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:

444-5th Ave GP Inc. (as represented by MNP LLP), COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

H. Kim, PRESIDING OFFICER
P. Charuk, BOARD MEMBER
J. Pratt, BOARD MEMBER

This is a complaint to the Calgary Assessment Review Board in respect of property assessments prepared by the Assessor of The City of Calgary and entered in the 2013 Assessment Roll as follows:

ROLL NUMBER:	**068052802**
LOCATION ADDRESS:	**444 5 Ave SW**
FILE NUMBER:	**70589**
ASSESSMENT:	**$57,590,000 amended to $58,230,000**

This complaint was heard on the 31st of July, 2013 at the office of the Assessment Review Board located at Floor Number 4, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 5.

Appeared on behalf of the Complainant:

- *G. Worsley*
- *W. Van Bruggen*

Appeared on behalf of the Respondent:

- *R. Ford*

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

1. Evidence and Argument Carried Forward

[1] The subject property was one of three B class office buildings in downtown Calgary under complaint by the Complainant's representative with broadly similar issues and argument to be considered. The Complainant requested that the subject property be considered in detail but that their presentations be carried forward to the other complaints with small modifications to the submissions based on site specific details. The Respondent agreed that it would be expedient to present their position on the four files in that manner.

[2] As the parties were in agreement, the Board agreed to proceed on that basis, and CARB 70590P-2013 and CARB 70694P-2013 refer to portions of this order.

2. Amended Assessment

[3] The Respondent had issued an amended notice on the subject property on February 28, 2013, which was the day before the complaint was filed. The Complainant had not been made aware of the amended notice and did not have information or evidence to contest the revisions to the floor areas issued in the amended notice. The Complainant agreed that if the assessment were to be confirmed the assessment on the amended notice would be acceptable.

Property Description:

[4] The subject is a 23 storey, 169,592 sf office building known as the Daon Building. It is located in the DT1 Sub Market area of downtown Calgary, constructed in 1972 on a 12,842 sf parcel of land. It is assessed on the income approach to value using the City's 2013 parameters for B class office buildings in DT1: 163,763 sf office space at a market net rental rate of $19/sf, 2,621 sf retail main level at $16/sf, 2,394 sf retail second level at $18/sf, 814 sf storage at $8/sf and 6 parking stalls at $4,800 per annum, for a potential net income of $3,231,837. Vacancy of 3.25% for office, 7.75% for retail, 8% for storage and 2% for parking is deducted. Vacant space shortfall based on operating costs of $17/sf office, $20/sf retail and $5/sf storage, and 2% non recoverables are applied and the resulting net operating income is capitalized at 5.0%. The resulting value has $1,640,000 deducted for an exempt tenant to arrive at the assessment under complaint.

[5] The Assessment Explanation Supplement for the 2013 amended assessment indicates changes to the floor area used in deriving the potential net income: the office and storage was revised to 166,088 sf and 423 sf from 163,763 sf and 814 sf respectively, increasing the total rentable area to 171,526 sf from 169,592 sf. The exempt tenant value increased to $1,760,000 to arrive at the amended assessment.

Issues:

[6] The Complaint form identified a number of reasons for complaint; however at the hearing the following issues were argued:

1. The capitalization rate should be increased to 6.0% from 5.0%
2. The office rental rate should be $16 instead of $19.

Complainant's Requested Value: $40,370,000

Board's Decision:

[7] The assessment is confirmed at the amended value of $58,230,000

Issue 1 - Capitalization Rate:

Complainant's Position:

[8] The subject is an older B building classed as B-. The cap rate for class B buildings in 2013 is 5.0%. The 2013 cap rate for class AA and A office buildings is 6.0%, as evidenced by the Assessment Explanation Supplement (AES) reports for the Bow, the Transcanada Tower, and Centrium Place, all premier buildings in the prime areas of the downtown core. The Complainant argued that it is unreasonable to consider class B buildings to have less risk to their income stream than class A. Historically there has always been a hierarchy of cap rates wherein class AA had the lowest cap rate and it increased for successive classes of building. The 2012 assessment was $27,720,000 and it more than doubled for 2013.

