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:

The Great West Life Assurance Company, COMPLAINANT, as represented by ALTUS GROUP LIMITED

and

The City Of Calgary, RESPONDENT

before:

T. Helgeson, PRESIDING OFFICER
J. Kerrison, MEMBER
B. Jerchel

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: 067049502

LOCATION ADDRESS: 605 5th Avenue SW

HEARING NUMBER: 67825

ASSESSMENT: $136,640,000

This complaint was heard on August 21st and 22nd, 2012 at the office of the Assessment Review Board located at Floor Number 4, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 2.

Appeared on behalf of the Complainant:

- *M. Meiklejohn*

Appeared on behalf of the Respondent:

- *A. Czechowskyi*

Board's Decision in Respect of Procedural or Jurisdictional Matters:

[1] No procedural or jurisdictional matters were brought to the attention of the Board.

Property Description:

[2] Assessed at $136,640,000, the subject property, known as "Fifth & Fifth," is a high-rise office building located on a 0.8 acre site at 605 5th Avenue SW in the "DT2" economic zone of downtown Calgary. The subject property was formerly known as the Texaco building.

[3] The subject property was constructed in 1970. It has a floor plate of 15,000 sq. ft., and a floor area ratio ("FAR") of 13. Rentable area is 469,397 sq. ft., of which 26,445 sq. ft. is devoted to retail space, and 3,063 sq. ft. is food court space. There is no exempt space in the building. The subject property is connected to +15, and as assessed, the subject property has been given a quality rating of class "A-." The assessment is based on the income approach, with a capitalization rate ("cap rate") of 6.75%. The assessment is $291.10 per sq. ft.

Issues:

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

Based on the evidence:

1. should the assessed value of the office space be reduced from $20 per sq. ft. to $16 per sq. ft.?
2. Should the assessed value of the retail space be reduced from $25 per sq. ft. to $20 per sq. ft.?
3. Should the vacancy allowance, 9.00% as assessed, be increased to 10.00%?
4. Should the parking rate be reduced from $475 per stall to $425?
5. Should the capitalization rate of 6.75% be increased to 7.50%?

Complainant's Requested Value: $96,520,000

Summary of the Complainant's Submission

Building Quality Rating and Requested Assessment

[5] The A- rating for the subject property is not in dispute. The only issue is the amount of the assessment, and underlying that issue are value, and fairness and equity. There are concerns with valuation, and the characteristics and physical condition of the building. The original requested assessment was $96,930,000. This has been revised to $96,520,000, based on a difference in the vacancy rate with regard to parking, for an assessed value of $205.63 per sq. ft.

Subject an Island in a Sea of B buildings

[6] The subject property was built in 1970, and is connected to +15. Most downtown office buildings were constructed from 1978 to 1982. The subject is an island in a sea of B class buildings. The Petex building is classified as a C building, Calgary House is a B-, Aquitaine Tower is a B-, the Standard Life building is a B, 510 5th Street is a B-, the ERCB building is classed as a B, Serval Tower is a B, and only Trimac House is, like the subject, an A- building.

Differentials between Building Classes and Economic Zones

[7] This complaint is much the same as the complaint in File 67824. Pages 29 and 30 of Exhibit C-1 show the Respondent's recommended differences in value between DT1 and DT2. In assessments of A- buildings, the Respondent does not differentiate between rental rates in A- buildings in DT1, and A- buildings in DT2, but the Respondent does recognize a differential in rental rates between B class buildings in DT1 and B class buildings in DT2. It is submitted that a similar differential must necessarily exist with respect to A- buildings in DT1 and DT2.

Rental Rates and Vacancy

[8] At pp. 61 and 62 of Exhibit C-1 is a summary of the rent roll for the subject property. It shows that the subject has a 15.51% vacancy, which translates into 73,141 sq. ft. Vacancies are higher for A- buildings in DT2 than in DT1, and that implies rents will be lower in DT2.

[9] Page 86 of Exhibit C-1 shows eight full floor office tenancies in Class "A-Old" buildings in DT1, all with terms of more than three years. The weighted average of these leases is $20.28 per sq. ft. Why is an A- building in DT2 assessed at $20 per sq. ft. when superior properties in DT1 show rents in the $20 per sq. ft. range?

[10] Pages 15 and 16 of Exhibit Part I C3A show that the weighted averages of A- office rents in DT1 and DT2 are $21.48 and $18.61, respectively. Nevertheless, Local Assessment Review Board decisions found there was no significant difference between DT1 and DT2.

[11] It is respectfully submitted that 15.0% *is* a significant difference. With renewals removed, the office rate in DT2 drops to $15.96, very close to what we are asking for: $16 per sq. ft.

