CALGARY
ASSESSMENT REVIEW BOARD
DECISION WITH REASONS

In the matter of the complaint against the amended 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 Ltd. (as represented by Altus Group), COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

W. Kipp, PRESIDING OFFICER
D. Julien, MEMBER
J. Massey, 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:	**068 230 309**
LOCATION ADDRESS:	**125 – 9 Avenue SE, Calgary AB**
HEARING NUMBER:	**58791**
ASSESSMENT:	**$98,440,000 (Amended)**

This complaint was heard on the 30th day of November, 2011 at the office of the Assessment Review Board located at Floor No. 4, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 2.

Appeared on behalf of the Complainant:

- *S. Meiklejohn & G. Kerslake (Altus Group)*

Appeared on behalf of the Respondent:

- *H. Neumann & A. Czechowskyj (Assessment Business Unit)*

Observers: W. Krysinski – Morning only (City of Calgary Assessment Business Unit)
Kevin Bui – Morning only (University of Calgary student)
Daniel Hurtado – Morning only (University of Calgary student)

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

[1] There were no procedural or jurisdictional matters to be decided by the Board.

Background:

[2] A complaint against this amended assessment had been heard on July 30, 2010 and Calgary Assessment Review Board (ARB) decision ARB 1217/2010-P was issued on August 24, 2010.

[3] On September 22, 2010, an Originating Notice was filed on behalf of the Applicant Palliser Square Properties Ltd., as Represented by Altus Group Ltd., in the Court of Queen's Bench of Alberta, Judicial District of Calgary, giving notice that an application would be made for an Order granting leave to appeal the ARB decision.

[4] Prior to any hearings pursuant to this application, the parties to the original complaint and the Calgary Assessment Review Board agreed that a new ARB hearing would be in order and a Consent Order was issued by the Court of Queen's Bench of Alberta on September 15, 2011.

[5] Upon receipt of notice, the Calgary ARB scheduled a *de novo* hearing for this complaint on November 30, 2011 and the parties were directed to disclose evidence in accordance with the timelines provided for in the *Matters Relating to Assessment Complaints Regulation AR 310/2009 (MRAC).*

[6] Disclosure was properly filed and exchanged and the hearing commenced at 9:00 AM on November 30, 2011.

Property Description:

[7] The property that is the subject of this assessment complaint is a 27 storey office building in downtown Calgary known as Palliser Square East (sometimes also referred to as "Palliser One"). Records before the Board indicate that the building occupies a site containing 32,533

square feet. The building, constructed in 1970, contains a total rentable floor area of 379,444 square feet (including office space @ 358,869 square feet, retail space @ 9,619 square feet and storage space @ 10,956 square feet). At the hearing, the parties agreed that all but 640 square feet of the retail space were actually occupied as offices. This building is directly connected to Tower Centre, a five storey building also in the Palliser Square complex. It is also connected, by a +15 bridge to the Calgary Convention Centre which is located on the north side of 9 Avenue SE. There is also a link to Palliser South, a new 18 storey office building behind the subject that faces onto 10 Avenue SE. Also in the Palliser Square complex are the Fairmont Palliser Hotel, the Calgary Tower and a multi-level parkade that provides over 1,300 parking stalls for all of the buildings in the complex. The subject property does not have any onsite parking. The Board was not informed whether or not there is any contractual arrangement for provision of parking in the adjoining parkade for tenants in the subject building.

[8] The amended 2010 assessment was calculated by use of the income approach to value. A portion of the building is occupied by a tax exempt tenant and an allowance of $4,830,000 has been made to arrive at the taxable assessment of $98,440,000. The 100% assessment of $103,277,750 represents a rate of $272.18 per square foot of total building area.

Issues:

[9] The Assessment Review Board Complaint form, filed March 4, 2010 had marks in boxes 3 (Assessment amount) and 4 (Assessment class) in Section 4 (Complaint Information). For Section 5 (Reason(s) for Complaint), an attachment listed 15 Grounds for Appeal.

