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:

Dundeal Canada (GP) Inc. C/O Dundee Realty Management Group (as represented by Colliers International Realty Advisors Inc.), COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

K. Thompson, Board Chair
E. Reuther, MEMBER
T. Livermore, 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 2013 Assessment Roll as follows:

ROLL NUMBER: **067020008**

LOCATION ADDRESS: **700 4 Av SW**

FILE NUMBER: **70911**

ASSESSMENT: **$95,520,000**

This complaint was heard on 31st day of July, 2013 at the office of the Assessment Review Board located at Floor Number 4, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 6.

Appeared on behalf of the Complainant:

- A. Farley, Agent, Colliers International Realty Advisors Inc.

Appeared on behalf of the Respondent:

- H. Neumann Assessor, City of Calgary

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

[1] Request from the Complainant and Respondent to cross reference all evidence and argument from file numbers 70796, 70916, 70928, 71104, and 73783. The Board had no objection to this request.

[2] No jurisdictional matters were raised. The Board proceeded to hear the merits of the complaint.

Property Description:

[3] The subject property is an eighteen story B Class office building constructed in 1979 and is known as Mcfarlane Tower Building. The building contains 241,987 square feet (sq. ft.) of office space, 2,630 sq. ft. of retail on the main, and 156 parking stalls. This property sits on 32,025 sq. ft. of land, and is located in the downtown (DT2 economic zone). The subject property is assessed based on the Income Approach to Value with a capitalization rate of 5.00%, rental rates of $19/ sq. ft. for the office space and has an assessed value of $95,520,000.

Issues:

[4] **Issue 1 – Rental Rate** – $16/ sq. ft. is a more appropriate rental rate for the office space of this property, instead of the $19/ sq. ft. used by the City of Calgary.

[5] **Issue 2 – Capitalization Rate** - The capitalization rate should be no lower than 6.00% and likely 6.50% for this property, instead of the 5.00% capitalization rate used by the City of Calgary.

Complainant's Requested Value: $63,240,000

Board's Decision:

[6] Assessment is confirmed at $95,520,000.

Legislative Authority, Requirements and Considerations:

[7] The Act, Section 460.1(2), subject to Section 460(11), a composite assessment review board has jurisdiction to hear complaints about any matter referred to in Section 460(5) that is shown on an assessment notice for property, other than property described in Subsection 460 (1)(a).

Position of the Parties

Issue 1 – Rental Rates

[8] The Complainant contends that the subject property shows current leasing activity that supports a $16/ sq. ft. rental rate for the 241,987 sq. ft of office space. Eight leases for the subject property [pg 28, C-1] (six occurring in 2011 and two in early 2012) indicate that the median lease rate in this building is $16/ sq. ft., with a range of $12/ sq. ft. to $30/ sq. ft. These current leases represent 8.6% of the subject property's leasable office space. The Complainant contends that this should be a large enough sample to prove that this property does not perform at the $19/ sq. ft. typical rent rate used by the City of Calgary in their assessment calculation for B Class office buildings in DT2.

[9] Additional leases in office buildings the Complainant thought to be very comparable were also provided. Leases in Place 800 and Bantrel Tower further support the Complainant's position. These buildings show a median lease of $17.75/ sq. ft. with a range of $13/ sq. ft. to $20/ sq. ft. [pg. 30, C1]. The Complainant stated that the values produced by the City may be developed based on typical rents for this type of property but should be defended on the specifics of the individual property. Rent rolls were provided [pg. 12-27, C1], based on useable square footage, for the rented areas in the subject building.

[10] There was no dispute on the B classification of the subject property. It was pointed out by the Complainant that this property does not command the rents typically obtained by other office buildings in this area.

Issue 2 – Capitalization Rates

[11] The Complainant stated that the downtown offices in Calgary should use a consistent hierarchy for capitalization rates, with the A Class office buildings always having a lower capitalization rate than the B and C Classes. The Complainant stated that the City of Calgary erred in developing their typical capitalization rates for 2013 in that the superior class of properties have been given the highest rates. Municipal Government Board Order 140/01 was cited [pgs. 99-124, C-1]. City capitalization rates were listed as [pg.36, C1]:

1) Class A properties – 6.00% (base)
2) Class B properties – 5.00% (base)
3) Class C properties – 5.50% (base)

[12] Historical information was provided on typical capitalization rates for the Class A and B properties located downtown, from 2008 to 2012, showing that until 2011 the A Class typical office capitalization rates were always lower than the B Class office capitalization rates. Historically there has been a .50% to 1.50% spread [pg.39, C-1].