Property Classification and Capitalization Rates

[12] If the benchmark capitalization rate ("cap rate") for "AA" buildings is 6.8%, the cap rate should be higher for a A- buildings to reflect greater risk. Clearly, the subject property is not comparable to Bankers Hall.

Valuation Parameters, Parking, and Requested Assessment

[13] In summary, valuation should be based on the characteristics and physical condition of the building. The assessed rate for office space in the subject property should be reduced from $20 to $16 per sq. ft. Retail space should be no more than $20 per sq. ft. The office vacancy rate should be increased from 9% to 10%, and the parking rate reduced from $475 to $425, to reflect the difference between DT1 and DT2. Finally, the cap rate should be 7.5%, not 6.75%.

Economic Zones, Vacancy, and Rents

[14] The Respondent's A- rent survey should have reflected the Respondent's vacancy survey, i.e., the rent survey should have been divided between economic zones DT1 and DT2. When vacancies go up, rents go down, and vacancies are higher for A- buildings in DT2 than in DT1. That implies rents will be lower in DT2.

Use of Post Facto data

[15] The Respondent does not use or consider leases that commenced after the valuation date of July 1st, 2011. Given the definition of market value and the valuation date of July 1st, *post facto* leases should not be used in assessing property, but using a *post facto* lease or sale to test a valuation is acceptable, provided there is an adjustment for time. The Respondent has presented no time adjustments.

Sales and Capitalization Rates

[16] To be relied upon for assessment purposes, sales should be at arm's length. With respect to the two Scotia Centre sales that occurred in April, 2011, i.e., within the valuation period, the only valid sale is the one for the first 50% interest. It was purchased by Scotiabank from Aspen, and it was a straight cash sale. The resulting cap rate is 7.50%. The other Scotia sale is unreliable; Scotiabank lent Homburg (a REIT) the money to make the purchase, and Scotiabank induced the sale. Homburg also got the lucrative management contract.

[17] The sale of Gulf Canada Square occurred on September 2nd, 2011, two months *post facto*. As mentioned above, the general rule is that you do not use *post facto* sales other than for testing an assessment, and only when the sales are time-adjusted.

[18] Included in the Gulf Canada sale was the right to use 240 parking stalls in the adjacent City of Calgary parkade. The Respondent did not use the income from the parking stalls in the assessment of Gulf Canada Square, but had they done so, the cap rate would have been greater than 6.39%. That said, the only valid sale of a Class A building is the one between Scotiabank and Aspen.

Scotia Centre Sale, and Risk

[19] If the income from the two smaller buildings that accommodate businesses, i.e., Mango Shiva and Riley & McCormick, is added to our income approach analysis for Scotia Centre, the resulting cap rate becomes 6.86%. If income from the two smaller buildings is not included, the cap rate becomes 6.73%. Scotia Centre is superior to the subject property, hence has less risk; why should the cap rate for Scotia Centre be roughly the same as the cap rate of the subject property?

Assessment-to-Sales Ratios and Vertical Inequity

[20] There is something inconsistent with respect to how downtown A and AA class buildings, and downtown B and C class buildings are assessed. An analysis of assessment-to-sales ratios ("ASRs") for 37 AA, A, B and C class buildings produced a mean ASR of 0.654, and a median ASR of 0.586. For Class AA and A buildings, the mean ASR is 0.979, and the median is also 0.979. This indicates vertical inequity in assessment. This puts Fifth & Fifth at a disadvantage with respect to all the B and C buildings in downtown Calgary. The request is to place A- buildings in line with B buildings

Summary

[21] To sum up, when you divide the A- class properties by their economic zones, DT1 and DT2, the typical office rental rate for the subject property turns out to be $16 per sq. ft., not $20. Although the Respondent recognizes that there is a difference in vacancy rates between DT1 and DT2, it fails to recognize a difference in rents. During the assessment year, the vacancy in the subject property was 15.51%. There should also be a difference in the parking rates between DT1 and DT2. Finally, the cap rate should be 7.5%, not 6.75%. These adjustments will solve the inequity, and result in the requested assessment.

Summary of the Respondent's Submission

Net Operating Income, and Cap Rate

[22] The assessment is at $291.10 per sq. ft. The Complainant is asking for $205.00 per sq. ft., with no supporting sales. If net operating income goes up, the cap rate goes up. The Complainant is asking the Board to take a cap rate developed from rental rates of $24 to $25 per sq. ft., and apply it to a rate of $16 per sq. ft. If the Board is convinced that the rental rate should be $16 per sq. ft., the cap rate will require adjustment.

