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:

PBX Properties Ltd. c/o Canadian Urban Limited (as represented by AEC Property Tax Solutions), COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

W. Kipp, PRESIDING OFFICER
D. Julien, BOARD MEMBER
A. Zindler, BOARD 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:	**079002200**
LOCATION ADDRESS:	**255 – 17 Avenue SW, Calgary AB**
FILE NUMBER:	**71066**
ASSESSMENT:	**$16,420,000**

This complaint was heard on the 19th day of August, 2013 at the office of the Assessment Review Board located at Floor No. 3, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 12.

Appeared on behalf of the Complainant:

- *B. Ryan*

Appeared on behalf of the Respondent:

- *L. Wong*

Observer:

- *Michael Oh*

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

[1] At the outset of this hearing, both parties requested that the evidence and argument regarding capitalization rates be heard once and then applied to this file (71066) and file 71082. There were no other issues on either file. The Board agreed to hear the capitalization rate evidence and argument of each party, apply it to each file and then issue separate decisions for each file.

Property Description:

[2] The property that is the subject of this assessment complaint is a class "B" office building known as Notre Dame Place. It is in market zone BL7 in the Beltline district south of downtown Calgary. The 48,977 square foot building is situated on a 16,899 square foot commercial site on the southeast corner of the intersection of 17 Avenue and 2 Street SW. The main floor of the building has 5,241 square feet of retail tenant space and there are 43,736 square feet of offices on the upper floors. There are spaces for 42 vehicles in a parkade beneath the building plus 40 parking spaces in a surface lot behind the building.

[3] The 2013 assessment was prepared by use of an income approach. Typical rents are applied to retail space ($30.00 per square foot) and to office space ($15.00 per square foot). Income from parking is added at rates of $200 per stall per month for surface stalls and at $225 per stall per month for those stalls in the underground parkade. Allowances are made to each space type for vacancy, operating costs on vacant space and non-recoverable operating costs. The resulting net operating income is capitalized at 5.25 percent to yield an overall property value. One tenant occupying 1,930 square feet of office space is exempt from taxation so that space is valued using the office criteria and the amount is deducted from the overall value to arrive at the $16,420,000 taxable assessment which represents a unit value of $335.26 per square foot of total building area.

Issues:

[4] In "Section 4 – Complaint Information" on the Assessment Review Board Complaint form, filed March 4, 2013, the Complainant checked the following matters as being applicable to the complaint:

#1 "the description of the property or business"

#3 "an assessment amount"

#4 "an assessment class"

#5 "an assessment sub-class"

#6 "the type of property"

#7 "the type of improvement"

#9 "whether the property or business is assessable"

#10 "whether the property or business is exempt from taxation".

[5] In "Section 5 – Reason(s) for Complaint", the Complainant stated numerous reasons for the complaint.

[6] At the hearing, the Complainant pursued one issue:

Should the capitalization rate be increased from 5.25 percent to 6.25 percent?

Complainant's Requested Value: $13,800,000.

Board's Decision:

[7] The Board finds that a capitalization rate of 6.25 percent is supported by evidence and it reduces the taxable assessment to $13,800,000. The assessment on the tax exempt roll was not complained against and the Board therefore has no jurisdiction to change that assessment.

Position of the Parties

Complainant's Position:

[8] The assessment increased by 69 percent from 2012 to 2013. That rate of increase is unreasonable for a property that has not changed during the year.

[9] In its *2013 Beltline Office Capitalization Rates* study, the Respondent derives capitalization rates by application of the wrong net operating income parameters. The Respondent analyzes sales on a calendar year basis. If a property sale closed in 2011, it is the typical net operating income as at July 1, 2011 that is used to derive a capitalization rate. The correct methodology is to derive capitalization rates using the typical net operating income for the valuation date that follows the date of sale. If the sale occurred between July 2011 and June 2012, then it must be analyzed using typical net operating income for the July 1, 2012 valuation date. The Respondent's lease summary shows office lease rates around $15 per square foot at the time of some of the sales but those sales have been incorrectly analyzed using a $13 per square foot 2011 office rent rate which would have been determined on the basis of lease data

for a period of at least one year prior to that date. For example, Alberta Place sold in December 2011 and it was analyzed by the Respondent on the basis of a $13.00 per square foot office rent rate. A lease for office space that commenced in October 2011 (two months prior to the sale) was at a rental rate of $15.50 per square foot. The July 1, 2012 typical office rent rate is $15.00 per square foot, a rate that is much nearer to actual rent rates at the time. In this instance, using the incorrect typical rent produces a capitalization rate that is too low.

