CALGARY
ASSESSMENT REVIEW BOARD
DECISION WITH REASONS

In the matter of the complaint against the property assessment as provided by the *Municipal Government Act*, Chapter M-26, Section 460, Revised Statutes of Alberta 2000 (the *Act*).

between:

PALLISER SQUARE PROPERTIES LIMITED, COMPLAINANT,
as represented by ALTUS GROUP LIMITED

and

THE CITY OF CALGARY, RESPONDENT

before:

T. Helgeson, PRESIDING OFFICER
Y. Nesry, MEMBER
D. Cochrane, 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 2012 Assessment Roll as follows:

ROLL NUMBER: 068230408

LOCATION ADDRESS: 131 9th Avenue SE

HEARING NUMBER: 67020

ASSESSMENT: $35,290,000

This complaint was heard on the 13th day of September, 2012 at the office of the Assessment Review Board located at Floor Number 4, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 1.

Appeared on behalf of the Complainant:

- *S. Meiklejohn*

Appeared on behalf of the Respondent:

- *R. Fegan*
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Board's Decision in Respect of Procedural or Jurisdictional Matters:

[1] At the outset of the hearing, the parties requested that material from the previous hearings, including questions and answers, applicable and relevant to this hearing be carried forward. The Board consented to the request of the parties.

Property Description:

[2] The subject property, Tower Centre, is a four storey office building behind and to each side of the Calgary tower in the "DT1" economic zone of downtown Calgary. Constructed in 1969, the subject property has a total assessed area of 260,083 sq. ft. The C.P.R. railway tracks abut the subject property on the south. The assessment recognizes the following influences: Traffic Main, Abutting a Train Track, and Shape Factor-reduced functionality.

[3] As assessed, the subject property has been given a quality rating of Class "B-" The assessment is based on the income approach, with a capitalization rate ("cap rate") of 7.50%. Parking for the subject property is on a separate parcel of land.

Issues:

[4] The Board found the issues in this complaint to be as follows:

1. Is the office space of the subject property assessed at rental rate beyond what a Class B- building comparable to the subject property is capable of achieving?
2. Is the retail space of the subject property assessed at a rental rate beyond what a Class B- building comparable to the subject property is capable of achieving?
3. Has floorspace that is exempt on other Roll numbers been included in the assessment?
4. Is the assessed vacancy rate of the subject property too low?
5. Should the cap rate used in the assessment be increased from 7.50% to 9.00% to better reflect risk and its effect on the value of the subject property?

Complainant's Requested Value: $23,820,000, with a 9.00% cap rate; $21,670,000 with exempt space removed.

Summary of the Complainant's Submission

The Issues

[5] The issues in this complaint are similar to those of other properties heard this week, i.e., office rental rates, retail rental rates, vacancy, and the capitalization rate ("cap rate"). There is also some exempt space in the subject property that will require an adjustment in the requested assessment, if confirmed.

[6] The subject property was formerly classed as a "C" building. If there is vacancy on sublease space, it indicates risk, because the sub-lessee might not renew. The level of risk is higher than it was in 2008, thus the cap rate should reflect that risk. We request 9.00% for the cap rate.

Building Characteristics

[7] Location and age influence economic performance. The subject property was constructed in 1969; it is an old building, it abuts the railway tracks, and there is no parking on this roll number. Aspen purchased the subject three or four years ago with a view to redevelopment. Aspen applied for an development permit, and they received one.

[8] In 2013, Aspen will begin construction of the first of two office towers in 2013. The tower will be located on the east side of Calgary Tower. The part of the subject property west of Calgary Tower will soon be cleared out. In view of what is going to happen, the subject is closer to a C or even a D building.

Exempt Space

[9] The assessment includes two spaces, one of 6,918 sq. ft., the other of 33,117 sq. ft. Both spaces are exempt, and are under their own Roll numbers. The first is under Roll #201391299, the second under Roll #068230408. The 6,918 sq. ft. is assessed at $98.66 per sq. ft., and the 33,117 sq. ft. space is assessed at $43.15 sq. ft. Removal of these spaces from Roll #068230408 will also serve to reduce the assessment.

Vacancy

[10] As assessed, the vacancy allowance is 8.00%. The vacancy allowance should be no less than 10%, consistently applied to all types of space, except low profile space. The actual vacancy rate for the subject property is 3.80%.

Rental Rates

[11] Office space, currently assessed at $15 per sq. ft., should be no more than $12 per sq. ft. There are four leases in the base year. The high lease is at $16 per sq. ft., the low, $12 per sq. ft.

[12] At p. 66 of Exhibit C-1(a), there is an analysis of 13 office leases in downtown B- buildings located in DT1, except for the lease in the building at 435 4th Avenue SW, which is not a B-

building. The weighted average of these leases is $13.63 per sq. ft., which appears to support a rate of $14 per sq. ft. for office space, rather than $12 per sq. ft., as requested. Nevertheless, the subject property is atypical; it is at the lower end of B- properties and its location is less than ideal, as noted in para. 6.

