

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:

SUN LIFE ASSURANCE COMPANY OF CANADA
(as represented by MNP LLP), COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

Earl K. Williams, PRESIDING OFFICER
K. B. Bickford, MEMBER
A. Maciag, 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: 067026807

LOCATION ADDRESS: 640 5 AV SW

FILE NUMBER: 71121

ASSESSMENT: \$94,380,000

This complaint was heard on 27th day of August, 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. Worsely Agent, MNP LLP

Appeared on behalf of the Respondent:

- K. Gardner Assessor, The City of Calgary

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

[1] The parties identified to the Board that the evidence and arguments to be presented in respect of the hearing on Capitalization Rate (cap rate) and vacancy rate for the subject property will be the same as presented in respect of File # 70747 for Property Roll # 068053206 and requested that the evidence and arguments be carried forward to the subject property. It was accepted that the Board's findings and decision regarding the cap rate issue would therefore be common to the subject property. The Board found this to be an appropriate approach to the matters at hand.

[2] No additional Procedural or Jurisdictional Matters were raised by the parties.

Property Description:

[3] The subject property at 640 5 AV SW is a 251,460 square foot (sq. ft.) office building on 0.55 acre of land with a 1979 approximate year of construction (ayoc), assigned a B quality rating in the Downtown Commercial Core in Downtown Zone 2 (DT2) with the Property Use: Commercial and Sub Property Use: CS1253 Office/Parking. The space profile of the subject property is 3,806 sq. ft. of main floor retail, 244,338 sq. ft. of office and 3,315 sq. ft. of recreational space. The subject property is named the Energy Resources Building.

[4] The assessment was prepared on the Income Approach with a capitalization rate (cap rate) of 5.00%, a rental rate of \$19.00 per square foot (psf) for the office space, \$16.00 psf for the retail space, \$16.00 psf for the recreational space, an office vacancy rate of 4.75% and a main floor retail vacancy rate of 7.75%.

Issues:

[5] Should the subject property be assessed on the Income Approach with the assessed office rental rate reduced from \$19.00 psf to \$16.00 psf?

[6] Should the December 31, 2012 base building condition of identified space be recognized with a reduction of \$6.00 psf in the assessed rental rate?

[7] Should the subject property assessed on the Income Approach and have the office vacancy rate increased from 4.75% to 10.0%?

[8] Is the current assessed cap rate of 5.00% reflective of the market conditions as of the designated valuation date or is the correct capitalization rate to apply 6.00%?

Complainant's Requested Value: \$58,500,000

Board's Decision:

[9] Based on the evidence and argument presented the Board supports the determination of the assessment based on the following:

- 1) the cap rate of 5.0%;
- 2) the vacancy rate of 4.75%;
- 3) a one-time increase in the vacancy rate to 10% to recognize the vacancy while the subject property was in the process of a retrofit;
- 4) an office rental rate to \$16.00 psf; and
- 5) a reduction of \$6.00 psf in the assessed rental rate for the 19,762 sq. ft. which was identified to be in base building condition at December 31, 2012.

[10] The assessment is reduced to \$70,210,000.

Position of the Parties

[11] The Complainant and Respondent presented a wide range of evidence consisting of relevant and less relevant evidence. In the interests of brevity, the Board will restrict its comments to those items the Board found relevant to the matters at hand. Furthermore, the Board's findings and decision reflect on the evidence presented and examined by the parties before the Board at the time of the hearing.

[12] The Complainant's evidence package included a Summary of Testimonial Evidence, a map identifying the location of the property, photographs of the exterior of the subject property, the City of Calgary 2013 Property Assessment Notice, the Property Assessment Detail Report, the City of Calgary Non-Residential Properties – Income Approach Valuation work sheet and the Assessment Request for Information (ARFI). In support of the vacancy rate the evidence included the MNP's "B" Vacancy Analysis. For the office rental rate the evidence included recent leasing activity in the subject property and MNP's "B" Lease Study. In support of the cap rate issue the Complainant submitted an overview of the City of Calgary and the MNP methodology, an analysis of a number of comparable properties including supporting documentation, market studies on cap rates, excerpts from applicable legislation, excerpts of technical information related to capitalization rate methodology, excerpts of decisions from the Alberta Court of Queen's Bench, as well as Assessment Review Board and Municipal Government Board decisions in support of its position.