[9] The Respondent's cap rate study is flawed, as they analyzed sales in all of 2011 using 2012 typical income parameters, and sales in all of 2012 using 2013 income parameters. The Complainant contends that this is incorrect, since 2012 income parameters are arrived at using information from July 1, 2010 to July 1, 2011. A sale in the latter half of 2011 should be analyzed using the 2013 income parameters that are derived from information from July 1, 2011 to July 1, 2012, the same time frame as the sale. Further, the Respondent heavily relied on a portfolio sale which included four buildings on three parcels to arrive at the 5.0% cap rate. The Complainant contends that portfolio sales should not be used.

[10] The sale of the Leeson & Lineham Building, at 209 8 Ave SW, was not considered by the Respondent on the basis that it is a retail, not office building. It has retail at street level and five floors of office. The Complainant presented the 2010 AES which listed the predominant use as an office building. It should have been included in the cap rate study. The Complainant presented their cap rate study removing the portfolio sales, correcting the NOI to use income parameters from 2013 and adding the Leeson & Lineham sale, and it demonstrates that the appropriate cap rate is 6.0%:

Address	Building	Class	NRZ	Reg. Date	Sale Price	Area (sf)	Typical NOI	Cap Rate
903 8 AV SW	8 West	A	DT2	2012-06-21	65,745,000	139,552	3,703,102	5.63%
800 5 AV SW	Trimac House	A	DT2	2012-05-11	100,907,000	238,247	6,075,133	6.02%
401 9 AV SW	Gulf Canada Square	A	DT1	2011-09-02	356,000,000	1,120,841	28,060,157	7.88%
333 4 AV SW	Calgary Place	A	DT1	2012-05-18	312,000,000	607,578	16,479,453	5.28%
209 8 AV SW	Leeson & Lineham	B	DT1	2012-01-16	10,500,000	34,895	616,534	5.87%
							Average	6.14%
							Median	5.87%

[11] The Complainant presented a sale at 401 4 St SW, Northland Place, which had lease rates of $32/sf for retail compared to the City's typical of $16/sf for an actual NOI of $990,277. The property sold for $16,500,000 on Dec 2, 2011 for a cap rate of 6.0%.

[12] Third party reports support the requested cap rate. The range of cap rates for A and B class buildings in the second quarter of 2012 follow the historical hierarchy of cap rates:

	CBRE	Colliers
AA	5.25 - 5.75%	
A	5.75 - 6.25%	5.5 - 6.0%
B	6.75 - 7.25%	6.25 - 7.0%

The Respondent's 2013 rates do not follow the hierarchy of cap rates normally found in the marketplace. It is unreasonable that the cap rate for B class buildings is a full percent below A class buildings. At a minimum, the B class cap rate should be increased to 6.0%

Respondent's Position:

[13] The Respondent agreed that historically, cap rates for class B were higher than for class A; however, the sales support the cap rates applied. The Respondent stated that unlike previous years, there were a number of sales of class A to C buildings in the analysis period (July 2011 to July 2012). The B class sales support the 5% cap rate used:

Address	Building	Class	NRZ	Reg. Date	Sale Price	Area (sf)	AYOC	Typ. NOI	Cap
833 4 Av SW	Canadian Centre	B	DT2	2012-06-15	63,725,000	156,402	1981	3,057,864	4.80%
635 6 Av SW	Ford Tower & Alpine Building	B, C	DT2	2012-06-13	69,125,000	200,099	1976/ 1964	3,468,266	5.02%
521 3 Av SW	Eau Claire Pl II	B	DT1	2012-06-13	52,150,000	139,130	1981	2,809,896	5.39%
615 Macleod TR SE	Rocky Mtn Plaza	B	DT3	2011-08-23	60,648,000	195,683	1972	2,327,135	3.84%
510 5 St SW	Five Ten Fifth	B	DT1	2011-08-23	30,442,000	110,423	1982	1,470,897	4.83%
119 6 Av SW	Telephone Bldg (AGT)	B	DT1	2011-04-13	29,000,000	62,650	1929	1,170,211	4.04%

[14] The median and mean of the B class sales since July 1, 2011 were 4.82% and 4.65% respectively, while A class were 5.64% and 5.61%. Considering only sales in 2012, the median and mean of the B class sales were 5.02% and 5.07 while A class were 5.63 and 5.46%. On that basis, the cap rates were set at 6.0% for A and 5.0% for B.

