CITY OF CALGARY
ASSESSMENT REVIEW BOARD
DECISION WITH REASONS

In the matter of a complaint filed with the City of Calgary Assessment Review Board pursuant to Part 11 of the *Municipal Government Act*, Chapter M-26, Revised Statutes of Alberta 2000 (the Act).

BETWEEN:

Colliers International Realty Advisors, COMPLAINANT

and

The City Of Calgary, RESPONDENT

BEFORE:

J. Krysa, PRESIDING OFFICER
J. Kerrison, MEMBER
B. Jerchel, MEMBER

A hearing was convened on June 22 and 23, 2010 in Boardroom 11, at the office of the Assessment Review Board, located at 1212 - 31 Avenue NE, Calgary, Alberta in respect of the property assessment prepared by the assessor of the City of Calgary, and entered in the 2010 Assessment Roll as follows:

ROLL NUMBER:	**067230409**
LOCATION ADDRESS:	**540 – 5 Avenue SW**
HEARING NUMBER:	**58668**
ASSESSMENT:	**$70,340,000**

PART A: BACKGROUND AND DESCRIPTION OF PROPERTY UNDER COMPLAINT

The subject property is a downtown, central core, 22 storey office building known as the Aquitaine Tower. It was constructed in 1968, on a 21,480 square foot (sq.ft.) parcel of land, and contains a total area of 240,736 sq.ft. comprised of office space (231,505 sq.ft.), retail space (8897 sq.ft.), storage space (361 sq.ft.), on a base plate of 13,800 sq.ft., plus 82 parking stalls.

PART B: PROCEDURAL or JURISDICTIONAL MATTERS

The CARB derives its authority to make decisions under Part 11 of the Act. Although at the commencement of the hearing there were no preliminary matters raised by either party, during the course of the hearing, the Respondent raised the following jurisdictional matters:

1. An objection to the Complainant's exhibit C2, due to alleged non compliance with disclosure requirements set out in Alberta Regulation 310/2009, *Matters Relating to Assessment Complaints Regulation.*

2. A request that the Board dismiss the complaint, after the Complainant's evidence was presented, pursuant to s.2(1) of Alberta Regulation 310/2009, *Matters Relating to Assessment Complaints Regulation*, due to the absence of any evidence in support of the requested value of $17,590,000 set out on the complaint form. The Complainant's submission requested a value of $50,770,000.

With respect to the first preliminary matter, the Board allowed the Complainant's evidence to be presented. A review of the Complainant's disclosure to the Board indicated that the materials were sent to the Calgary Assessment Review Board. The Respondent conceded that the materials were sent, and indicated he would not require any additional time to review and respond to them.

With respect to the second matter, the Board denied the Respondent's request to dismiss the Complaint. The Board agreed with an earlier decision of the Calgary Assessment Review Board (J009/2010-P) submitted by the Complainant (Exhibit C5) for the same reasons.

PART C: MATTERS / ISSUES

The Complainant indicated the following matters in section 4 of the complaint form:
1. the description of the property or business
2. the name or mailing address of an assessed person or taxpayer
3. an assessment amount
4. an assessment class
5. an assessment sub-class
6. the type of property
7. the type of improvement

At the commencement of the hearing, the Complainant withdrew matters 1, 2, 4, 5, 6, and 7, and stated he would be providing evidence and submissions only on matter number 3, an assessment amount. The Complainant set out 15 reasons for complaint in Section 5 of the Complaint form, however, the Complainant stated only the following issues, condensed from the reasons in Section 5 of the complaint form, were in dispute:

Issue 1: Characteristics and physical condition of the property as of December 31, 2009
Issue 2: The valuation standard of market value
Issue 3: Fairness and Equity

The Complainant submits that a correct, fair and equitable assessment value is $50,770,000.

Issue 1: Characteristics and physical condition of the property as December 31, 2009

The Complainant submitted evidence of leases commencing or negotiated or signed up to December 31, 2009 (subsequent to the July 1 valuation date), and suggested that these lease rates reflected the improvement's characteristics and physical condition as at December 31, and should be used in the calculation of the market value assessment (Exhibit C1 pgs 29 – 44).