[13] To show the effects of the reversed capitalization rate hierarchy the Complainant recalculated five B Class office buildings using the City of Calgary's rates for Class A- office buildings. In every instance the Class A- rate applied to the Class B building resulted in a lower assessed value. Calculations were provided [pg. 58, C-1]. The Board determined that the information provided by the Complainant in the rebuttal package on the recalculation of the remainder of the B Class office buildings in this economic zone was new evidence and it was not allowed into the hearing as evidence.

[14] The Complainant further stated that the methodology that the City used in determining the capitalization rates is incorrect. It agreed with the City that:

1) The typical assessed income should be used to determine the net operating Income (NOI) in determining the capitalization rate for assessment purposes.
2) Typical income for sales from January to July 1 of a given year should have an NOI using income from the following valuation year's assessment.

[15] The Complainant claims that where the City fails in its analysis is when a sale occurs between July 1 and December 31. For these sales the Complainant is of the position that typical incomes should be taken from the year of the sales transaction to calculate the typical NOI. The City uses the income closest to the sales date and therefore calculates, in the Complainants opinion, an incorrect typical NOI with which to calculate the capitalization rate.

[16] Three of the sales used in the City's capitalization rates analysis occurred between July 1 and December 31st of 2011. These were Gulf Canada Square, Rocky Mountain Plaza and Five Ten Fifth. The Complainant submitted typical NOI's using typical rents and data from the 2012, July 1 values while the City used information from the 2011, July 1 values.

[17] A number of Board Decisions were included for the Board to consider.

[18] To demonstrate that the City has sometimes in fact used the typical NOI's from the year of the sale for properties that sold between July 1 and December 31, the Complainant submitted the 2011 City of Calgary's Neighbourhood, Community Centre Capitalization Rate Summary which is exactly how the Complainant calculated the typical capitalization rate for the subject property, [pg.71, C-2].

[19] A study was presented [pg. 39, C-1], by the Complainant, with 13 of the sales used in the City's 2013 Office Capitalization Rate Study. Sales for the years 2011 and 2012 were used. The capitalization rates were recalculated for three of the sales from the latter part of 2011 using assessed income from 2012. The Complainant removed one sale from the original study as it was deemed not comparable; it also removed all Class C transactions. Information was provided on the one B Class sale that wasn't included in the Complainant's Capitalization Rate Study. The Telephone Building was purchased by Allied Real Estate Income Trust, which specializes in acquiring older repurposed light industrial buildings. The Complainant contends that this property would not trade in the same market as the subject.

[20] The median capitalization rate, based on the Complainant's calculation for B Class office buildings, was 5.39% with 2012 sales indicating a median capitalization rate of 5.02%. The Complainant stated that the capitalization rate should be rounded to 6.00% and in fact, considering the long standing hierarchy of capitalization rates, where Class A's are .50% to 1.50% lower than the Class B's, the typical capitalization rate should be 6.50%.

[21] The Complainant offered that if this wasn't amenable to the Board, then the Class A office sales should be combined with the Class B office sales and analyzed together. The resulting capitalization rate would be a median of 5.83% overall and 5.63% for the 2012 sale

year. Again these rates should be rounded to 6.00% for all A and B Class office buildings. The premise is that this would be much better than the inverse relationship of capitalization rates seen between Class A and B offices, as currently provided by the City.

[22] Portfolio sales were included in the capitalization rate studies submitted by both the Complainant and the City. However, the Complainant contends that they should really be excluded. Based on the Complainant's experience, the investor pays a premium for portfolio transactions and there are other factors involved thus tainting a portfolio sale. Three sales in these studies were part of a purchase by a Real Estate Income Trust (REIT).

[23] The Board determined that the information provided by the Complainant in the Rebuttal package on the remainder of the B Class to A- Class calculations was new evidence and it was not allowed into the hearing as evidence.

Respondent's Position:

Issue 1 – Rental Rates

[24] The Respondent pointed out to the Board that it is a legislated requirement for the City to produce yearly assessments using mass appraisal and to assess all similar properties at a similar value so that taxation is fairly and uniformly distributed.