[15] The Respondent stated that the use of the 2012 income parameters is appropriate in analyzing a sale in 2011. The parameters closest to the date of sale should be used, which is the July 1, 2011 valuation date for sales in 2012. The Respondent presented one 2013 CARB decision and two MGB decisions highlighting that a cap rate applied to NOI based on typical factors (inputs) must be a cap rate that also has been derived using typical NOI factors, and that typical factors for the year of sale should be used to maintain consistency.

[16] The Respondent defended the use of the Lasalle/Artis REIT portfolio sale. It was a sale of four buildings on three parcels in downtown Calgary for $189,300,000 for the total portfolio. The Respondent presented two 2013 CARB decisions where the sworn transfer values in portfolio sales were accepted as an indicator of market value. The Affidavit of Transferee for each building was submitted to support the transfer value, and corporate search documents to show the parties were unrelated. Portfolio sales are the norm, and the values of the individual

properties within the portfolio are stated. To ignore or eliminate a sale because it was part of a portfolio is wrong.

[17] The Respondent noted the RealNet reports show the 2011 assessments in place at time of sale were substantially lower than the sale price in every case, and several were less than half of the selling price. The Respondent presented a chart of 18 sales between April 2011 and June 2012, comparing 2013 assessments and sale price. The median Assessment to Sale Ratio (ASR) is .97 for A, 1.04 for B and 1.03 for C. This supports the cap rates set for the building class.

[18] The Respondent also showed an analysis of the buildings that sold using the Complainant's requested parameters to show that the resulting assessments would have ASRs between 0.69 and 0.77, well below the required standards.

[19] The Respondent stated that with respect to equity, while the A class buildings have a 6.0% cap rate, the rental rates applied are much higher, therefore the assessment per square foot is equitable. The respondent presented the range of assessment per square foot for the various classes of buildings:

Quality	Mean	Median	Weighted mean
AA New	$576	$585	$577
AA	$566	$561	$565
A New	$529	$533	$543
A	$435	$442	$444
A-	$409	$409	$412
B	$382	$382	$385
B-	$322	$320	$312
C and C-	$266	$223	$219
D	$224	$221	$204

[20] These values are consistent with the average and median sale price per square foot of $424 and $440 for A, $363 and $360 for B, and $244 and $244 for C. The subject assessment is $349/sf and within the range of B buildings. The requested assessment is $248/sf and would be inequitable with other similar buildings in the municipality.

Complainant's Rebuttal

[21] In previous years, the Respondent used reported cap rates. The reported cap rate on the Lasalle/Artis REIT portfolio sale was 6.7% compared to the Respondent's derived cap rates of 4.80%, 5.02% and 5.39%. The actual NOI of the sale is substantially greater than the typical NOI. The current situation with dated leases is advantageous to the owner, if the situation were reversed it would be advantageous to the lessee. The assessment should reflect typical income parameters with actual cap rates.

[22] The 1.04 median ASR of the class B buildings is misleading. The average ASR is 1.10 with 510 5th St at 1.32 and Rocky Mountain Plaza at 1.24. Also the Alpine Building is characteristic of a B building but is assessed as a class C building so there is 15,000 sf that is under assessed, otherwise the ASR would be much greater than 1.

[23] The Complainant also noted that it was inequitable that the average of class A sales is 5.46 but the cap rate set was 6.0 while the average of class B sales was 5.07 but class B buildings are assessed using 5.0 cap rate.

Findings and Reasons:

[24] The capitalization rate should be 5.0%. While the Board agrees that it is unusual to have a class B cap rate of 5.0% when 6.0% is applied to class A, the cap rates are only a means to an end, which is to determine a value that is a reasonable estimate of the market value of the property, as required under the legislation. The relationship between 2013 class A and class B cap rates may be unusual; however the other income parameters are such that the overall value applied to class A compared to class B maintains equity. The Board found that the range of assessed value per square foot of the various classes of buildings maintain a relationship to the range of selling prices and was satisfied that the overall values attached to the assessments were reasonable notwithstanding the deviation from the usual hierarchy of cap rates.

[25] The Lasalle/Artis REIT portfolio sale involved three B class buildings and one C class building on three parcels, all within downtown Calgary. The Board considers assigned values in a portfolio sale of this nature to be more reliable than a portfolio sale of properties in different market areas. In this case, the Board considered the total sale price relative to the total assessment and determined that the application of the derived cap rate yielded a value that better reflected market value than the requested 6.0% cap rate.