The Complainant further submitted that the improvement should be classified as a B- office building due to its location on the borderline of net rent zone DT1 (central core) and DT2 (mid-west), as well as the 1968 year of construction, and relatively small floor plate. This would suggest a rental rate lower than that of typical B office buildings in the heart of the central core, and a typical market rent of $24.00 was requested. There was limited evidence submitted with respect to specific physical attributes or building classification due to uncertainty over what class the building is currently assessed at.

The Respondent's evidence indicated that the building is currently classified as a B- Office, at a $26.00 market rent rate; as a result of several other reclassifications, net rent zone DT1 now contains only B+ and B- buildings, excluding exempt (institutional) buildings.

Decision- Issue 1 Characteristics and physical condition of the property as December 31, 2009

The Board finds the Complainant's position that the market rental rate as at the December 31 "condition date" is not appropriate in the calculation of an assessment at market value. As an assessment prepared in accordance with the Act must be an estimate of the value of a property on July 1 of the assessment year, lease rates that reflect typical market conditions as of July 1 are fundamental. There was no evidence provided to the Board that the characteristics and physical condition of the property had changed between July 1, the valuation date and December 31, the "characteristics and physical condition date" set out in *Municipal Government Act* s.289(2), to warrant a reduced July 1 net rental rate.

The Board accepts that the subject property is properly classed as a B- Office building in net rent zone DT1. Notwithstanding the Board's finding, the Board is very concerned about the capricious and misleading nature of the Respondent's evidence, to both the Complainant in an apparent attempt to be elusive with the subject's classification and related coefficients, and to the Board. The Board noted that had the Respondent been forthright about the stratification and corresponding coefficients the Assessor relied on, the Complainant would not have had to speculate on that matter in his submissions to the Board.

The Board also found the Respondent's Exhibit R1 confusing and contradictory. For example:

- Page 23 sets out the criteria used in the preparation of the assessment with office rents at $28/sq.ft.; an identical assessment is arrived at on page 37 with office rents at $26/sq.ft. Neither document specifies the stratification of the subject property for mass appraisal, or comparative purposes.
- The Board was advised by the Respondent that there were no B buildings in DT1, however page 61 lists 22 office leases, all identified as class B.
- Although the Respondent argued that the office inventory was classified based on the physical characteristics and attributes of each property, there was no explanation of why some properties were "re-classed" between assessment years, without any physical changes to the property. The Board accepts the Complainant's position that market reporting agencies and BOMA rarely alter a building class from year to year.

Issue 2: The valuation standard of market value (Rent, Vacancy, Capitalization Rate).

The parties were in agreement that the valuation standard applicable to the subject property was market value pursuant to s.6(1) of the Act, and that of the 3 recognized approaches to value, the income approach was most appropriate. The parties were also in agreement with the inputs (excluding the capitalization rate) applied to the retail, parking and "other" components of the building, therefore only the valuation inputs of the 231,505 sq.ft. office component was in dispute, as well as the overall capitalization rate for the property. The chart below indicates the rent, vacancy and capitalization rate utilized by the Assessor in the preparation of the assessment, as well as the corresponding values requested by the Complainant.

Inputs	Current Assessment	Complainant's Request
B- Office Market Rent {DT1}	$26.00/sq.ft.	$24.00/sq.ft.
B- Office Typical Vacancy	8.0%	15.0%
Capitalization Rate (All Components)	8.0%	9.0%

With respect to the inputs noted above, several sub issues arose regarding the proper methodology of determining these inputs which the Board will address.

- **Issue 2A:** Establishing typical market rent as of the valuation date

Should lease rate data of the 12 month period preceding the valuation date be time adjusted to the valuation date?

Is it appropriate to consider the date a lease is negotiated and signed, or does the commencement date of a lease reflect the market lease rate as of that date?

- **Issue 2B:** Establishing a typical vacancy rate

Should an assessment at market value take into consideration sublease vacancy in addition to headlease vacancy?

- **Issue 2C:** Establishing an appropriate capitalization rate

Should a calculated typical capitalization rate of a historical sale be recalculated to reflect changes in market rent, and vacancy since the sale date?

Decision - Issue 2 The Valuation Standard of Market Value - **Rent**

The Board finds that the correct rental rate for a B- class office building in net rental zone DT1 is $24.00/sq.ft.