[10] If properly analyzed, four of the five sales studied by the Respondent would have higher capitalization rates:

The Keg/Ingersoll	Respondent	5.25%	Correct:	5.32%
Cooper Block	Respondent	3.63%	Correct:	4.66%
Alberta Place	Respondent	5.68%	Correct:	6.29%
Dominion Place:	Respondent	6.53%	Correct:	7.69%

[11] When the correct rates are considered along with the properly analyzed Connaught Centre sale where the capitalization rate is 4.83 percent, the average of all five sales is 5.76 percent, the median is 5.32 percent and the weighted mean is 5.99 percent. If the two purchases (The Keg/Ingersoll and Cooper Block) by Allied Properties are excluded, the average capitalization rate is 6.27 percent, the median is 6.29 percent and the weighted mean is 5.99 percent.

[12] Alberta Place and Dominion Place were the subjects of two Composite Assessment Review Board assessment complaints for the 2013 tax year. The assessment of Alberta Place was reduced to its 2011 sale price. That price, when related to the Respondent's typical factors, indicated a capitalization rate of 6.29 percent. The assessment of Dominion Place was reduced by capitalizing the net operating income using typical factors at 6.25 percent.

[13] The Respondent included two property sales in its capitalization rate analysis where Allied Properties REIT was purchaser. One of those properties, the Cooper Block was one property in a portfolio of four Calgary buildings. Typically, the Respondent does not use portfolio sales in its analyses but has chosen, without good reason, to include this portfolio property in the 2013 capitalization rate study. For that reason alone, it should be excluded from the capitalization rate analysis. The Keg/Ingersoll is another very old building that was purchased by Allied on the basis of its ownership philosophy and investment approach.

[14] Allied is an investment company whose core mission is "acquiring and managing beautiful, historic buildings that inspire creative excellence." For this reason, the company is motivated differently than other real estate investors and does not make purchase decisions using the same investment criteria as others might do.

[15] Several real estate brokerage companies conduct periodic surveys wherein they ask investors' opinions on such things as rental rates and capitalization rates. A compilation of survey results from Colliers International and CB Richard Ellis shows that for quarters 2 and 3 of 2012, Class "B" suburban office capitalization rates ranged from 6.50 to 7.25 percent. Even downtown capitalization rates were higher than the 5.25 percent rate applied by the Respondent in valuing Class "B" Beltline offices. Downtown rates for Class "B" buildings ranged from 6.25 to 7.25 percent for the same two quarters.

Respondent's Position:

[16] Five Class "B" office property sales were analyzed in the Beltline office capitalization rate study. In order to retain consistency, sale year typical rents, vacancies and operating expenses were utilized in the analysis. If a property sold during 2011, then July 1, 2011 typical factors were used.

[17] Two of the five sales were properties acquired by Allied Properties REIT in August and September 2011. These were both considered by the Respondent to have sold at market value. Exhibit R1 contains the cover pages and letters of transmittal from appraisals of those properties with value estimates as at June and July 2011. Both of those value estimates were similar to the reported sale prices.

[18] Two 2010 Municipal Government Board (MGB) decisions (DL 019/10 and MGB 123/10) support the contention that a capitalization rate applied to typical factors must be derived using typical factors. One of the decisions was a merit hearing regarding the 2009 assessment of several suburban Calgary office properties. The second decision was the result of a review of the prior decision by two of the three MGB members who had heard the first appeal.

Board's Reasons for Decision:

[19] Having regard to the 69 percent year over year increase in the assessment, there was no market evidence to suggest what a proper rate of change should be. Nevertheless, the Board will not adjust assessments solely on the basis of year over year changes.

[20] During this hearing, many decisions and orders of courts, the Municipal Government Board (MGB) and numerous Composite Assessment Review Boards (CARBs) were presented by each of the parties. The Board is cognizant of those decisions and orders but wishes to make it clear that it is not bound by MGB or prior CARB decisions and the merits of this case are weighed on the evidence and argument put forward by the parties.

