CALGARY
ASSESSMENT REVIEW BOARD
DECISION WITH REASONS

In the matter of the complaint against the Property/Business assessment as provided by the *Municipal Government Act*, Chapter M-26.1, Section 460(4).

between:

AEC International Inc, COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

H. Kim, PRESIDING OFFICER
S. Rourke, MEMBER

This is a complaint to the Calgary 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:	**094204807**
LOCATION ADDRESS:	**4201 52 St SE**
HEARING NUMBER:	**60311**
ASSESSMENT:	**4,110,000**

This complaint was heard on the 5 day of August, 2010 at the office of the Assessment Review Board located at Floor Number Four, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 5.

Appeared on behalf of the Complainant:

- *Cameron Hall*

Appeared on behalf of the Respondent:

- *Jason Lepine*
- *Jarrett Young*

Property Description:

The subject is a 52,175 sq. ft. self-storage facility built in 1998 on a 3.01 acre (131,320 sq. ft.) parcel of land in the Erin Woods district. It is a one storey concrete building with 20% of the units climate-controlled. It is assessed on the cost approach with land at market value of $1,737,124 and buildings valued using Marshall and Swift Estimator at $2,377,799 for a total value of $4,114,923 truncated to $4,110,000.

Issues:

The Complainant identified the following issues on the Complaint form:

1. The assessor is required to take into account the principle of equity in arriving at the assessment. The property has been valued on the cost approach as, we are advised, it is special purpose. Excessive over-valuation results. Existing self-storage facilities cannot be reliably or equitably valued using the cost approach to value. They are not special purpose property.
2. The property assessment is in excess of the legislated market value standard required by the Municipal Government Act and regulations. Regardless of the methodology used, all forms of depreciation must be accounted for. All forms of depreciation are not accounted for.
3. The assessment of this property is in excess of the value evidenced by sales of comparable property
4. Such further and other facts or grounds as are identified through disclosure of the manner in which the assessment was, and similar assessments were, prepared and as the equity analysis develops through amended notices and/or board decisions.

At the hearing, the issues heard and argued were:

1. Self-storage facilities are not special purpose property and should be assessed based on their income-producing capability, not using the cost approach.
2. The assessment is inequitable with other similar properties in the municipality.
3. The assessment is greater than market value.

Complainant's Requested Value:

$2,750,000 revised to $3,050,000 at the hearing.

Board's Decision in Respect of Each Matter or Issue:

Issue 1: Assessment using cost or income approach

Complainant's position:

The assessment was calculated using the cost approach to value. The Respondent states in his submission "the cost approach has been utilized for special purpose buildings which have limited sales or income information." Self-storage facilities are not special purpose buildings and there is income information readily available. In fact, the Respondent has been requesting income information since 2008, as evidenced in their submission.

The Complainant submitted a decision of the Municipal Government Board, DL047/10 in which the MGB agreed that self-storage is not special purpose property, as well as an excerpt from the Appraisal Institute document Market Analysis and Valuation of Self-Storage Facilities, Richard Correll (2003):

> **For an Existing Project**
> There is no doubt that the cost new to replace a project is important information for any appraiser. The replacement cost of a project suggests the cost of entry into the market and is relevant when an investor is considering whether to buy or build a facility. The problem arises when the cost analysis becomes a tool for valuing an existing project. Investors simply do not use depreciated cost as a basis for making purchasing decisions so this approach is not directly tied to the market.
>
> **Conclusion**
> In the valuation of existing self-storage properties, the cost approach is generally not relevant for several reasons:
> 1. The estimates of value generated by the sales comparison and income capitalization approaches are often well-supported and persuasive, while the depreciation estimates needed to apply the cost approach are often difficult to support.
> 2. Market participants including owners, investors, developers, and brokers do not rely on depreciated cost estimates as a basis for estimating prices.
> 3. The cost to replace an existing property has little relevance to the "as is" value of the property.

He also submitted an excerpt from the Alberta Assessors Association Valuation Guide – Special Purpose Properties that states in its introduction:

> The methods described in this valuation guide are designed to suit special purpose properties that typically possess the following characteristics:
> - Properties that typically do not rent, or where there is no rental information available.
> - Properties that do not sell, or where the sale typically reflects both a business and real estate transaction.
>
> The valuation guide is *not* designed to apply to the valuation of:
> - Typical warehouses (see the Warehouse Valuation Guide),
> - Multi-tenanted industrial properties, or
> - Other types of industrial or commercial properties that typically generate income.