[26] The Board considered the cap rates from the two sales provided by the Complainant. The Board did not consider the Leeson and Lineham building to be a typical B class building as it is substantially smaller, and a restored 1910 construction. Northland Place is a newer building but only three storeys, again not a typical class B building. The Complainant's cap rate analysis was based on a number of A buildings and the Board did not find it supported a 6.0% for B buildings.

[27] The Board was satisfied that the assessment per square foot of the subject and comparable properties was reflective of their market value and preserved equity among similar properties in the municipality.

<u>Issue 2 - Office Rental Rate:</u>

Complainant's Position:

[28] The Complainant presented an analysis of recent leasing activity for B- office buildings in DT1 showing 35 leases averaging $15.64/sf, with a median of $16/sf and weighted average of $15.47/sf. This shows that the $19/sf office lease rate applied to the subject is too high and that a $16/sf rate should be applied.

Respondent's Position:

[29] The Respondent presented the 2013 Downtown Office Rental Rate Analysis for B- Class in DT1 and DT8 from July 1, 2011 to July 1, 2012. The average of all 35 leases was $16.67/sf, with a median of $16/sf and a weighted mean of $15.27/sf. However, lease rates were going up, and the average of the 15 leases commencing in 2012 is $19.21/sf with a median of $18/sf and a weighted mean of $19/sf.

[30] The Respondent also presented the rent roll from the subject building's Assessment Request for Information (ARFI). The floor areas in the ARFI were used to arrive at the corrected floor area which gave rise to the amended assessment. The recent leases in the subject building support the $19/sf applied to the assessment.

Complainant's Rebuttal:

[31] The Complainant disputed the validity of some of the Respondent's 2012 leases. The analysis included one at $28/sf in the subject building which was a sublease. Another lease at $24/sf was month to month, as the term of the lease was blank. The Complainant presented an email from the property manager of the subject building which stated that one of the Respondent's 2012 leases is a 6 year lease in the subject building at $27/sf, but it included $30/sf in tenant improvements therefore a net effective rent of $18/sf.

Findings and Reasons:

[32] The Board finds the $19/SF office rate is appropriate. The analysis submitted by the Complainant is heavily weighted to leases prior to January 2012. The Board agrees that the trend was for lease rates to increase between July 1, 2011 and July 1, 2012. While leases in that range are used in the analysis, the Board is of the opinion that the typical rate to be applied in determining value using the income approach for 2013 is the rate in effect at July 1, 2012. Accordingly, when the trend shows the rate is changing, leases in the first and second quarter of the assessment year are a better indication of typical leases at the relevant time than those in the third and fourth quarter of the previous year.

[33] The Board agreed with the Respondent that adjusting for $30/sf in tenant improvements over a 6 year term would still result in a $22/sf lease rate, greater than the $19/sf applied. An examination of the rent roll provided in the ARFI shows leases commencing in the first half of 2012 in the subject building supported the $19/sf rate applied.

[34] The Board considers the floor areas noted on the ARFI to be an accurate reporting of the rentable area of the property, and the Complainant did not have information to contradict it, accordingly the assessment is confirmed at the amended value that reflects the corrected floor areas for office and storage.

DATED AT THE CITY OF CALGARY THIS 9th **DAY OF** September **2013.**

H. Kim
Presiding Officer

APPENDIX "A"

DOCUMENTS PRESENTED AT THE HEARING AND CONSIDERED BY THE BOARD:

NO.	ITEM
1. C1	Complainant's Disclosure
2. R1	Respondent Disclosure
3. C2	Complainant's Rebuttal to page 239
4. C3	Complainant's Rebuttal pages 240-317
5. R2	Respondent's Rebuttal CARB 72016P-2013
6. R3	Respondent's Rebuttal DL019/10
7. R4	Respondent's Rebuttal MGB123/10
8. R5	Respondent's Rebuttal CARB 70282P-2013
9. R6	Respondent's Rebuttal CARB 72586P-2013

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.

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Property Type	Property Sub-Type	Issue	Sub-Issues
(3) Office	High Rise	Income Approach	Capitalization Rate Net Market Rent