Cap Rate

[13] When the market falls, cap rates rise to reflect risk, but there haven't been any current sales of B or B- buildings from which current cap rates can be derived. Nevertheless, a differential, or "spread," exists between cap rates based on "going in" rents, i.e., actual rents, and cap rates based on typical rents, as used in assessments. Typical rents are usually higher than contractual rents, hence result in a higher cap rate.

[14] There were sales of B and B- buildings in 2007 and 2008, which are the valuation years for 2008 and 2009, respectively. Cap rates derived from those sales, i.e., cap rates based on actual rents, and cap rates based on typical rents, reveal that cap rates based on typical rents are 1.0% to 1.50% higher. It is submitted that this differential, or "spread," should hold true for subsequent years.

[15] The Respondent has used a 7.50% cap rate even though the economy is in a trough. If risk was the same for Class A and Class B buildings, the rents for B buildings would be higher. At the height of the market in 2007 and 2008, rental rates soared to $38 per sq. ft., and vacancy rates hovered around 2.25%. For the valuation year of 2011, with rental rates for B buildings in DT2 ranging from $12 to $14 per sq. ft., and vacancy at 15.0%, the Respondent is using a 7.50% cap rate, even though the cap rate used in the previous valuation year, 2010, was 9.0%. The requested cap rate for the subject property is 9.0%.

[16] Due to the dearth of sales in 2009, 2010 and 2011, the Respondent relies on the reports of third parties like Colliers and CB Richard Ellis for its cap rates. These cap rates are based on actual rents.

[17] There is nothing hypothetical about our requested cap rate. A differential exists between cap rates derived from actual rental rates, and cap rates derived from typical rental rates. Based on this spread, the Composite Assessment Review Board that decided CARB 1006/2012-P increased the cap rate from 7.5% 8.0%. We ask that the Board respect the decision in CARB 1006/2012-P.

Requested Corrections

[18] Based on our analysis of the market, we respectfully request that the Board make the following corrections to the assessment:

(a) office space, assessed at $15 per sq. ft., should be $12 per sq. ft.,

(b) retail space, assessed at $16 per sq. ft., should be $14 per sq. ft.,

(c) the exempt space under Roll numbers 201391299 and 068230416 be removed from the subject property's assessment,

(d) the vacancy allowance, assessed at 8%, should be 10%, and,

(e) the cap rate, assessed at 7.5%, should be 9.0%.

With assessment parameters corrected as shown, and the exempt property removed from the subject property's Roll number, the requested assessed value is $21,670,000.

Summary of the Respondent's Submission

Vacancy and Lease Rates

[19] The assessed vacancy rate for the subject property reflects reality. There is a high demand for office space in Calgary. In the analysis of leases in downtown B- rent equity comparables found at pages 53 and 54 of Exhibit R-1, the median of leases that commenced in 2011 is $15.00 per sq. ft., the mean is $15.26, and the weighted mean $15.77.

[20] We have included Altus' analysis of office leases in downtown B class buildings at p. 47 in Exhibit R-1. With *post facto* leases and Dominion Centre leases excluded, the median is $14 per sq. ft. This supports our analysis, and the assessed value of the subject property.

Equity in Assessment

[21] As for assessment equity, the B- class buildings in DT1 are assessed at an office vacancy rate of 8.0%. Furthermore, according to CresaPartners, as shown at p. 98 of Exhibit C-1(a), the average vacancy rate for Class B office buildings during the second quarter of 2011 is 8.47% for head leases. Head leases are key, because even if there is sublease vacancy, the head lease tenant pays. There is no substantive evidence that would support an adjustment in the vacancy rate.

[22] Further to the matter of equity, all B- class buildings in DT1 are assessed at an office rental rate of $15 per sq. ft., and a cap rate of 7.50%.

Cap Rates

[23] On the subject of cap rates, MGB decision 145/07 confirmed the use of typical rents for the derivation of cap rates. The simple fact is that current rents are less than they were in 2006 and 2007. The only cap rates available are from third party sources. There is no difference between "going in" rents, and typical rents.

Summary of the Complainant's Rebuttal

[24] The subject property is not a typical office building. It is unique; it is terraced. The subject property's space in differently configured in that most tenant are medical/dental types, thus most leases are leases of small spaces. The subject property's floor area ratio is 1.62. Given the size of the site, there is a lot of density achievable.

The Board's Findings in Respect of Each Matter or Issue:

Office Space

[25] At p. 66 of Exhibit C-1(a), there is a table showing 13 leases in B class buildings in DT1.