[10] The decision from the July 30, 2010 hearing stated that there were three issues: Rental rate, vacancy and cap (capitalization) rate.

[11] At this hearing, the Complainant presented evidence and argument on two matters, both of which impact on the market value of the property. For this complaint, the issues are:

1) Should the office rental rate be reduced from $26 to $22 per square foot?
2) Should the capitalization rate be increased from 8.0% to 9.0%?

Complainant's Requested Value: $73,374,538 (Taxable portion)($193/square foot of building)

Party Positions on the Issues:

Complainant's Position:

[12] The property is located at the southeast fringe of the DT1 downtown market zone. It is adjacent to the Canadian Pacific railway mainline that passes through Calgary. This secondary location and railway influence warrant a lower rent rate being applied to office space. The building is an older style, having been built in 1970. While there is parking available in the adjoining parkade, it is on a separate title and assessment roll – there is no onsite parking for the building. The lack of any parking within the subject building is a negative factor. There have been significant tenant relocations and more are to come once Encana vacates its large rental space to relocate to The Bow, its new office building that is now nearing completion a few

blocks to the north. The Complainant agrees that the building should be in the B- classification but it should be positioned at the lower end of that class since it cannot compete with better located B- buildings in the DT1 zone. All of these factors warrant a reduction in the office rent rate and an increase in the capitalization rate to reflect greater risk associated with ownership of this property.

[13] Given the secondary location of the subject building, it should have been assigned a base rent rate for offices at $24.00 which then should have been reduced to $22.00 to reflect the negative influence of the CP railway.

[14] In support of the requested office rent rate, the Complainant provided a table of assessment parameters used by the Respondent in assessing downtown Class B properties. All parameters were the same for B+, B and B- properties in all downtown market zones except for the office rent rate. In DT1, the Class B- rate is $26.00 per square foot whereas in DT2, DT3 and DT9, the rate is $24.00 per square foot. The Complainant argued that the peripheral DT1 location warranted consideration of placing the subject property into a less central zone where the base rent rate is lower ($24.00 per square foot).

[15] Citing a Local Assessment Review Board (LARB) decision on a business tax assessment complaint, the Complainant argued that the CP rail influence is akin to the Light Rail Transit (LRT) influence on 7 Avenue properties. On space in the property at 120 – 7 Avenue SW, LARB decision 0473/2010-B set the rent rate at $22.00 per square foot, at least partially due to the 7 Avenue (LRT corridor) location. A number of other LARB and CARB decisions were provided wherein B class office properties had received rent reductions for reasons similar to those set out in this complaint.

[16] Some of the CARB decisions recognized that the downturn in the market commenced in the third quarter of 2008 and for that reason, weight was given only to leases where the start dates had been within three months of the valuation date (i.e., in the second quarter of 2009).

[17] A study of market changes over time was conducted which led to a time adjustment rate of 7.0% per month through 2009. In a table of 54 leases in Class B buildings with start dates in 2009, the Complainant time adjusted the rent rates at -7% per month for leases starting between January and June 2009 and +7% per month for leases with start dates in the last half of the year. The adjusted rates ranged from $7.54 to $36.45 per square foot and averaged between $20.64 and $20.95 per square foot. For just B- buildings, the range was from $7.54 to $31.82 and the mean and median were $20.38 and $21.55, respectively. This was support for the requested $24.00 per square foot base rent rate for the subject.

[18] There was no reliable data regarding new leases in the subject building during the valuation year leading up to July 1, 2009, however one tenant had negotiated an early renewal of its lease at a rent rate of $17.40 per square foot with an inducement of six months free of gross rent. This new term would start in October 2009.

[19] With respect to the capitalization rate, the Complainant argued that the Respondent had not adequately recognized the economic downturn that started in the third quarter of 2008.

