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:

411 Capital Corp. (Represented by Altus Group), COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

W. Kipp, PRESIDING OFFICER
R. Cochrane, BOARD MEMBER
J. Rankin, 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 2014 Assessment Roll as follows:

ROLL NUMBER:	**068110105**
LOCATION ADDRESS:	**409 – 8 Avenue SW, Calgary AB**
FILE NUMBER:	**74677**
ASSESSMENT:	**$10,180,000**

This complaint was heard by a Composite Assessment Review Board (CARB) on the 19th day of August, 2014 in Boardroom 4 at the office of the Assessment Review Board located at 1212 – 31 Avenue NE, Calgary, Alberta.

Appeared on behalf of the Complainant:

- *S. Meiklejohn* *Agent, Altus Group*

Appeared on behalf of the Respondent:

- *C. Fox* *Assessor, The City of Calgary*
- *K. Gardiner* *Assessor, The City of Calgary*

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

[1] Neither party had any objection to the composition of the CARB panel.

[2] Pursuant to legislation regarding assessment complaints and assessment review board responsibility, the CARB reviewed the complaint file and determined that the complaint form and an agent authorization form were appropriately filed. There were no problems with filing of party disclosure but it was noted that one of the Respondent's disclosure documents (R1) was intended to be applicable to several complaint files that were being heard on the same agenda. The Complainant had no objection to the CARB designating the document as Exhibit R1 and making it applicable to files 75742, 75656, 75671, 74677, 74661, 75654 and 75659.

[3] There were no jurisdictional matters to be decided.

Property Description:

[4] The property that is the subject of this assessment complaint is a downtown Calgary office building known as the CalFrac Building. It is situated on a 10,477 square foot commercial site in the DT8 economic zone. The 1954 four storey building contains a total area of 48,267 square feet of office (35,112 square feet) and storage space (13,115 square feet). There is no onsite vehicle parking.

[5] For 2014, this property is assessed as a "C" quality office using an income approach. Typical rent rates are applied to each space type (office @ $20.50 per square foot and storage @ $6.00 per square foot). For "C" properties, vacancy allowances are 16.00 percent for offices and 2.00 percent for storage income. After allowances for operating costs on vacant space ($14.50 per square foot of office $5.00 per square foot of storage) and non-recoverable expenses (2.00 percent of total effective net income), the net operating income as at July 1, 2013 is $585,565. A 5.75 percent capitalization rate is applied to arrive at the assessed value which is truncated to $10,180,000 ($210.91 per square foot of building area).

Issues:

[6] The Assessment Review Board Complaint form was filed on February 25, 2014 by Altus Group on behalf of 411 Capital Corp., the "assessed person." Section 4 – Complaint Information had a check mark in the box for #3 "Assessment amount".

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

[8] At the hearing, the Complainant pursued the following issues:

1) The vacancy rate for office space in "C" buildings should be 24.25 percent instead of 16.00 percent; and
2) The capitalization rate applicable to "C" buildings should be 6.25 percent instead of 5.75 percent.

Complainant's Requested Value: $7,760,000 ($160.77 per square foot of building area).

Board's Decision:

[9] The assessment is reduced to **$8,980,000** by increasing the vacancy allowance applied to office income from 16.00 to 22.00 percent.

Legislative Authority, Requirements and Considerations:

[10] The CARB is established pursuant to Part 11 (Assessment Review Boards), Division 1 (Establishment and Function of Assessment Review Boards) of the Act. CARB decisions are rendered pursuant to Division 2 (Decisions of Assessment Review Boards) of the Act.

[11] Actions of the CARB involve reference to the Interpretation Act and the Act as well as the regulations established under the Act. When legislative interpretation is made by the CARB, references and explanations will be provided in the relevant areas of the board order.

<u>Position of the Parties</u>

Complainant's Position:

[12] The Complainant's evidence disclosure, filed on July 7, 2014 and marked by the CARB as Exhibit C1 was filed with the CARB administration and the Respondent on the prescribed filing date.

