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:

SEC GP INC. (as represented by Colliers International), COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

W. Kipp, PRESIDING OFFICER
K. Farn, MEMBER
P. Pask, 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 2011 Assessment Roll as follows:

ROLL NUMBER:	**068 054 998**
LOCATION ADDRESS:	**117 – 5 Avenue SW, Calgary AB**
HEARING NUMBER:	**61318**
ASSESSMENT:	**$770,950,000**

This complaint was heard on the 8th day of September, 2011 at the office of the Assessment Review Board located at Floor No. 3, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 8.

Appeared on behalf of the Complainant:

- C. Hartley and S. Cook (Colliers International)

Appeared on behalf of the Respondent:

- R. Fegan and A. Czechowskyj (Assessment Business Unit)

Board's Decision in Respect of Procedural Matters:

This hearing was opened by K. Kelly who recused himself after learning of the subject of the complaint. W. Kipp took the Presiding Officer position for the remainder of this complaint hearing. Neither the Complainant nor the Respondent objected to the Presiding Officer change.

Property Description:

The property that is the subject of this complaint is Suncor Energy Centre, a two building office complex (32 and 52 storeys) in downtown Calgary. The two buildings rise above the two level podium which covers most of a full city block (117,279 square feet) between 5 and 6 Avenues SW on the east side of 1 Street SW. The development was completed in 1983. The assessment record shows:

1,736,558 square feet (SF) of office space – typical rent rate of $30.00/SF
14,089 square feet of main floor retail space – typical rent rate of $30.00/SF
5,245 square feet of food court space – typical rent rate of $150.00/SF
442 square feet of storage space – typical rent rate of $12.00/SF
12 square feet automated teller machine space – typical rent rate of $150.00/SF
850 parking stalls – typical net rent rate of $6,300/stall

The 2011 assessment is $770,950,000 ($438.95 per square foot of total rentable area)

Issues:

The Assessment Review Board Complaint form, filed March 2, 2011, had box 3 (Assessment amount) checked in Section 4. There was a lengthy list of reasons and grounds for the complaint.

At the hearing, the Complainant focussed on three issues:

1. What is the correct rentable area of the buildings?
2. Do the characteristics of the property place it in the "AA" Class or the "A" Class?
3. What are the correct market rental rates and capitalization rate to apply to the property in assessing its value by the income approach?

Complainant's Requested Assessment: $563,690,000

Party Positions on the Issues:

Complainant's Position:

Issue 1. What is the correct rentable area of the buildings?

Evidence from the Complainant includes rent rolls for the subject property as at July 2008, 2009 and 2010. In the rent rolls, total leased areas are:

	2008	2009	2010
Office "Billing" Area (Square feet)	1,709,596	1,705,722	1,699,556
Retail "Billing" Area (Square feet)	23,258	22,525	22,525
Total Leased Area (Square feet)	1,732,854	1,728,247	1,722,081

It is reasonable that total areas vary from year to year because the creation of new leases frequently results in re-measuring space. For example, measurement changes can occur when a single tenant floor is subsequently leased as a multi-tenant floor. The Complainant requests that the assessment be based on the total floor areas as shown in the July 2008 rent roll.

Issue 2. Do the characteristics of the property place it in the "AA" Class or the "A" Class?

The subject property is assessed as a Class "AA" office complex. The property is the oldest in the class having been built in 1981 (Note: the Complainant states a 1981 construction date, however, several other sources indicate 1983). The subject shares more physical characteristics with Class "A" buildings such as Fifth Avenue Place, First Canadian Centre and BP Centre than it does with TCPL, Livingston Place, Jamieson Place and the Centennial Building to name a few.

The "AA" category has become the classification for predominantly new and newly constructed towers. A list of 17 buildings designated as Class "AA" includes the two subject buildings. All others are newer with the next oldest being Canterra Tower which was built in 1988. Some of the other buildings in the list are buildings that were completed in 2009-2010 and even one that will not be completed until 2011. The Class "A" buildings to which the subject compares, were built in 1981 (Fifth Avenue Place E and W), 1988 (BP Centre) and 1982 (First Canadian Centre).