[21] The Board rejects both of the Allied Properties acquisitions for capitalization rate derivations. The Cooper Block was a part of a portfolio of four properties that were purchased by Allied. Typically, the Respondent does not place weight on sales that are a part of a portfolio but has chosen to do so in this instance. The Board finds that there is insufficient evidence to show that the sale price fits within the definition of market value "*the amount that a property might be expected to realize if it is sold on the open market by a willing seller to a willing buyer.*" The Keg/Ingersoll property is not useful because of too much conflicting information. As at July 1, 2011, the Respondent estimated net operating income at $628,803 and by July 1, 2012, it had risen to $819,582, an increase of more than 30 percent. Assessment records show that there was a major shift in floor area allocations between those two valuation dates and it is not known what the status was when the sale occurred. The excerpts from appraisal reports are of no assistance to the Board since there are no other parts of the appraisal reports that might explain the "Scope of Work" or the assumptions, limiting conditions, certifications and definitions, for example. Each of the properties is described as a "character" property but there is no explanation of that term as it relates to real property. Neither of the appraisals describes the interest that was appraised (fee simple, leased fee or other).

[22] Two of the sales that remain in the capitalization rate analysis were sales that occurred in late 2011 (December 1 and December 29). The Board finds that the appropriate net operating income estimate to use in the capitalization rate derivation process is the one based on typical factors as at July 1, 2012. Appraisal theory surrounding the concept of market value describes value as the present worth of future benefits. The basis of the income approach is that income

producing real property is purchased for the right to receive future income flow. In the direct capitalization process, it is the net operating income for a one year period commencing on the valuation date that is capitalized. When an investor is deciding how much to pay for a property, it is a forward looking exercise. That investor, while cognizant of the recent past, is primarily concerned with the property's ability to produce income in the future. Rental data provided by the parties shows that office rental rates in late 2011 were nearer to the typical rates as at July 1, 2012 than to those for July 1, 2011.

[23] One of the contrasts between the marketplace and the Respondent's assessment process is the derivation of capitalization rates. Two components of the valuation formula must be known: the price at which the property sold and the net operating income. The price that was paid for a property is an amount that was based on a great many factors at the time of sale. It is a market fact that was based on actual income with strong consideration given to potential for changes in that income. The net operating income that is based on typical factors is not a market fact. It is an income amount that is based on the ideal situation where the property is assumed to have been producing income based on market rents. In reality, seldom is a multi-tenant property fully occupied by tenants paying full market rents for their premises. To use the three remaining Beltline sales as examples, Alberta Place and Dominion Place were generating incomes that were not significantly different than incomes based on typical factors. Their capitalization rates based on July 1, 2012 typical net operating incomes were 6.29 and 7.69 percent, respectively. Connaught Centre, on the other hand, had an actual income that was almost 60 percent greater than its estimated July 1, 2012 income based on typical factors. While the capitalization rate based on actual income was of the order of 7.7 percent, the rate derived by relating actual price to typical income is just 4.83 percent. It is logical that greater weight should be placed on the Alberta Place and Dominion Place sales with a lesser weight on the Connaught Centre sale.

[24] The Board concludes that the Complainant's requested capitalization rate of 6.25 percent is supported by the sales analysis. The Board places no reliance on the market survey reports prepared by real estate brokers however it is noteworthy that the mid-year 2012 surveys from Colliers and CB Richard Ellis support the 6.25 percent rate.

[25] Two other Beltline property sales were referenced from time to time during the hearing. A Class "A" property sale occurred in March 2013 while a Class "B" office sold in January 2013. While there could be some merit to using late 2012 sales to discern or confirm trends in the marketplace, 2013 sales are too far past the valuation date (July 1, 2012) to be useful.

DATED AT THE CITY OF CALGARY THIS 24 **DAY OF** September **2013.**

W. K

W. Kipp

Presiding Officer

APPENDIX "A"

DOCUMENTS PRESENTED AT THE HEARING AND CONSIDERED BY THE BOARD:

NO.	ITEM
1. C1 (Parts A, B & C)	Complainant Disclosure
2. C2	Complainant Disclosure
3. R1	Respondent Disclosure
4. C3	Complainant Rebuttal

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 Internal Use

Appeal Type	Property Type	Property Sub-Type	Issue	Sub-Issue
CARB	OFFICE	HIGH RISE	INCOME APPROACH	CAPITALIZATION RATE