[13] The Respondent's evidence package included a Summary of Testimonial Evidence, a map identifying the location of the property, photographs of the exterior of the subject property, the City of Calgary 2013 Property Assessment Summary Report, the City of Calgary Non-Residential Properties – Income Approach Valuation work sheet, and the Assessment Request for Information (ARFI). In support of the vacancy rate the evidence included the City of Calgary 2013 Downtown Office Vacancy Analysis: B Class DT2, DT3, DT9. In support of the rental rate the evidence included the City of Calgary 2013 Downtown Office Rental Rate Analysis: B- Class in DT2& DT3. In support of the cap rate issue the Respondent submitted an overview of the City of Calgary Capitalization Rate Summary, the analysis of a number of comparable properties including supporting documentation, excerpts from applicable legislation, excerpts of

technical information, as well as Assessment Review Board and Municipal Government Board decisions in support of its position.

[14] As noted above, both parties placed before this Board a number of Alberta Court of Queen's Bench, Assessment Review Board and Municipal Government Board decisions in support of their position. These decisions were made in respect of issues and evidence that may however be dissimilar to that before this Board.

Issue – Capitalization Rate

Complainant's Position:

[15] The Complainant argued that the methodology utilized by the City of Calgary in the derivation of the cap rate is based on flawed assumptions related to the development of the net operating income (NOI). One assumption that is challenged is the absence of consistency in the application of time frames. For example, the use of income parameters from July 1, 2010 to July 1, 2011 to calculate the NOI to derive the cap rate for sales occurring in the period July 1, 2011 to December 31, 2011, is flawed as there is a difference in timing by up to 6 months. The NOI is not reflective of the period when the transaction occurred. The Complainant proposes that the 12 month period used to determine the income to calculate the NOI should be the same as the 12 month period during which the sale occurred. For example, the income parameters for the period July 1, 2011 to July 1, 2012 should be used for sales which occurred in that same 12 month period. Details on the Complainant's position are provided on pages 45 to 65 of Exhibit C1.

[16] A second concern expressed by the Complainant related to the practice of the City of Calgary to include portfolio sales in the derivation of the cap rate. The Complainant's primary concern with portfolio sales is the difficulty in determining what the actual value is for each property included in the portfolio. Supporting documentation for this position is provided on pages 66 to 101 of Exhibit C1.

[17] Page 48 of Exhibit C1 presents the parameters used by the City of Calgary for the income approach to assess downtown office buildings in the DT1 and DT2 zones. The cap rate by office classification for DT1 and DT2 is as follows:

<u>Office Classification</u>	<u>Cap Rate</u>
AA New/AA/A/A-	6.00%
B/B-	5.00%
C/C-	5.50%

[18] The Complainant reviewed the MNP Capitalization Rate Study (pages 102 to 131 of Exhibit C1) for the period July 1, 2011 to July 1, 2012. Their methodology excludes portfolio sales and calculates the NOI based on rental rates for the same 12 month period as the sales. The table on page 103 presents particulars on the 5 sales in DT1 and DT2 on which the MNP study is based. The 5 sales include 3 Class A, 1 Class B and 1 Class C building. The median capitalization rate determined by the study is 6.02% which is rounded to 6.00%. This cap rate would be applied to all downtown office classifications.

[19] As further support the Complainant reviewed the details on the Class B transaction reported in paragraph [18]. This January 2012 transaction is reported by the Complainant as an office building in DT1 and derived a cap rate of 5.87%.

[20] As additional evidence the Complainant reviewed the CBRE Canadian Cap Rate Study for Q2 2012 which reported a range of 6.25% to 7.0% for downtown Class B buildings.

[21] In summary, the Complainant argued that the MNP methodology determines a cap rate on consistent assumptions of 6.0% which is to be allied to the subject property.

Respondent's Position:

[22] The Respondent presented an argument in defence of the methodology used to determine the cap rates used in the income approach valuation.

[23] A table titled 2013 Downtown Office Capitalization Rate Summary on page 106 of Exhibit R1 presented details on 16 transactions for Class A, B and C buildings reported for the period 2011 and 2012. The Class B transactions included B and B- buildings. An analysis by building class and year provided further details.

[24] The analysis of all the B transactions reported a median and mean cap rate of 4.82%. A further analysis of the 2012 Class B transactions reported a mean of 5.07% and a median of 5.02%.