The Complainant informed the Board that the buildings are actually B- buildings, save for the building at 435 4th Avenue SW. In reviewing the leases, the Board finds that the average rental rate of those leases in B- buildings with commencement dates in the valuation period from July 1st, 2010 to June 30th, 2011, is $14.50 per sq. ft. The Board finds that the assessed office rental rate of $15 per sq. ft. is supported by lease rents of other B- properties in DT1. There is insufficient evidence to ground an adjustment to the assessed office rental rate of the subject property.

Retail Space

[26] The Board found insufficient evidence to demonstrate why the exempt space should be removed from Roll number 068230408.

Vacancy

[27] In their Q2 2011 report, CresaPartners arrived at a head-lease vacancy of 8.47% for downtown class B offices. From the Board's review of the microscopic numerals in the rent roll, it appears that the vacancy in the subject property is 3.90%. There is nothing to support an adjustment to the office vacancy rate as assessed. The Board confirms the assessed vacancy rate for office space.

Exempt Space

[28] The Board found insufficient evidence to support an adjustment for exemption on this roll number.

Cap Rate

[29] At p. 138 of Exhibit C-1(a), there is a table similar to, but not the same, as the one labelled Exhibit C-3 in complaint #68433. Because the parties requested that material from previous hearings that is relevant and applicable to the current hearing be brought forward, and because the Board understands Exhibit C-3 from complaint #68433 to be a revised version of the table at p. 138 of Exhibit C-1(a), the Board's comments will be with respect to the said Exhibit C-3.

[30] Exhibit C-3 is an analysis of cap rates based on typical rental rates (as assessed, and from sales), and cap rates based on actual rents, i.e. "going in" or contractual rents. The cap rates based on contractual rents are from RealNet, Colliers, and CB Richard Ellis. Cap rates based on typical rents are shown under the headings "City Sales (145/07)" and "Assessed".

[31] The Complainant has averaged the cap rates, both contractual and typical, for B+, B, and B- buildings over assessment years 2008, 2009, 2010, 2011, and 2012. The table purports to show the differential, or "spread" between the two kinds of cap rates for all three building classes. The "combined" column is found at the right of the columns that purport to show "going in", or contractual rents.

[32] It appears that the Complainant has averaged the cap rates derived from contractual rents, and placed the averages under the appropriate building class headings in the "combined" column. At the bottom of the "combined" column are the averages of the cap rates for B+, B, and B- over the five assessment years.

[33] Similarly, under the "assessed" column, the cap rates used in the assessments for the five year period are listed by year, and their averages also appear at the bottom of the "assessed" column. The "City Sales (145/07)" column is next to the "assessed" column. Both of these columns are under an overall heading, i.e., "Typical Market Rents".

[34] At the far right of the table is the "spread" column, showing the spreads, or differentials, between the cap rates from the "combined" column, and the "City Sales 145/07" column. The spread column also shows the differentials between the "assessed" column and the "combined" column. As with the cap rates, the average of the differentials over the five year period is found at the bottom of the columns.

[35] From the Board's review of the analysis, it appears that for B- buildings over the assessment years of 2010, 2011, and 2011, cap rates based on contractual rents, i.e., those from Realnet, Colliers, and CB Richard Ellis, as combined, are greater than the cap rates based on typical rents, i.e., as used in assessments, and those resulting from sales. For example, for assessment year 2012, the cap rate for B- properties under the "combined" column is 8.25%, while the assessed cap rate is 7.50%, for a differential of -0.75.

[36] Further to this, the Board notes that the overall average of the cap rates of B- properties found at the very bottom of the analysis under the "combined" column is 8.18%. This is 0.45 higher than the overall average at the bottom of the B- category in the "City Sales (145/07)" column, and 0.48 higher than the overall average of the "assessed" column. In other words, the "going in" or contractual rents produce higher cap rates than the typical rents.

[37] These outcomes run counter to the assumption the Respondent's argument is based upon, i.e., that cap rates based on typical rents are invariably higher than those based on contractual rents, and that the spread, or differential, between the two supports cap rates for assessment purposes that are 1.0 to 1.50 higher than "third party" cap rates allegedly used in assessments In the result, the Board finds the Complainant's evidence in support of an increase in the cap rate inconclusive.

Board's Decision:

[38] The Board confirms the assessment of the subject property at $35,290,000.

DATED AT THE CITY OF CALGARY THIS 6 DAY OF DECEMBER 2012.

[redacted]

Presiding Officer

Exhibits

C-1(a), Evidence Submission of the Complainant

C-1(b), RealNet Reports, Office Sales

C-2, Rebuttal Submission

C-3, Capitalization Rate Summary-Class B

R-1, Respondent's Assessment Brief

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Appeal type	Property type	Property sub-type	Issue	Sub-issue
CARB	Office	High Rise	Income Approach	Land & Improvement

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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.