Rent and Building Quality

[23] At pp 61 and 62 of Exhibit C-1 you will find a summary of the rent roll of the subject property. It shows a median rent of $24 per sq. ft. That supports the assessment at $20 per sq. ft. The size, floor plate, food court, and +15 connection make the subject an A building.

The Scotia Centre Sales, and Gulf Canada Square

[24] In the "straight cash" deal, i.e., the sale from Aspen to Scotiabank, Aspen had the right of first refusal. The first sale was not put on the market, but the second sale was. There is no evidence of the second sale being subject to undue elements.

[25] Gulf Canada Square does use part of the City of Calgary's parkade, but the income stream from those stalls goes to the City, not Gulf Canada Square

Vacancy

[26] The CresaPartners Q2 2009 Class A office vacancy survey at p. 110 of Exhibit C-1 shows that 12.99% of the sublease of the subject property is vacant. Nevertheless, vacant or not, the landlord gets paid. The CresaPartners Q2 2011 Class A office vacancy survey at p. 114 of Exhibit C-1, shows no sublease vacancy, but 30,521 sq. ft. of headlease vacancy, or 6.33% of the office space. There is no justification for increasing the vacancy rate.

Assessment to Sales Ratios

[27] The sales of Banker's Hall and Suncor Energy Centre, as shown at p. 187 of Exhibit C-1, indicate a mean and median cap rate of 6.80%. The ASRs are very close to 1. This supports the 2011 cap rate for A- properties, for there have been no other sales to support a change.

[28] The subject property is different from Trimac House in that it is on the edge of DT1, has a food court, and is connected to +15. There are no sales to support an assessment of $205 per sq. ft., as requested by the Complainant.

Summary of the Complainant's Rebuttal

Basic Questions

[29] The two complaints, for Trimac House and the subject property, are remarkably simple, but there are some basic questions that need answering. First, should you recognize a value differential between economic zones DT1 and DT2? Second, should you include lease renewals in an assessment, and third, should you include outliers?

A Significant Error

[30] There is in error in the ARB decision cited as LARB 0647/2012-B. The complainant data clearly shows that there is a difference in lease rates between DT1 and DT2, but the LARB found the difference to be insignificant.

[31] At pp 15 and 16 of Exhibit Part 1, C3A, there are 48 office leases shown, all in A-buildings. The weighted average of leases in DT1 is $21.48, while the weighted average of leases in DT2 is $18.61. That is a 15% difference, and despite what was said in LARB 0647/2012-B, it is a significant difference.

Outliers and Renewals

[32] The Board in LARB 0647/2012-B also decided that renewals were "out." With outliers and renewals removed from the 48 office leases mentioned in para. 28, the difference becomes even greater, i.e., the weighted average for DT2 leases becomes $15.96. This supports our requested rate of $16 per sq. ft.

The Only Valid Sale

[33] Of the three sales of A class buildings, the only valid sale is the one between Scotiabank and Aspen. To have a valid time adjustment, a valid sale is necessary, followed by a second sale. Anything else cannot be relied on. The Respondent used an invalid receivership sale.

Inconsistency

[34] There is inconsistency in how downtown A and AA buildings are assessed in comparison to downtown B and C class buildings. An analysis of ASRs for 37 AA, A, B, and C class buildings produced a mean ASR of 0.654, and a median ASR of 0.586, but for AA and A class buildings, the mean, as well as the median, ASR is 0.979. This indicates an inequity in assessment that puts the subject property and other A class buildings at a disadvantage with respect to the B and C class buildings in downtown Calgary. The request is to place A- buildings in line with B buildings.

Simple Facts

[35] The simple fact is this: when you divide the A- properties by their economic zones, DT1 and DT2, the typical office rental rate for the subject property becomes $16 per sq. ft., not $20. The Respondent recognizes that there is a difference in vacancy rates between DT1 and DT2, but somehow or other, fails to recognize a difference in rents.

[36] The vacancy in the subject property during the assessment year was 15.51%, not 10%. A difference in parking rates between DT1 and DT2 also needs to be recognized. And finally, the cap rate, presently 6.75%. should be 7.50%. These adjustments will solve the inequity, and produce the requested assessment.

<u>Board's Findings in Respect of Each Matter or Issue:</u>

Sales and Cap Rates

[37] The Complainant submits that the cap rate of 6.75% for the assessment of the subject property does not adequately reflect its risk as a lesser property when the benchmark for AA buildings is 6.8%. Ideally, the cap rate should be derived from arm's-length sales and net operating income, not by comparison with cap rates used in assessing other building classes. The evidence shows that there were only two sales of an A class office building in DT1 during the agreed-upon valuation period, i.e., the period from July 1st, 2010 to July 30th, 2011. Both sales were of Scotia Centre at 225 7th Avenue SW, and both occurred on the same date, April 21st, 2011.