Self-storage facilities trade to investors based on income. The principle of substitution and the cost approach is generally only useful when making development decisions, if one can build for less than the cost to purchase. This provides a soft cap on market value, but does not address market influences and can yield wildly unreliable estimates, both high and low. The business value of a self-storage business is inseparable from the value of its real estate, and its value reflects actual market rent, unlike conventional industrial or commercial buildings which often have long-term leases at rates that do not reflect the current market. To that extent it is more like hospitality property where room rates always reflect current market value.

Respondent's position:

Prior to 2006 industrial property was assessed based on income. In 2006 the valuation method for warehouses was changed to direct sales. At that time self-storage facilities were changed to the cost approach. In 2007 the property was assessed on the cost approach for $2,920,000. The following year it was moved to the sales approach and assessed for $6,690,000 on the basis that it had been sold on the open market for $7,450,536 and the cost approach was clearly not reaching the market potential of the property. In 2009 it remained on the sales approach and originally assessed at $9,690,000. The 2009 assessment was appealed by a different agent with a requested assessment of $6,500,000 based on income. The 2009 assessment was recalculated on the cost approach and amended to $3,870,000. The City values typical industrial property on the sales approach and non-typical property on cost. The 2010 assessment remains on the cost approach.

Decision and Reasons:

The Act and regulations do not mandate the use of any particular approach in valuing property; however, the valuation standard is market value (Section 293 of the Act and 6 of Alberta Regulation 2004/220 Matters Relation to Assessment and Taxation):

> **293(1)** In preparing an assessment, the assessor must, in a fair and equitable manner,
> (a) apply the valuation and other standards set out in the regulations, ...
>
> **6(1)** When an assessor is preparing an assessment for a parcel of land and the improvements to it, the valuation standard for the land and improvements is market value ...

The Board notes that the Respondent's submission describes the three approaches to value: sales, income and cost, and states: "The valuation approach chosen emulates the approach and analysis taken by parties in the relevant market." The Board is persuaded the Complainant's evidence that the cost approach does not emulate the approach and analysis taken by the parties in the self-storage market.

Ultimately, it is not the choice of approach, but the closeness to which the assessment value approximates market value that determines whether the assessment is in accordance with the Act and regulations. The Board does not have the jurisdiction to direct the use of a particular approach to value in determining an assessment.

Issue 2: Equity with similar properties

Complainant's position:

The use of the cost approach results in obvious inequities between the subject and other self-storage properties. The Complainant presented two comparable self storage facilities in reasonable proximity:

1. StorageMart at 15216 5 St SW is 46,872 sq. ft. compared to the subject at 52,175 sq. ft. and 2 years newer than the subject. It is constructed with a steel/wood frame and a stucco/masonry exterior and is given 39% depreciation compared to 9% for the subject. It has significantly better sales performance than the subject and would be valued at roughly twice the value of the subject, but the assessment of the comparable is $62/sq. ft. compared to the subject at $79/sq. ft. Both properties are built in clover-leaf verge locations and would be expected to have the same economic life, there is no basis to suggest that the subject concrete self-storage facility should only have 9% when the comparable has 39%. If the cost approach is used, all forms of depreciation should be taken into account. The subject should have 45% depreciation to account for being two years older than the comparable.

2. Maple Leaf Storage at 803 64 Ave SE is a new, 100% climate-controlled, 4-storey 178,500 sq. ft. self-storage warehouse with a 41,293 sq. ft. conventional multi-tenant warehouse on a 5.45 acre parcel prominently located at the Glenmore/Blackfoot interchange. The total assessment of the property is $9,320,000. Removing $4,500,000 from the assessment for the value of the warehouse (the assessment of an older smaller warehouse located directly north of the Maple Leaf facility), the value of the self-storage facility is 4,840,000 or $27/sq. ft. compared to the subject at $79.

Respondent's position:

The difference in depreciation is due to the difference in construction methods. Single storey buildings cannot be compared with multi-storey buildings, and comparing the assessment by extracting the value of the conventional warehouse based on the assessment of a neighbouring stand-alone warehouse is not reasonable.

Decision and Reasons:

The Board finds that the subject is assessed inequitably with 15216 5 St SW. The Boards is satisfied that the relative market value of self-storage facilities would be based on their relative income-generating potential, all other factors being equal. The Board was presented with no evidence that the comparable performed better than the subject, but agrees that it is in a similar location and would be expected to generate similar revenue.

With respect to the Maple Leaf facility, the Board agrees that multi-storey and single-storey facilities are not comparable and that extracting the value of the warehouse portion based on the assessment of a separately titled neighbouring warehouse may not yield an accurate value for the self-storage portion. Nevertheless, with a total floor area of 4.2 times the subject in a substantially better location, its assessment reinforces the inequity noted in the first comparable.