Both parties presented tenant roll information of the subject property outlining the leases in place as of April 13, 2009 for the Respondent (Exhibit R1 pg 42), and as of Dec 31, 2009 for the Complainant (Exhibit C1 pg 21). As many of the subject property leases have been in place since the early 1990's, they are of limited value to the Board in determining the market value of the fee simple estate as of the valuation date of July 1, 2009. The only lease commencing in the assessment year of 2009, was a 5 year lease of unit 1510 granted to Access Pipeline Inc. at $32/sq.ft. commencing February 01, 2009. Rebuttal evidence from the Complainant indicated that negotiations and signing of the lease occurred in 2008, limiting the weight the Board applied to this indicator of market rent. Further, the Board will not look to one lease contract as being representative of typical market rent as of the valuation date without supporting evidence.

The Board was also provided with lease information from both parties pertaining to leases of all classes of office buildings in DT1 and DT2, which made it quite difficult to ascertain appropriate rates for the subject, especially when the building classes and the net rent zones were not always clearly identified. The Board appreciates the Respondent agreeing to provide Exhibits R4 and R5, and the Complainant's detailed analysis of leases commencing at page 29 of C1 and again in the rebuttal exhibits.

In light of the argument that office rental rates were in decline prior to, or subsequent to the valuation date, the Board looked to Class B leases signed in the second quarter (Q2) of 2009, to determine an appropriate lease rate for the subject, and examined the relationship to leases signed in Q1 and prior, within the evidence from both parties.

From Exhibits R1 (Pg. 61) and C6 (Pg. 19), the following DT1 leases were identified as commencing in Q2:

Class	Building	Month	Area	Rate	Assessed	Variance	Source	Total
B-	Can Mercantile Bank	April	3837	$28.00	$26.00	$2.00	R1	$107,436
B+	Eau Claire Place II	April	1297	$25.00	$28.00	($3.00)	R1	$32,425
B+	Grain Exchange	May	920	$26.09	$28.00	($1.91)	R1	$24,003
B+	Grain Exchange	May	500	$24.00	$28.00	($4.00)	R1	$12,000
B+	Hanover Building	April	2781	$21.50	$28.00	($6.50)	C6	$59,792
		Total	**9335**					**$235,655**
		Mean		$24.92				
		Weighted Mean		$25.24				
		Median		$25.00				

Based on the above evidence, the Board concluded that the Complainant's request of a $24.00 per sq.ft. rental rate was a reasonable estimate of typical market rent for a B- office as of the valuation date of July 1, 2009. Further, in light of the above evidence, and its relationship to the leases commencing in prior periods included in both parties submissions, the Board was persuaded to accept that Exhibit C4, a third party downtown office market report, appropriately reflects the downtown Class B office market, with Class B office rent rates at June 30, 2009 (Q2) to be approximately $23/sq.ft. for the entire downtown net rental zones. It would stand to reason that the DT1 properties would be somewhat higher than the average, and the DT2 properties would be somewhat lower than the average, confirming the range of market rents decided above.

The chart in Exhibit C4, also exhibits the following Class B approximate average rental rate values for the prior periods, and indicates that the decline in rental rates started to accelerate in the fourth quarter of 2008.

Quarter	Rental Rate
2008Q2	$36.00
2008Q3	$35.00
2008Q4	$31.00
2009Q1	$27.00
2009Q2	$23.00 (Current valuation date)

The Board noted that these values are supported by the CB Richard Ellis and Avison Young reports at pages 6 to 11 of Exhibit C8 and serve to support the Complainant's time adjustments to rental rates in rebuttal Exhibit C8.

Issue 2A: Establishing typical market rent as of the valuation date

- Should lease rate data of the 12 month period preceding the valuation date be time adjusted to the valuation date?

The valuation date is set out in legislation and in the opinion of the Board, time adjusting market rents to the valuation date is no less critical than time adjusting sales or any other market data to the valuation date. In a dynamic market, the average or median market rent of the preceding 12 month period will obviously be higher or lower (depending on the direction of the market) than the typical market rent as of the valuation date.

- Is it appropriate to consider the date a lease is negotiated and signed, or does the commencement date of the lease reflect the market lease rate as of that date?