Board's Reasons for Decision:

[25] The Respondent and Complainant outlined their respective positions on cap rate methodology and the cap rate for Class B buildings. Specifically:

- 1) Respondent - on a sample of 3B Class 2012 transactions, reported a mean of 5.07% and a median of 5.02%.
- 2) Complainant – argued for a 6.00% cap rate regardless of building class and one B Class transaction with a cap rate of 5.87%.

[26] The Board determined that the Respondent's evidence related to the B Class transactions was more representative of the market and there is a lack of compelling evidence to support a change on the cap rate.

[27] Based on the evidence and arguments presented, the Board confirms the cap rate of 5.0% in the determination of the assessment.

Issue – Office Rental Rate

Complainant's Position

[28] The Complainant reviewed the table titled MNP's DT2 "B" Class Office Lease Rate Study on page 42 of Exhibit C1. The study reported lease particulars on 60 leases with commencement dates in the period July 2011 to July 2012. The rental rates ranged from \$9.00 psf to \$25.25 psf. The median rental rate was \$16.00 psf and the mean \$16.09 psf.

[29] In Summary the Complainant argued that the market leases presented in the table referenced in paragraph [28] support the requested office rental rate of \$16.00 psf.

Respondent's Position:

[30] The Respondent on page 100 of Exhibit R1 presents a table titled the City of Calgary 2013 Downtown Office Rental Rate Analysis: B Class DT2 & DT3. The study provided lease particulars on 66 office leases with commencement dates in the period July 2011 to July 2012.

[31] The following table presents the rental rate analysis:

	2011 – 2012 Comm. Date	2012 Comm. Date
Number of Leases	66	30
Range	\$9.00-\$25.25 psf	\$13.00-\$23.90 psf
Mean Rental Rate	\$16.83 psf	\$17.41 psf
Median Rental Rate	\$16.00 psf	\$16.18 psf
Weighted Mean	\$17.47 psf	\$20.12 psf

Comm. Date: Commencement Date

[32] In summary the Respondent argued that the mean and weighted mean rental rate for the 30 leases with 2012 commencement dates support the \$19.00 psf.

Board's Reasons for Decision:

[33] The Complainant's study referenced in paragraph [28] reported a median rental rate of \$16.00 psf and a mean rental rate of \$16.09 psf. A further analysis of this study determined that 30 of the leases had start dates in the period January 2012 to July 2012. An analysis of these 30 leases calculated a median rental rate of \$16.00 psf.

[34] The Respondent's study referenced in paragraph [30] reported a median rental rate of \$16.00 psf for the sample of 66 leases for the July 2011 to July 2012 period and a median rental rate of \$16.18 psf for the sample of 30 leases in the period January 2012 to July 2012.

[35] Based on the arguments and evidence presented the Board supports the use of a \$16.00 psf rental rate for the office space.

Issue – Tenant Improvements

Complainant's Position

[36] The Complainant reviewed with the Board the December 31, 2012 status of the building. The vacancy is 19,762 sq. ft. comprised of 15,956 sq. ft. of office space and 3,806 sq. ft. of main floor retail space. This space is at base building and does not have any tenant improvements.

[37] In respect of the condition of this space at December 31 the Complainant argued that Section 289 (2)(a) of the Municipal Government Act (MGA), Chapter M-26 Section 460 states:

"289(2) Each assessment must reflect

(a) the characteristics and physical condition of the property on December 31 of the year prior to the year in which a tax is imposed under Part 10 in respect of the property,"

Therefore the 19,762 sq. ft. referenced in paragraph [37] which was completely vacant and in a shell state at December 31, 2012 are deserving of an adjustment in the rental rate to recognize their condition.

[38] In support of their position the Complainant referenced a number of previous Municipal Government Board and Composite Assessment Review Board decisions related to this matter as well as the 2005 Queen's Bench of Alberta Decision in the case of 97604 Alberta Ltd V. Calgary (City of) ABCB 512.

[39] In an email on pages 32-34 of Exhibit C1 from Bentall Kennedy (Canada) LP, the

property manager for the subject building, provided documentation in respect of the costs of interior work. Paragraph 3 Cost of Interior Work in the email reported that the average cost of Tenant Improvements (TI's) is \$60.00 psf. On a 10 year lease this equates to TI's of \$6.00 psf per year.