[20] In addition, a number of factors unique to the subject property all have a negative influence on risk associated with ownership and thus, the capitalization rate.

[21] Vacancies in office buildings had increased dramatically during the second quarter of 2009. The amount of sublease space coming on the market was also a factor which meant that vacancies would increase more and more as headleases expired. In the subject property, Encana Corporation is a major tenant (over 147,000 square feet) and it is well known that this tenant will vacate all of that space sometime during 2012 when its new building, "The Bow" is completed. Other large space tenants have already moved on and others plan to follow when their leases expire. The increased risk associated with ownership of a property where it is known that vacancies will increase dramatically during a market period when demand is soft leads directly to higher capitalization rates to reflect that risk.

[22] The Complainant analyzed office building sales that occurred in 2008 by comparing reported actual capitalization rates with those rates calculated by the Respondent using its extraction formula. Noting that the Respondent is obligated to assess the fee simple interest in property and the fact that sales of office properties such as the subject are almost always sales of a leased fee interest, an adjustment of about 0.25% was found to be necessary to bring rates from leased fee sales to a fee simple level.

[23] There were no sales of office buildings during the valuation year ending July 1, 2009 that could be studied for capitalization rate extraction.

[24] Opinions of capitalization rates can be found in market commentary reports that are periodically published by third parties such as Colliers International, CB Richard Ellis, Cresa Partners and Altus Insite. For the second quarter of 2009, Colliers reported capitalization rates for Class B downtown office properties to be between 8.00 and 8.50%. For the same quarter, CBRE reported rates from 8.75% to 9.25%. If these rates are increased by 0.25% to reflect fee simple ownership, then the requested capitalization rate of 9.0% is well supported.

[25] Without any adjustment, the market reports present a range of capitalization rates from 8.0% to 9.25% for the quarter. The location, physical characteristics and potential for high vacancies in the subject all point to a rate nearer the top end of the range. The 8.0% rate upon which the assessment is based in fine for better B+ properties in superior locations but it is too low for the subject.

Respondent's Position:

[26] The focus of the Respondent's evidence was to refute the evidence of the Complainant with limited argument and evidence to support the assessment.

[27] The Respondent provided copies of the 2009 and 2010 Assessment Request For Information (ARFI) responses for the subject property. One July 2008 lease at $22.00 per square foot and one January 2009 lease at $32.00 were averaged to $27.00 per square foot which supported the $26.00 per square foot rate used in the assessment.

[28] Third party quarterly reports from Colliers, CBRE and Altus Insite showed asking rent rates for Class B offices at $24.00, $26.00 and $33.44 per square foot, respectively. These asking rent rates provided additional support for the $24.00 to $28.00 rates applied to various Class B properties in downtown.

[29] A table of lease data for 35 2009 leases in Class B buildings provided a mean average rate of $31.40, a median of $32.00 and a weighted mean of $32.43 per square foot. Using only leases that started during the second quarter of the year, the weighted mean was $38.47 per square foot. This data was for both Class B+ and B- properties and it supported the rates used in making the assessments.

[30] Another table set out lease data that had been presented by the Complainant. For some leases, it was pointed out that the start dates were subsequent to July 1, 2009. There were also some leases in the same buildings that had not been reported by the Complainant. No conclusions as to revised means or medians were drawn from the data.

[31] There was narrative with Board decision support for the Respondent's position on factors such as future vacancies, use of sublease rent data and lease commencement date versus lease signing date.