There is inequity in the assessments of buildings like the subjects because of the assessor's inclusion of rental rates from newly constructed buildings. A table of assessment office rent rates shows $30.00 per square foot for Class "AA" space, $23.00 for Class "A" space and $22.00 for Class "A-" space. The dramatic difference as is exhibited by the Class "A" and "A-" rates, compared to the much higher Class "AA" rate is a clear indication of the inequity.

A review of leasing in the subject and other buildings, however, indicates that the subject actually belongs between the Class "AA" and "A" categories and a proper assessment should reflect current leasing.

Issue 3. What are the correct market rental rates and capitalization rate to apply to the property in assessing its value by the income approach?

Office space in Class "AA" buildings is assessed on the basis of a $30.00 per square foot typical rate. A summary of recent office leasing in Suncor Energy Centre shows that 2010 rents (from two 2010 leases) are greatly diminished from 2009 rents. Leases on areas of 8,325 and 1,336 square feet with May 1 and June 1, 2010 commencement dates were both at $25.00 per square foot. Four 2009 leases were at $40.00 to $44.00 per square foot.

Leasing in two other properties (one Class "AA" and one Class "A") supported the $25.00 office rent as typical for the subject. In the "AA" class Bankers Hall complex (1999 and 2000 construction dates), three 2010 leases (two not commencing until 2011) were at rent rates of $24.00, $25.00 and $26.00 per square foot. In the Class "A" BP Centre (1988 construction), a January 2010 lease on 280,354 square feet specified a rental rate of $20.00 per square foot.

All of the foregoing rent analysis supports a rental rate for the subject office space of $25.00 per square foot which is the rate reflected in the assessment requested by the Complainant.

Retail space in Suncor Energy Centre is assessed at a rate of $30.00 per square foot. Three leases with start dates in January 2007, January 2008 and May 2010 specified rental rates of $24.00, $24.00 and $26.00 per square foot respectively. With weight on the most recent lease, the requested change reduces the retail assessment rate from $30.00 to $26.00 per square foot.

Food court space in the subject is assessed using a rental rate of $150.00 per square foot. Based on three recent leases that started in 2009 and 2010, the rate should be reduced to $120.00 per square foot.

For the current assessment year, downtown office properties are assessed using an income approach. In that approach, net operating income is capitalized at 7.0% for Class "AA" properties. Two downtown office property sales were analyzed by the Complainant. There had been changes in classification of these two properties in past assessments and an Alberta Municipal Government Board decision in 2009 (MGB 045/09) ordered that both properties be considered as Class "A" properties. With that classification, the capitalization rates calculated by the assessor of 7.79% (Plains Midstream Building – also referred to as Opus 8) and 7.85% (Gulf Canada Square) derived from their 2007 sales are the capitalization rates applicable to Class "A" property assessments. There are reasonable judgements that capitalization rates have increased from 2007 based upon increased risks within the real estate market such as those brought on by declining office rents, increased vacancies and the economic crisis in general. This suggests that Class "AA" capitalization rates cannot be rationalized below 8.0%. While the two sales are a few years old, the study undertaken by the Complainant considers this and it is the only capitalization rate study in evidence before the Board.

On the basis of equity, the subject property should be assessed using input data for Class "A" properties. This includes a $23.00 per square foot typical rent rate for offices, $26.00 for retail space, $120.00 for food court space, $5,700 per parking stall and an 8.0% capitalization rate. (Note: the Complainant uses an 8.0% capitalization rate for Class "A" properties while data in the Respondent's evidence indicates that the current rate is 7.5%). Vacancy rates would also be adjusted to those for Class "A" property assessments as would be operating costs. A recalculation of the subject assessment using Class "A" parameters results in an assessment of $491,659,210 ($283.14 per square foot of rentable building area).

The supported rent rates for Class "A" office building assessments can be input into the income approach model, along with the corrected floor areas and the supported capitalization rate to produce the requested assessment of $563,690,000.

Respondent's Position:

Issue 1. What is the correct rentable area of the buildings?

The Respondent provided a copy of an Assessment Request For Information (ARFI) response regarding Suncor Energy Centre dated March 11, 2010. There was no rent roll provided. The assessment was based on floor areas reported in the ARFI. If the Complainant's requested floor area changes were input into the assessment calculations, the resulting assessment would show a reduction of only one tenth of one percent.

Issue 2. Do the characteristics of the property place it in the "AA" Class or the "A" Class?