[40] In summary the Complainant requested that the condition of the 19,762 sq. ft. be recognized as base building at December 31, 2012 and a reduction of \$6.00 psf be applied to the assessment rental rate.

Respondent's Position:

[41] The Respondent argued that lease up costs such as TI's are a marketing tool used by Landlords as an incentive for tenant's which are recaptured by the Landlord in the rent structure. As the improvements enhance the value of the building there should be no reduction in the rent used to determine the NOI to recognize the value of the improvements expressed as a psf cost. Pages 50-89 of Exhibit R1 outline the Respondent's position on this matter as well as providing supporting decisions.

Board's Reasons for Decision:

[42] Based on the provisions of Section 289 (2)(a), the arguments and evidence presented by the Complainant, the Board supports that the condition of the area of 19,762 sq. ft. be designated as base building and receive a reduction of \$6.00 psf in the assessment rental rate for this space.

Issue – Office Vacancy Rate

Complainant's Position

[43] The Complainant outlined that the owner of the subject property has initiated a major retrofit of the building prior to actively marketing the property. This action has resulted in the building experiencing a major vacancy for the past 18 months. As support the Complainant reviewed the tenant roll for the property which for the months of July 2011 and December 2011 reported a vacancy of 99.96%. In July 2012, the vacancy was reported as 206,425 sq. ft. (81.14%). The Complainant requested that this situation be recognized in the vacancy rate applied to the subject property.

[44] As further support, the Complainant reviewed the July 1, 2012 DT2 "B" Class Office Vacancy Study on page 44 of Exhibit C1. The study reports a 10.13% vacancy based on a sample of 18 "B" class office buildings which included the subject property which reported a vacancy of 81.99%.

[45] In summary the Complainant argued that the historical vacancy in the subject property and the July 2012 market study supports the requested 10.0% vacancy rate.

Respondent's Position:

[46] The Respondent on page 103 of Exhibit R1 presents a table titled the City of Calgary 2013 Downtown Office Vacancy Analysis: B Class DT2, DT3, DT9. The study reports a 4.67% vacancy rate for a sample of 18 "B" class buildings which excluded the subject property.

[47] In respect of the vacancy for the subject property the Respondent reviewed the July 2012 ARFI on page 21-24 of Exhibit R1. This document reported the vacancy as of July 20, 2012 to be 28,269 sq. ft. (11.2% vacancy rate) comprised of 24,463 sq. ft. of office space and 3,806 sq. ft. of retail space.

[48] In summary, the Respondent argued that the ARFI demonstrates that the subject property is no longer experiencing a high vacancy and the vacancy study reported in paragraph [46] supports the 4.75% vacancy rate.

Board's Reasons for Decision:

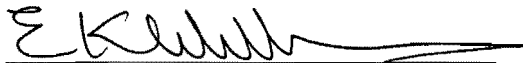
[49] In respect of the subject property, the Board following a review of the evidence determined that the July 2012 ARFI did report a vacancy of 28,269 sq. ft. as well as reporting that 175,859 sq. ft. was leased but unoccupied as at July 2012. The leases commenced August and October 2012 (page 23 of Exhibit R1).

[50] The Complainant's vacancy study referenced in paragraph [44] included the subject property where as the Respondent's study excluded the subject property. If the subject property, which reported a vacant area of 200,322 sq. ft., is excluded from the Complainant's analysis the vacancy rate for the remaining 17 buildings is 4.79%. The Respondent's vacancy study referenced in paragraph [46] reported a vacancy rate of 4.67%.

[51] The vacancy studies support the mass appraisal office vacancy rate of 4.75% which the Respondent uses as a parameter in the Income Approach. Upon further review of the evidence related to the vacancy of the subject property, the Board has decided to make a onetime exception for this "a typical" situation where the entire building was vacated with a retrofit program taking place from 2010 through 2012.

[52] The Board also noted the new 2012 leases included significant free rent periods. On that basis the Board is allowing a site specific, one time, and 10% vacancy allowance for determining the value of the subject property.

DATED AT THE CITY OF CALGARY THIS 27 DAY OF November 2013.



Earl K. Williams
Presiding Officer

APPENDIX "A"**DOCUMENTS PRESENTED AT THE HEARING
AND CONSIDERED BY THE BOARD:**

NO.	ITEM
1. C1	Complainant Disclosure Subject Property Disclosure
2. C2	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.*

FOR ADMINISTRATIVE USE

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