[32] For capitalization rate support, the Respondent provided copies of third party market reports which had also been provided by the Complainant. In a summary table, the Class B 8.0% capitalization rate was shown to be supported by the reported rates in the surveys:

Colliers:	8.0-8.5%
CBRE:	8.75-9.25%
Altus Insite:	8.10%

[33] A page in the Respondent's evidence entitled "*Downtown Office Properties – 2010 Capitalization Rate Analyses Summary*" contained the following:

> *There are no valid sales in the Downtown Office category that occurred within the current valuation time frame. Consideration of dated sales in the determination of Capitalization Rates for the current assessment year is unquestionably ruled out, given the significant change in market conditions and hence, investor perception, since the occurrence of those sales.*
>
> *Notwithstanding the lack of office sales activity, it is nevertheless, necessary for the City to determine appropriate capitalization rates towards application of the Income Approach.*
>
> *The general consensus within the real estate industry, is that the Downtown Office market has been in decline over the previous year . . .*
>
> *Quarter 2 Industry reports (Colliers, CBRE, Altus Insite) suggest capitalization Rates ranging from 6.75% to 9.25%. Published Data is based on industry-polled investor expectations **as at midyear 2009.***
>
> *As a result of the preceding market indicators, Downtown Office Capitalization Rates applied in the 2010 assessment process have been increased by a ½ point, over the previous year on AA, A, and B Class offices, while C Class offices receive a ¾ point increase. D Class offices have moved up by ¼ percentage point.*
>
> *The 2010 Downtown Office assessments reflect the change in market conditions that occurred between July 1, 2008 and July 1, 2009. While, at the time of this writing, market indicators are suggesting that Capitalization Rates continue to increase, we must*

remain mindful of the July 1, 2009 valuation date. At the effective date of valuation, the market was signalling only the early stages of what appears, in a post facto market, to be a more dramatic decline. If sustained, these current conditions will be reflected in the forthcoming 2011 assessed values. The City of Calgary has complied with legislated requirements specifying that assessed values reflect the market conditions and investor perceptions as the valuation date, ie; July 1, 2009.

Board Note: The "time of writing" of the document in not known.

Complainant's Rebuttal:

[34] Based on the Respondent's evidence regarding the 54 lease transactions relied upon by the Complainant, the data was revised and recalculated. The number of lease transactions was reduced from 54 to 50. The Complainant then added "corrections" to the Respondent's lease data and then compiled a master list of lease information. For all Class B properties, the mean average rent rate was $26.47 per square foot and the median was $27.00 per square foot. From the total listings, leases in Class B+ buildings were removed, leaving only Class B- leases. For these properties, the mean average lease rate was $25.19 per square foot and the median was $24.25 per square foot.

[35] The time adjustment analysis that had been applied to the Complainant's original 54 lease data was redone for the revised list of Class B- data and the time adjustment declined from the 7.0% per month rate to 4.95% per month. After time adjustments were made, the Class B- data showed a mean average of $22.67 per square foot and a median of $22.75 per square foot.

[36] A second recalculation was made on B- data from leases with commencement dates during the first half of 2009. A time adjustment rate of 6.21% per month was found and when this was applied to the applicable lease data, the mean average declined to $21.09 per square foot and the median declined to $21.98 per square foot.

Board's Decision:

[37] The Board finds partially for the Complainant and reduces the 2010 assessment from $98,440,000 (Taxable) to $80,370,000 (Taxable) by reducing the office rent rate from $26.00 to $24.00 per square foot and increasing the capitalization rate from 8.0% to 9.0%.

Reasons for the Decision:

[38] The Board finds that there is merit to the Complainant's rent rate and capitalization rate argument which then places the onus on the Respondent to support its assessment and the parameters that went into making the assessment.

[39] There was argument about the reasonableness of attacking the input parameters to the income approach without providing market support for the final valuation (i.e. the assessment amount). Under the circumstances where there have been no open market sales of office buildings with similar characteristics to the subject, the Board finds that, although desirable, it is not possible to check the assessment against sales if there have been no sales. The

Complainant had no sales to support its requested reduced assessment and the Respondent had no sales to support its $98,440,000 assessment. The Board therefore finds that when only one valuation method (income approach) has been utilized, the only realistic method of determining the correct assessment is to examine input parameters into that valuation approach. In this case, rent rate and capitalization rate are the parameters to be determined.