[25] Further, the Respondent stated that to derive a typical rent for a group of similar properties, all the rents need to be included. The subject is a Class B building in the economic zone of DT2. The class of the subject property is not in dispute and the economic zone DT2 has been agreed to by the industry for many years. Therefore, a typical rental rate derived from all of B Class offices in the DT2 area should be applied to all B Class buildings in DT2. A different rent, derived from a single building in the zone and applied to the subject would defeat the point of mass appraisal and typical rents.

[26] The Respondent explained that in determining typical rents there will be a range of rents, in every group of properties. There are always some rents that will be high and some low. The median is used to represent the group and this value therefore should be applied to the group in determining the correct assessment value.

[27] In the 2013 Downtown Rental Analysis: B Class in DT2, the range of rental rates varied from $9/ sq. ft. to $37/ sq. ft. with 2012 values ranging from $13/ sq. ft. to $23.68 /sq. ft. The subject rents ranged from $12/ sq. ft. to $20/ sq. ft. with only two rents of $16/ sq. ft. in 2012 [pg. 68-69, R-1 and pg. 28, C-1].

[28] With regard to the Complainant's point regarding the recalculation of B Class properties to the A- Class and getting lower values, the Respondent states that this only clouds the issue. There may be many reasons why that occurs with respect to these five properties. As an example, it may be that in 2013 some of the properties in one class appreciated in value faster than others and therefore the resulting values overlap. The Respondent noted that the Complainant has never contended that this property is not a B Class office building. Further, the Respondent notes that the B Class office building's typical values are close to those of the A- Class and in 2013 the ranges are also close between those classes.

[29] The Respondent stated that the resulting values are what count and the results make sense. To show this, the Respondent produced a chart and graph in which the final values of 2013 downtown offices were reduced to a dollar per square foot value. The results below [pg. 58, R-1] show that the hierarchy was maintained. All information relating to the calculations was provided.

2013Downtown Offices	
Overall Class	Weighted Mean of Assessed value per square foot
AA new	$577
AA	$565
A2 new	$543
A2	$444
A-	$412
B	$385
B-	$312
C & C-	$219
D	$204

[30] The Respondent also pointed out that the NOI from the 2013 rent roll, provided by the building owner [pg. 27, R-1], shows $5,976,342 (for the 12 month period ending December 31, 2012) which more than supports the $4,849,481 typical NOI used by the City, representing the value as of July 1, 2012. The Complainant objected to this evidence and stated that this wasn't in the Respondent's Summary of Testimonial Evidence and should therefore be stricken from the evidence.

[31] Finally, the Respondent was of the opinion that if the rent were to be reduced to $16/sq. ft. then the capitalization rate would need to be recalculated. They stated that the formula to produce the market value is interrelated so if one element is changed then you must consider all of them. The resulting capitalization rate would be 4.64% if this was done. There are nineteen B Class buildings in this economic area with 65 leases to be analysed to come up with the typical rents.

Issue 2 – Capitalization Rate

[32] The 2013 Downtown Office Capitalization Rate Summary and supporting documents were submitted [pg. 71-271, R1], showing a median capitalization rate of 5.02% for B Class office buildings in 2012, and a 4.82% median for the 2011 and 2012 period.

[33] The Respondent stated that to calculate the NOI to use to determine a typical capitalization rate, the City always uses the typical NOI closest to the sale date. That way, it is always within 6 months of the sale. This is what it has been directed to do through previous Board Decisions. If the current NOI was used there might be as much as 11 months' from the sale date.

[34] In addition, 19 B Class office buildings in DT1 were produced as equity comparables to show that all the B Class buildings were valued the same way [pg. 273, R-1].

[35] The Respondent said that the portfolio sales may well be the market value for properties in this high dollar value category. It offered that there are very few investors for this calibre of property other than REIT's, and given their expertise, these transactions should in fact be a

good indication of true market value. Without evidence, portfolio sales may be above, below or at market and therefore the Respondent stated that it does fully examine each of these portfolio transactions, reviews the details and compares them to other true sales to determine their validity as a true market transaction for its analysis.

[36] With respect to the sale of the Telephone Building, the Respondent admitted it may not be the best comparable, but that it was the only B Class building sale in DT1, so was used to test the market value. This property had a .99 Assessment to Sale Ratio (ASR) (non-time adjusted 2011 sale).