[38] Each sale was for a 50% interest. In one transaction, the vendor was Aspen Properties, the purchaser Scotiabank, and the sale price was $95,000,000. At the same time, Scotiabank sold a 50% interest in Scotia Centre to Homburg Canada REIT GP for $116,000,000.

[39] The Complainant submits that the sale from Scotiabank to Homburg Canada was "bad" because Scotiabank lent Homburg the money for the purchase and brokered the sale, but insists that the sale from Aspen to Scotiabank for $95,000,000 was a straight cash deal, hence a valid sale that supports a non-typical cap rate of 7.40%, and a cap rate (as assessed) of 6.50%. The Respondent disagrees with the Complainant as to the Scotiabank to Homburg sale,

and submits that the Aspen to Scotiabank sale was not brokered, therefore unreliable as an indicator of fair market value.

[40] Another sale that was considered was one that occurred in September, 2011. This was the sale of Gulf Canada Square, an A class building, which has an assessed cap rate of 6.75%. In addition to being *post facto*, the Respondent's evidence was that there was a right of first refusal. The Complainant submits that had the parking stalls been included in the assessed value, the cap rate would be more than it is as assessed, thus supporting the Complainant's argument for a higher cap rate for the subject property. This ignores the fact that the parking stalls are leased from the City of Calgary, and there is no evidence as to how much more the owner charges for parking over and above what it is paying the City of Calgary.

[41] The Board finds that the above sales are hardly characteristic of what might be called a universe of sales, and concludes that none of the sales are sufficiently trustworthy to ground a valid cap rate. In the absence of substantive evidence, the cap rate used in the assessment of the subject property is confirmed at 6.75%.

Vertical Inequity

[42] Finally, with respect to the Complainant's argument that there is "vertical inequity" between A class buildings with ASRs approaching 1.00 and B class buildings whose ASRs are in the 0.5 range, the Board agrees that the inequity should be remedied, but not in the manner contemplated by the Complainant. Reducing the assessments of A buildings so their ASRs would approximate those of B buildings would only worsen the problem, and result in further breaches of s. 10(3) of the *Matters Relating to Assessment and Taxation Regulation* ("MRAT").

Vacancy

[43] Vacancy may be short term, or long term. Generally, higher than normal vacancy must be long term, or "chronic," before it will be taken into account in an assessment. The Board finds that there is no evidence that the subject property suffers from a chronic high vacancy rate. The vacancy rates for both office space (09.0%) and retail space (07.0%) will remain as assessed

Parking

[44] As assessed, the parking rate for the subject is $475 per stall. The Complainant provided information from a third party, Cresa Partners, in support of a lower parking rate for A- buildings in DT-2. This information indicates median rate of $450 per stall for reserved parking, and $435 for unreserved parking. The Complainant provided no evidence with respect to the number of stalls in the subject property that are reserved, and the number that are unreserved. In the result, the Board found insufficient evidence to support an adjustment in the assessed parking rate, and the assessed parking rate is confirmed at $475 per stall.

Rental Rates

[45] The Complainant submits that rents in A- buildings in DT2 should be less than rents in A-class buildings in DT1. In support of this argument, the Complainant referred to a table at pp. 15 and 16 of Exhibit Part I, C3(a), which shows all leases that commenced during the valuation year in A- buildings in DT1 and DT2. The A- leases in DT1 reveal a mean of $20.66 per sq. ft., and a weighted average of $21.48 per sq. ft. The mean for the leases in DT2 is $16.97 per sq.

ft., and the weighted average is $18.61 per sq. ft. The Board agrees that this evidence indicates a significant difference in A- rental rates between DT1 and DT2.

[46] Nevertheless, in reviewing the rent roll of the subject property at pp 61 and 62 of Exhibit C-1, the Board finds that the rents of office leases that commenced between July 1, 2010, and July 1, 2011, average $20.25 per sq. ft. Whether this average rate is due to the location of the subject property on the western edge of DT1 is not known, but whatever the cause, it supports the assessed rental rate of $20 per sq. ft.

[47] With regard to a retail rate for A- buildings in DT2, the Board found insufficient evidence to support an adjustment to the rate as assessed.

Board's Decision:

[48] The assessment is confirmed at $136,640,000.

DATED AT THE CITY OF CALGARY THIS 2nd **DAY OF** November **2012.**

[redacted]

Presiding Officer

Exhibits

C-1, Complainant's Evidence Submission

R-1, Respondent's Assessment Brief

C-2, Complainant's Realnet Reports

Part I, C-3(a), Complainant's Rebuttal Submission

Part II, C-3(b), Complainant's Rebuttal Submission - Authorities

****

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

****

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.