Extensive research is undertaken in the assignment of quality classes. Industry reports, such as those published by Colliers International, Cresa Partners and CBRE are consulted. Further to this, numerous physical building attributes are reviewed. These might include location, physical condition, building functionality (floor plate, space configuration, HVAC and technological installations), year of construction, number of storeys, total rentable area, +15 connectivity, on-site parking capacity and building tenant amenities. The final step in the process is a test of rents and expenses for all office properties within the assigned group as a whole and for each property within the group on an individual basis.

The Respondent's evidence included lists compiled from various sources listing Class "AA" buildings. Suncor Energy Centre, East and West Towers, is listed by Cresa Partners as an "AA". The City of Calgary has consistently assessed it as an "AA" property for 2010 and 2011. Properties such as Fifth Avenue Place, First Canadian Place and BP Centre are not in the "AA" lists. Nor are Gulf Canada Square or Plains Midstream/Opus 8 on the "AA" lists.

Issue 3. What are the correct market rental rates and capitalization rate to apply to the property in assessing its value by the income approach?

The Respondent notes that the Complainant is taking issue with only two components of the assessed income approach – the rent rates and the capitalization rate and as such, has not reasonably contested the assessed value as a whole.

The Complainant's lease data for Suncor Energy Centre is limited to only a few leases and the 2010 leases are on small areas of space. If 2008-2009 leases are considered, it can be seen that the subject buildings were competitive with other downtown Class "AA" buildings and there was consistency in office rents around $43-$44 per square foot.

2010 leases in other Class "AA" buildings support the assessed $30.00 office rent rate. Six leases in the Ernst & Young Tower at 422 – 2 Avenue SW have rental rates from $20.00 to $36.00 per square foot with all but one over $30.00. In Bankers' Hall, the lease reported by the Complainant at $25.00 was also listed. In the newer Centennial Building at 555 – 2 Avenue SW, three leases were at rates from $28.00 to $36.50 per square foot and in Jamieson Place, another newer building, one lease was at $25.00 while three others were at $32.00. All of the lease data, including one $25.00 rent in the subject, lead to a mean average of $30.84, a median of $32.00 and a weighted mean of $32.45.

Further support can be found in industry reports such as those published by Avison Young, Barclay Street and CBRE wherein it is stated that asking rents were of the order of $34.00 to $35.00 throughout most of 2010.

The Respondent did not present any evidence to support assessed rent rates for retail and food court space.

Having regard to capitalization rates, a summary of rates reported by industry observers such as Altus Insite, CBRE and Colliers showed Q2 2010 rates from 6.0% to 8.0% for Class "AA" buildings and 6.25% to 7.75% for Class "A" buildings. For 2011, the City of Calgary assesses "AA" building using a 7.0% capitalization rate and "A" buildings using 7.5%. It was pointed out that the capitalization rate evidence regarding Gulf Canada Square and Plains Midstream/Opus 8 has been rejected by other assessment review boards and, thus, it should be rejected by this Board as well since those properties are clearly not comparable to Suncor Energy Centre.

The Respondent provided some information on a sale of an interest in the subject property. In April 2010, a 50% interest in the property was transferred at a stated value of $389,800,000. The sale, reported to have been between two related corporations, one of which was a real estate investment trust (REIT), involved the assumption of $183,200,000 mortgage financing and the issuance of corporate shares for the balance. Notwithstanding that this was not an open market sale of the property, the Respondent argued that it was an indicator of market value.

Complainant's Rebuttal:

The Respondent argued that Suncor Energy Centre is a superior property to Fifth Avenue Place, one of the properties that the Complainant used in its comparisons. The leasing data shows that there are leases in Fifth Avenue Place at $31.00 per square foot and leases in the subject at $25.00 per square foot. This clearly shows that the subject is not a superior property.

The Respondent's $30.00 rent rate for "AA" offices is skewed by "construction leasing" in newer properties such as Centennial Place and Jamieson Place. For example, leases in Jamieson Place that had been executed in 2008, while the property was under construction, were at $32.00 per square foot but a January 2010 lease (subsequent to building completion), was at just $25.00 per square foot. The Complainant included email correspondence from property managers to support their position that several of the Respondent's lease comparables were actually executed in 2007-2008 when market conditions were significantly different than they were in early 2010 and well prior to the completion of construction of the buildings.