In the opinion of the Board, validating lease agreements is as important as validating sales, and anything that may have affected a lease rate should be identified and taken into consideration. Lease renewals, with no exposure to the market, and lease agreements signed well in advance of the commencement date may or may not reflect market rent for that property. The Board appreciates that an assessor may not receive all of the information it requests of an assessed person, however the legislation provides an avenue to ask for the information required to properly analyze market data.

Decision - Issue 2 The Valuation Standard of Market Value - **Vacancy**

The Board finds that the correct vacancy rate for a B- class office building in net rental zone DT1 is 8%.

The evidence provided by both parties suggests that (headlease) vacancy rates for downtown class B office buildings range from 6.8% to 8.73% as of the valuation date, with the subject property exhibiting an actual vacancy rate of 2% as of April 13, 2009 from the Assessors Request For Information form (ARFI) (Exhibit R1 pg 40), and 7% as of January 26, 2010 (Exhibit C1 pg 27).

A rate of 8% appears to be a reasonable estimate of typical vacancy as of the valuation date for this class of building.

Issue 2B: Establishing a typical vacancy rate

Should an assessment at market value take into consideration typical sublease vacancy in addition to headlease vacancy?

The Complainant provided evidence of a sublease vacancy rate of 7.56% in Class B offices in the downtown net rent zones, and argued that this vacancy should also be deducted from the net operating income that is capitalized into value for the subject (Exhibit C1 Pgs 46–72).

The Complainant also argued that the sublease vacancy competes directly against vacant headlease space and further, that landlords contractually maintain control over vacant sublease space, although no direct evidence was provided to substantiate this argument.

The Respondent argued that as the building owners are currently receiving rent for the vacant space by way of the headlease, the income generated by the building and the resulting value are unaffected by the sublease vacancy.

The Board referred to s.2 of Alberta Regulation AR220/2004, *Matters Relating to Assessment and Taxation Regulation*

2. An assessment of property based on market value
   (a) must be prepared using mass appraisal,
   (b) must be an estimate of the value of the fee simple estate in the property, and
   (c) must reflect typical market conditions for properties similar to that property

With respect to s.2(b), the fee simple estate in the property reflects the value of all interests in a property, including leasehold interests as described in the Respondent's Exhibit R1 at page 8, "*The concept of Fee Simple requires the capture of **all** interests in a property, that of both lessor and lessee. The only way to capture this is through the application of current "Typical Market" coefficients in the calculation of Net Operating Income.*"

Typical market conditions (reflected in the coefficients) as per s.3(c) should reflect overall market vacancy rates regardless of who is legally in control of the properties via a lease contract (Fee Simple). In the same way that a lease contract above current market rates would reflect a negative leasehold interest to the lessee, sublease vacancy would also reflect a negative leasehold interest to the lessee.

The Board finds that although sublease vacancy is a component of typical market vacancy, there are dissimilarities from headlease space that must be taken into account. For example, contractual influences with respect to a lessor's potential control of the space, the typical marketing process of sublease space vs. headlease space, the different motivations of a headlease vs. a sublease lessor, the shorter remaining terms of sublease space, etc. As a result the Board finds that vacant sublease space cannot be awarded the same significance as vacant headlease space, however it clearly does represent a negative leasehold interest to the current tenant, and a future loss in value to the landlord when the headlease expires. To that effect, sublease vacancy represents a risk that the current headlease income is unsustainable, and the Board finds that this risk should be accounted for in the selection of an overall capitalization rate.

Decision - Issue 2 The Valuation Standard of Market Value - **Capitalization Rate**

The Board finds that an appropriate capitalization rate is 9%.

Both parties provided the Board with sales comparables in their submissions, including sales from the "Beltline" market area that the Board found were not comparable to the subject. Of the 7 sales of Class B downtown office buildings between 2006 and 2008, two were in the DT1 net rent zone, and exhibited capitalization rates of 8.36% (Apr 2007 sale) and 7.25% (Mar 2008 sale) calculated from typical market rents and vacancies at the time, as per MGB BO 145/07 (Exhibit C1 pages 74-76).