[40] Part of the Respondent's support for the office rent rate came in the form of one 2009 lease in the subject building wherein an existing tenant, Olympia Financial, added 2,001 square feet to its lease holding of 19,323 square feet and the rent rate was set at $32.00 per square foot, commencing January 1, 2009. The Board notes from the April 2009 ARFI that other space leased to Olympia had lease rates from $11.00 to $35.00 per square foot. Olympia was apparently growing (according to the Complainant) and as such, required additional space which had been added from time to time. That tenant's leasing is as follows:

January 2005	Suite 254B	1,635 SF	$11.00/SF
March 2006	Suite 15	268 SF	$12.00/SF
May 2007	Suite 1	1,027 SF	$15.00/SF
September 2007	Suite 2300	16,315 SF	$15.00/SF
March 2008	Suite 255	1,120 SF	$35.00/SF
January 2009	Suite 250	2,001 SF	$32.00/SF

[41] From the perspective of the tenant, the weighted average rent being paid was $17.19 per square foot. The Complainant stated that this tenant is now consolidating its space due to blocks of space becoming available as other tenants leave the building. The Complainant also stated that another tenant, Quicksilver Resources, negotiated an early lease renewal on its 32,541 square feet at $17.40 per square foot, effective October 2009. There was a consensus amongst the parties that the market had taken a significant downturn in late 2008 but there was little economic data for month-to-month changes after that. The Board, however, has difficulty accepting the Respondent's apparent position that rents declined from $32.00/SF to $17.40/SF over the span of nine months from January to October 2009 after there had already been a major decline at or around September-October 2008.

[42] The Respondent included the (*post facto*) April 2010 Assessment Request For Information (ARFI) response in its evidence. The Board notes that in addition to an increase in building vacancy since the 2009 ARFI, changes were made to two of the Olympia Financial leases. For Suite 255, the lease rate on the 1,120 square feet of space was changed from $35.00 to $16.00 per square foot and for the 1,635 square feet in Suite 254B, the rent rate changed from $11.00 to $16.00 per square foot and the lease term was extended from 5 to 7 years. The Board also noticed that the rent rate for the Imperial Parking lease of 5,609 square feet in Suite 140 changed from $22.00 to $24.00 per square foot. These lease changes were not pointed out at the hearing. Nor was there any explanation of how or why these changes had occurred. In the final analysis, the Board concluded that there was no leasing in the subject building that could be relied upon to determine a typical rent rate to be applied in the income approach valuation.

[43] Other office rent evidence from the Respondent included data from industry reports (Colliers, CBRE and Altus Insite) on average asking lease rates as at the 2nd Quarter of 2009 and a table of DT1 Class B rent rates for 35 lease transactions with commencement dates between January 1, 2009 and July 1, 2009. From the rent data, the Respondent found a mean average rate of $31.40 per square foot, a median of $32.00 per square foot and a weighted mean of $32.43 per square foot. When leases commencing during the 2nd Quarter of the year were isolated, the weighted mean dropped to $28.47 per square foot. It had been previously

reported that the Respondent had no buildings in DT1 classified as Class B but there were only B- and B+ properties. There was no differentiation made in the rent table between B- and B+ properties. The rent rates ranged from a low of $18.00 per square foot (May 1, 2009 lease) to $42.00 per square foot (January 1, 2009 lease). A second version of the lease table, arranged by month of lease commencement, showed that 17 of the properties were classed as B-. For 10 lease starts in the 1st quarter of 2009, the B- rent rates ranged from $30.00 to $39.00 per square foot. For the 7 starts in the 2nd quarter, rent rates ranged from $20.00 to $37.00 per square foot. The Board's analysis of the data indicates that the mean decreased by 16.71% from the 1st quarter to the 2nd quarter, the median decreased by 18.84% and the weighted mean decreased by 14.54%.