Spreadsheets prepared by the Complainant, using lease areas from the ARFI's in the Respondent's evidence showed total office area of 1,706,141 square feet and total retail/food court area of 25,091 square feet. These are not the areas upon which the assessment is based.

To support its position that the subject partial interest transfer to a REIT related to the vendor should not be regarded as evidence of market value, the Complainant presented data on a 2005 partial interest sale in a downtown office property that the Respondent chose not to use as market value evidence at that time. If the Respondent would not give weight to that 2005 transaction at that time, why would it now attempt to offer a similar transaction as evidence of market value? Further, the subject transfer was one of a series of similar transfers between the same owner and its related REIT.

In summary, the Complainant argued that the subject property should not necessarily be removed from the "AA" class and reduced to an "A" class. Rather, a market based set of rental rates should be applied to space in the building for valuation purposes. There is a marginal variance in rates between "A" and "A-" buildings but differences between "AA" and "A" building rates are substantial. There is no reason that the subject should not be fit somewhere between the "AA" and "A" classes.

Board's Decision:

The assessment is reduced from $770,950,000 to $645,320,000.

Reasons for the Decision:

The Board accepts the Complainant's position on rentable floor areas within the buildings. The summation of areas from the ARFI provided by the Respondent does not match those used in the assessment. The Complainant's areas are displayed in rent rolls. The Board did not get a reason for requesting the areas from the 2008 rent roll when the 2010 roll areas may have been more appropriate, however, it is the recommendation that is accepted.

There is insufficient support for the requested change in the capitalization rate from 7.0% to 8.0%. The Complainant provided some analysis in the form of data and analyses of the 2007 sales of Gulf Canada Square and Plains Midstream/Opus 8 and drew the conclusion that current (2010) capitalization rates, even for "AA" buildings had to be higher. Industry reports do not express capitalization rates from actual sales and the rates seem to differ widely between analysts. Part of the reason might be that certain analysts do not segregate top quality buildings into "AA" and "A" classes. Class "AA" buildings are assessed using a 7.0% capitalization rate and the Board is not compelled to change it.

There is merit to the Complainant's argument that the subject property should fall somewhere between the "AA" and "A" classes. Age is a factor. As buildings age, they often fall from one class to a lower one. The spread in office rental rates from $30.00 (Class "AA") to $23.00 (Class "A") is too wide. There are properties that fall somewhere between those benchmarks and the evidence of the Complainant shows that Suncor Energy Centre is one of those. Scrutiny of the lease data from both parties shows that the majority of the leasing reported for Jamieson Centre and Centennial Place, in particular, was pre-construction leasing executed in

2007 and 2008 and this leasing clearly skewed the means and median in the Respondent's rent analysis. More current leases in those buildings as well as that in the subject and in Bankers' Hall shows that the office rent rate requested by the Complainant is reasonable and is accepted by the Board. The rent rate for food court space is also accepted. The Board does not find the retail rental data from the subject property to be adequate evidence that this rate should be reduced from the current $30.00 per square foot rate. The food court lease samples from the subject property were not challenged by the Respondent.

The Board adjusts the assessment to reflect the Complainant's floor area measurements for various space types in the buildings.

Office Space	1,709,596 square feet
Retail Main Level	20,692 square feet
Food Court	4,836 square feet

It accepts the rent rates for office and food court space put forward by the Complainant.

Office Space	$25.00 per square foot
Food Court	$120.00 per square foot

DATED AT THE CITY OF CALGARY THIS 19 **DAY OF** October **2011.**

W. Kipp

W. Kipp
Presiding Officer

APPENDIX "A"

DOCUMENTS PRESENTED AT THE HEARING AND CONSIDERED BY THE BOARD:

NO.	ITEM
1. C1	Complainant Disclosure
2. C2	Complainant Rebuttal
3. R1	Respondent Disclosure
4. R2	September 1, 2011 Email – Fegan, Roy to Colliers
5. R3	Colour copies of photos, tables and graphs in Exhibit R1

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.

For Administrative Use:

Appeal Type	Property Type	Property Sub-Type	Issue	Sub-Issue
CARB	Office	High Rise	Income Approach	Leasable Area Market Rent Rates Capitalization Rate