Issue 3: Market Value based on Income

Complainant's position:

The subject property sold in April 2007 in a portfolio sale of 11 self-storage facilities across Canada. He presented an appraisal prepared for the purchaser on April 1, 2007 for acquisition and financing purposes. The opinion of value at the appraisal date was $6,600,000 based on an income analysis using potential revenue of $1.43/sq. ft. and other revenue of 7.2%, stabilized occupancy of 90%, operating expenses of 36% and 7.25% cap rate. The Complainant presented charts that showed the monthly rent per occupied sq. ft. in the period January 2008 to December 2009. Self-storage units rent on a month-to-month basis with termination on 15 days' notice; therefore rental rates always reflect current market value. The rate varied from a low of $1.30 to a high of $1.45/sq. ft. over the past year with a rate of $1.30 at July 2009 and further declines thereafter to $1.25 in December 2009. The occupancy rate was also charted over the same period and increased from a low of 70% in July 2008 to a high of 80% in July 2009 before declining to 75% in December 2009. He presented a survey of operating expenses from seven Alberta facilities to support 3.7% in other revenue and 50% operating expenses. This resulted in a typical net operating income of $295,402 for July 2009 compared to $477,395 in April 2007.

The Complainant presented a number of sales to support his requested cap rate. He submitted that while allocation of individual property values in a portfolio sale is a known challenge, the portfolio-wide capitalization rates are relevant and reliable. The argument against using portfolio cap rates is that the sale price includes a flag premium, which is difficult to calculate. For the purposes of this complaint, the use of cap rates from portfolio sales would result in a higher value therefore no adverse inference can be drawn. The reported cap rates from 2002 to 2010 were plotted and compared to Colliers International Calgary Industrial cap rates. Generally the self-storage cap rates trend within a range of .5% to 1% between highest and lowest rates, and the lower range trends .5% to 1% above the reported Industrial cap rates.

The Complainant selected 9.7% cap rate from a 9 to 10% indicated range in July 2009, due to the dated configuration of the subject and having only 20% climate controlled units. A 9.7% cap rate applied to the net operating income results in the requested value of $3,020,000.

<u>Respondent's position:</u>

The Respondent presented the RealNet industrial transaction summary from the April 2007 sale showing the sale price as $7,450,536. The Complainant's request of $3,020,000 is less than half of the sale price. The Respondent disputed that the property could have dropped so significantly from the sale date. In support of this, he presented the Assessment Request for Information reports for the subject from 2008, 2009, and 2010. Rent rolls were provided in 2008 and 2010 but in 2009 accompanied only by the notation "no change vs. last year". He presented an analysis of the report that showed the vacancy rate had actually dropped between the 2008/09 ARFI and the 2010 ARFI, and that the rental income had not significantly changed. The only significant change is the cap rate, which is presented at 9.7% from 7.25% in the 2007 appraisal. The Respondent questioned the sales presented as only five were in Calgary, of which four were portfolio sales. Cap rates derived from sales in Blackfalds and Innisfail could not be used to support a requested cap rate in Calgary. Therefore the assessed value is reasonable and should be confirmed.

<u>Decision and Reasons:</u>

The Board finds the assessment of the subject is in excess of its market value. The rent rolls provided in the ARFI are for a particular month, and cannot be relied on as indicative of the performance over the year. The graphical evidence of the Complainant shows that income and occupancy vary substantially from month to month but a best fit curve can indicate the trend. With respect whether a significant drop in value relative to the April 2007 could be reasonable, the Board notes that the comparable at 15216 5 St SW sold in October 2006 for $8,500,000 and the 2010 assessment is 2,890,000.

The Board finds the income analysis to be reasonable, however agrees with the Respondent that the cap rate should not be based on sales in smaller communities outside of Calgary. The capitalization rate is a measure of risk of the income stream, and the Board does not agree that the risks would be the same for commercial properties is small population centres as for larger ones. With respect to whether a higher cap rate could be supported due to the dated configuration and lack of full climate control in the subject, there was insufficient details provided to determine whether or not the sales shared some of the same characteristics.

The Board agrees that individual allocations of value on a portfolio sale may be unreliable, for example the subject sale price appears to be simply based on the proportionate floor area of the total sale. However, provided the properties within the portfolio share the same risk profile, the overall cap rate can be of assistance. On analysis of the sales presented, the Board determined the best suggestion of an appropriate cap rate would be that of the November, 2008 sale of 8 properties in major urban centres including Calgary, Toronto and Vancouver, for an overall cap rate of 9.2%. The general trend showing self-storage facilities have a cap rate about 1% higher than industrial also supports a 9.2% cap rate.

Board's Decision:

The complaint is allowed, in part, and the assessment is reduced to $3,210,000 based on a 9.2% capitalization rate applied to the stabilized net operating income.

DATED AT THE CITY OF CALGARY THIS 19 **DAY OF** August **2010.**

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 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.