The Respondent submitted a chart indicating the capitalization rates applied to various classes of offices for the current and prior assessment, as well as three, third party Q2 capitalization rate summaries indicating current valuation date capitalization rates ranging from a low of 8.0% to 9.25% (Exhibit R1 pg 95). For Class B offices a rate of 8.0% was applied in the preparation of the current subject assessment, from 7.5% in the previous year, and the rationale for the selected capitalization rate was set out on pages 96 and 97.

The Board is mindful of the fact that the Assessor is obligated to determine an appropriate capitalization rate in the absence of any recent sales activity, and as with any subjective criteria, the Board is prepared to allow considerable latitude in that regard. The Board generally accepts the considerations set out on pages 96 and 97 of Exhibit R1, however in light of the significant amount of sublease vacancy in the market, the evidence of approximately 3 million sq.ft. of new office space currently under construction and coming on the market in the near future, the evident decline in typical market rents prior to and subsequent to the valuation date, (all of which appear to confirm that that the office market has changed direction since the 2007 and 2008 office sales); the selection of a capitalization rate at the lowest end of the range at 8%, appears to be very aggressive.

The Board notes that whereas an Assessor's typical market coefficients are generally determined from historic data up to the valuation date, participants in the market generally look forward in time. The selection of an appropriate capitalization rate is the assessor's only way to reconcile the differences, especially in a reversing market. Further, the trend of the market could be confirmed during the six month assessment preparation period if market data subsequent to the valuation date (post facto) is not ignored.

Issue 2C: Establishing an appropriate capitalization rate

Should a calculated typical capitalization rate of a historical sale be recalculated to reflect changes in market rent, and vacancy since the sale date?

Recalculating a capitalization rate of a historical sale using current typical market data would imply that regardless of economic changes in the marketplace, sale prices would remain constant and capitalization rates would be the variable. As is evident over time, sale prices of properties change to reflect the market conditions at the time of the sale; capitalization rates are a reflection of risk and market sentiment at a point in time, the sale date.

Issue 3: Fairness and Equity

The Complainant submitted that market rent rates for offices in classes A and C were adjusted downward from the prior years' assessment, however the same adjustment was not applied to class B offices, rather that the Assessor had merely re-classed some offices upwards to maintain a rental rate equal to that of the previous year, resulting in an inequity between classes. The Respondent provided limited evidence in this regard, but argued that the current rent rates represented typical lease rates for the current assessment year, and provided a list of comparable B- class offices all assessed with a $26.00 rental rate coefficient (Exhibit R5).

Decision - Issue 3 Fairness and Equity

The Board finds that the decision to revise the market rent coefficient to $24.00 as part of issue 2 above, would effectively address the matter of equity with amongst other classes of offices, which have been adjusted downwards from the prior assessment year.

PART D: FINAL DECISION

The assessment is revised from $ 70,340,000 to $ 57,880,000. It is so ordered.

Dated at the City of Calgary in the Province of Alberta, this 27 day of JULY, 2010

J. Krysa

J. Krysa
Presiding Officer

APPENDIX "A"

DOCUMENTS RECEIVED AND CONSIDERED BY THE CARB:

NO.		ITEM
1.	Exhibit C1	Complainant's Brief
2.	Exhibit C2	Comparable Sales Evidence
3.	Exhibit C3	Market Change Evidence
4.	Exhibit C4	Colliers International – Calgary Office Market Report
5.	Exhibit C5	Calgary Assessment Review Board Decision J009/2010-P
6.	Exhibit C6	Complainant's Rebuttal Evidence Part 1 of 3
7.	Exhibit C7	Complainant's Rebuttal Evidence Part 2 of 3
8.	Exhibit C8	Complainant's Rebuttal Evidence Part 3 of 3
9.	Exhibit R1	Respondent's Brief (251 pages)
10.	Exhibit R2	Appendix A – Municipal Government Board Decisions
11.	Exhibit R3	Appendix B – Judicial Review of MGB Order 145/07
12.	Exhibit R4	List of Class B+ Downtown Offices (2010)
13.	Exhibit R5	List of Class B- Downtown Offices (2010)

APPENDIX 'B"

ORAL REPRESENTATIONS

PERSON APPEARING		CAPACITY
1.	Scott Meiklejohn	Representative of the Complainant
2.	Harry Neuman	Representative of the Respondent

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 relates 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 persons 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.*