing a cap rate it is reasonable to reduce the "A" rate to 7.5% for an "AA" property. The fact that the major office tenant will be vacating the subject office space by 2011, leaving a large vacancy, would require a risk rate adjustment. The adjustment should be an increase in the cap rate of plus 0.05%. When this risk rate is added to the indicated market rate at 7.5% an overall cap rate of 8.0% is requested for purposes of determining the final assessed value.

With respect to the 6.75% cap rate the Respondent offered that in Calgary there are two "AA" class properties assessed by use of a 6.75% cap, "Bankers Hall: and the subject with all remaining "AA" properties having a 7.0% cap rate applied. It was submitted that the difference in cap rate was a result the various properties not being similar in relation to the retail component. The subject property was developed with a retail component of over 10.0% of the total property area, as in Bankers Hall. All other "AA" class properties have on average a 2.0% retail component.

Once all the office type properties were classified, each property was reviewed for similar and dissimilar features. In this case it was determined that the subject TD/Eaton Centre was unique and different than other "AA" classified properties. Bankers Hall was the other exception. The difference was due to the higher than typical retail component. Due to this higher than typical retail ratio it was reasoned that the income stream generated would accrue at a lower than typical risk rate resulting in a 0.25% lowering of the cap rate to 6.75%. The Complainant offered two sale transactions prior to the July 1, 2009 valuation date. Both of these sales are dated. The Gulf Canada Place sale took place on December 2007 and is classed as a "B" office. The Gulf Canada Place sale is clouded due to the fact that a large off site parkade 99 year lease was included in the transaction. The actual unadjusted cap rate is indicated at 5.28% compared to the Complainant's suggested cap rate at 8.03%. The Plains Midstream transaction appeared to be an arm's length sale. The actual unadjusted cap rate is indicated at 7.44% whereas the Complainant shows

7.69%. The other sale indicator supplied by the Complainant was a transaction as a result of a Court Order and occurred in February 2010 which was not available as of July 1, 2009 assessment valuation date. One other transaction for a "A" class property occurred in April 2008 with an indicated actual cap rate at 6.67%. In addition four "B" class properties transacted having an actual cap rate ranging from 5.42% to 6.11%. Since none of these transactions were for similar "AA" class properties the office industry cap rate reports were reviewed. Colliers show "AA" class properties in Calgary for the second quarter 2009 at a range of 7.00 to 7.50%. CBRE shows Calgary "AA" class at 6.75% to 7.25% for the second quarter 2009. Altus Insite show Calgary "AA" rates at 7.20% and trending up after the second quarter in 2009.

While the evidence is not compelling from either party respecting the cap rate, the Board is satisfied that a typical "AA" class office property in downtown Calgary can generate the 7.0% cap rate this is suggested by the industry publication. With respect to the subject "AA" class property, the fact that there is a retail component greater than typical would lead to the conclusion that it is different. The Board agrees that the difference in income stream due to the retail component should result in a lower risk rate. The 0.25% reduction that has been ascribed is reasonable and is accepted.

4. Leasable Office Area

Following a review of the total leasable office space in the subject property, there is an agreement that the space as assessed was overstated. A recalculation based on the correct space resulted in a revised total assessment at $883,020,000. Since both parties were in agreement respecting this issue, the Board will adjust the assessment accordingly.

Decision:

Having given careful consideration to the evidence, argument and facts which came forward in this case the complaint is allowed, in part.

Accordingly, the assessment is reduced to $883,020,000.

Dated at the City of Calgary, in the Province of Alberta, this 15 day of July, 2010.

for J. Schmidt, Presiding Officer

An appeal may be made to the Court of Queen's Bench on a question of law or jurisdiction with respect to a decision of an assessment review board.

Any of the following may appeal the decision of an assessment review board:

(a) the complainant;
(b) an assessed person, other than the complainant, who is affected by the decision;
(c) the municipality, if the decision being appealed related to property that is within the boundaries of that municipality;
(d) the assessor for a municipality referred to in clause (c).

An application for leave to appeal must be filed with the Court of Queen's Bench within 30 days after the person notified of the hearing receive the decision, and notice of the application for leave to appeal must be given to

(a) the assessment review board, and
(b) any other persons as the judge directs.