[44] The Board finds the Complainant's time adjustment of rent rates to be a unique analysis since time adjustments are most commonly associated with property sale prices. However, in the absence of an ample amount of comparable lease data, it is given some consideration. The Board also finds that there are variances between Class B- and B+ rent rates that are significant enough to skew averages one way or another. Concentration must therefore be on B- data.

[45] The Board accepts the Complainant's argument that the subject property does not enjoy the same locational characteristics of most of the properties analyzed to find typical rent rates. The subject property is at the southeast corner of the DT1 market zone. It is not in an area where there is a concentration of downtown class office properties. In fact, it is not only at the edge of the DT1 zone but it is at the southerly edge of the downtown which is separated from the Beltline by the CP railway mainline. For well located Class B- properties, the $26.00 per square foot office rent rate is appropriate. The subject property is not as well located and for that reason, an office rent rate of $24.00 per square foot is warranted. This is the rate applied to B- properties in the other downtown market zones that are not as central as DT1.

[46] The Board does not find the Complainant's argument for a further rent rate reduction of $2.00 per square foot due to a location adjacent to the CP railway line to be supported by market evidence. For this reason, no further adjustment is made to the base $24.00 rent rate.

[47] Turning to the capitalization rate, the Board looks to the evidence which consisted primarily of market participant opinions and expectations as reported in the third party market reports. The following is noted:

Colliers – Class B Downtown Office Capitalization Rates

2009 - Q2	8.0% - 8.5%
2008 – Q2	6.25% - 6.75%
Variance	1.75% - 1.75%

CBRE – Class B Downtown Office Capitalization Rates

2009 – Q2	8.75% - 9.25%
2008 – Q3	6.50% - 7.25%
Variance	2.25% - 2.00%

[48] There was no historical data from Altus Insite studies and the best available from CBRE was for the third quarter of 2008 rather than the second quarter. The data shows that capitalization rates increased by 1.75% to 2.25% from 2008 to 2009. The Respondent adjusted Class B downtown office capitalization rates upwards by 0.50% from 2008 to 2009, citing industry report findings as the indicators of market decline. The Board finds this to be too low.

[49] The Respondent selected its 8.0% Class B office capitalization rate from the low end of the range of rates set out in the third party reports. Although there is no evidence to support variations in capitalization rates by market zone, it does seem to be logical that better located properties might be more desirable to investors and thus, trade at lower capitalization rates than similar properties in less desirable locations. It is also logical that B+ properties might trade on the basis of lower capitalization rates than B- properties. The subject property is a B- property in a peripheral location which does not put it in the same stratum as other 8.0% capitalization rate properties.

[50] The Board is fully aware that the Respondent is obligated to prepare an annual assessment even when there is an absence of market sales from which factors such as capitalization rates can be extracted. When sales data is lacking, there is onus on the assessor to determine capitalization rates for various property types and classes in a reasonable and supportable manner. In this instance, the Board does not find the 8.0% rate to be reasonable or supported by market evidence.

[51] Both parties provided numerous assessment tribunal decisions to support their positions. The Board carefully examined each of those decisions, noting that each of the parties took only portions of some decisions as support while disregarding other portions that put the decisions into a clearer context. This Board paid heed to prior decisions, recognizing that it is not bound by any of them in coming to this decision. Prior decisions are most useful when the Board is convinced that the evidence and argument that led to those decisions is similar to that presented to this Board.

DATED AT THE CITY OF CALGARY THIS 16 **DAY OF** December **2011.**

for. **W. Kipp**
Presiding Officer

APPENDIX "A"

DOCUMENTS PRESENTED AT THE HEARING AND CONSIDERED BY THE BOARD:

NO.	ITEM
1. C1A, B, C, D, E	Complainant Disclosure
2. R1	Respondent Disclosure
3. C2	Complainant Rebuttal
4. C3	Complainant Recalculated Assessment Request

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	Market Rent Capitalization Rate