[37] Six 2013 market transactions [pg. 275, R-1] (sale prices not time adjusted) show a median ASR of 1.04 to illustrate that the process the City used does arrive at the market value for this class of properties.

[38] A number of Board Orders were provided by the Respondent to support its position.

Board's Reasons for Decision:

Issue 1 – Rental Rates

[39] The Board finds that the rental information submitted by the Respondent does support the $19/sq. ft. rate that was used to create the assessed value. To reach a typical rent the Board agrees that the rents from all the buildings in this class need to be considered. When reviewing the subject property, the Board notes that the Complainant does not have any objection to the B Classification of this property and states that it's rental history is typical. The Complainant stated that the building was not atypical and gave no reason that it did not achieve market rents. The Board also notes that the subject property's range of rents over the 2011 and 2012 period fall within the range of rents shown in the City's rental analysis for the B Class offices in the downtown. The Board finds insufficient evidence to alter the typical rents applied to this property.

[40] The subject property is in a well established economic zone in the downtown core and this subject's placement in this zone was not challenged by the Complainant. The Board finds no cause to suggest that a sub group of B Class buildings within this zone should have its own rental rates instead of the typical for that area. Nor does the Board find that it would be desirable to reduce the sample size of rents to determine typical rent.

[41] With regard to the Complainant's objection to the 2013 rent roll and NOI produced in the Respondents package, the Board determined that these were part of the overall response to the rental and NOI argument of the Complainant and were listed broadly enough in the Respondent's Summary of Testimonial Evidence to be allowed into evidence.

Issue 2 – Capitalization Rate

[42] The Board reviewed the evidence provided by both parties and in particular, consideration was given to the capitalization study provided by the Complainant. The Board finds that nothing in this study supports the Complainant's 6.50% capitalization rate request. The Complainant's evidence showed a median capitalization rate of 5.39%. The Board did test this request against the market evidence provided and found that the resulting values moved further away from market value. This result mirrored the Respondent's test result as well [pg. 63, R-1]

[43] The Board considered but rejected the premise of the Complainant's request to combine the A and B Class office buildings in this economic zone to calculate a combined

capitalization rate. The Complainant's own arguments regarding capitalization rate hierarchy make this counterintuitive.

[44] Historical information regarding capitalization rates was given little weight by the Board as capitalization rates are a function of market transactions relating to any given assessment year. While the Board agrees that it isn't common to see the current hierarchy of capitalization rates for A and B Class buildings, the move in this direction netted resulting values that (expressed on a per sq. ft. basis) did satisfy the Board that a reasonable relationship and market value was maintained. Ultimately, this is what is important, more so than the process and components of the process.

[45] The Board gave regard to the evidence presented by the Complainant on the recalculation of five B Class properties to the A- Class, resulting in lower values. Evidence in the rebuttal package on the further recalculation of five more B Class properties was deemed to be new evidence and not considered. The Board determine that the subject is a B Class building and therefore only the B Class building rents and capitalization rates were considered.

[46] Portfolio sales – No evidence was presented to show that these sales were anything but actual market value transactions. The Complainant stated that, in its opinion, they were above market value transactions and in response the Respondent indicated that these sales were carefully reviewed and tested against other transactions in the downtown area. Both parties included these sales in their respective capitalization rate studies. Given that there was no actual evidence to the contrary the Board accepts these three sales as part of the capitalization study.

[47] The Board notes that it is not bound by previous Board Orders, but did consider all those that were submitted but based its decision on the evidence before it.

[48] The Board has two tests to meet, that of equity and that of market value: The Board finds that the evidence shows there is equity within the B Class downtown office buildings and the subject property is assessed similar to other B Class office buildings in the DT2 zone. There would be no cause to change the value based on equity. This leaves market value and the Board found that market value was not satisfied when the capitalization rate was changed and tested.

DATED AT THE CITY OF CALGARY THIS 29th **DAY OF** August **2013.**

K. Thompson

Presiding Officer

APPENDIX "A"

DOCUMENTS PRESENTED AT THE HEARING AND CONSIDERED BY THE BOARD:

NO.	ITEM
1. C1	Complainant Disclosure
2. C2a and C2b	Complainant Rebuttal
2. R1	Respondent Disclosure

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.

Appeal Type	Property Type	Property Sub-Type	Issue	Sub issue
CARB	Office	High rise	Income Approach	Capitalization rate
				Rental rate