[13] The vacancy study undertaken by the Respondent sets out gross and vacant areas of 10 "C" buildings in the DT1,8 economic zone of downtown. The subject property is included but it should not be because it is a single tenant building. The Complainant argues that a city-owned property (Andrew Davison Building) and an owner-user property (City TV) should not be included. Assessments of downtown office properties are prepared on the underlying assumption that each building is a multi-tenant property. For that reason, typical rents, vacancy and other allowances are all drawn from reported data on multi-tenant properties. If single tenant lease rates from single tenant properties are not included in the quest for a typical rent

rate, then those properties should not be included in the vacancy study either. Government and owner-user properties do not report rent and do not compete with multi-tenant properties in the same market area.

[14] The Complainant's DT1,8 commentary on vacancy included the City TV property which had a 0.0 percent vacancy. This property was not included in the Respondent's DT1,8 evidence. The Respondent's finding from the nine properties in its study was that the "C" vacancy rate is 16.44 percent. With the suggested property deletions, the Complainant determined that the correct rate is 24.17 percent which rounds to 24.25 percent.

[15] The CalFrac Building is a high risk investment because of its single tenant occupancy. CalFrac has outgrown the building and leases space in an adjoining building. Its lease in the subject building expires in August 2015 and there is a strong possibility that this tenant will vacate the space at that time. That would leave the building empty and in search of a new tenant.

[16] In its capitalization rate study, the Respondent extracts the rate from a sale using the typical net operating income that is effective as at the nearest July 1 valuation date. Since data from a one or two year period leading up to a valuation date is used to determine typical rents, some of the leases could be several months old. If there have been changes in the market, that older data can impact the capitalization rate that is derived from the sale. The appropriate net operating income amount is the one as at the date of the property sale. The Complainant used the Respondent's lease comparables to develop a typical net operating income estimate as at the date of sale.

[17] In the downtown "C" property class, there was one sale that occurred within the analysis period. The Centennial Building at 816 – 7 Avenue SW sold for $6,020,000 in January 2012. The Respondent extracted a capitalization rate of 5.61 percent by dividing the sale price into the typical net operating income as at July 1, 2012. That income amount was based on a typical office rent rate of $13.00 per square foot. Since the property sold in January 2012, it is the typical net operating income as at that month that should be used. Using the Respondent's full listing of Class "C" office rent comparables, the Complainant selected those that fit within certain ranges. For analysis of this property, six subsets of rents were set out: nine months prior to and after the sale date, six months prior to and after the sale date, three months prior to and after the sale date, three months straddling the sale date, six months straddling the sale date and nine months straddling the sale date. All three of the before and after analyses showed that rents were rising. Through the analysis method, it was possible to determine when increases occurred. The Complainant's conclusion was that the typical office rent rate was understated by the Respondent's use of a net operating income amount from an incorrect period of time. The correct rent rate is $14.00 per square foot for offices with all other rates remaining the same as those used by the Respondent. The $14.00 rate takes into account lease data both before and after the sale date. The analysis showed that rates were increasing. With appropriate changes made, the correct capitalization rate to be extracted from the Centennial Building sale is 6.02 percent. There is also concern that the Centennial Building sale was not an office building sale because it was acquired by the owner of adjoining land that was slated for redevelopment.

[18] The Complainant offered a second property sale for consideration. That sale involved the Burns Building, a seven storey office building at 237 – 8 Avenue SE (Stephen Avenue Mall), directly across Macleod Trail from the Calgary Municipal Building (City Hall). There are 60,387 square feet of office space, 13,314 square feet of ground floor retail space and 1,265 square feet of basement storage space. There is no parking on the site. The Burns Building is designated by the Province of Alberta as an historical resource. The leasehold interest in the property sold for $13,100,000 in August 2012. Fee simple title is held by The City of Calgary

and there is a long term lease to the leasehold estate owner. By adding $2,270,000 for land value to the leasehold sale price, the Complainant determined that an equivalent fee simple price would have been $15,370,000 ($205 per square foot of building area). The land add-on was calculated by application of the City of Calgary land assessment rate of $175 per square foot to the area of the land under the Burns Building. Because of the potentially very long remaining lease term, the market would not perceive a difference in risk from ownership of the leasehold estate versus ownership of the fee simple interest so this was essentially a sale of the fee simple estate. Using a similar analysis to that for the Centennial Building sale, the Complainant estimated the net operating income based on typical rents as at the date of sale (August 2012). In this instance, a 12 month prior and post sale time period was added. The conclusion was that the typical rent rates as at August 2012 would have been: Office - $16.00, Retail - $16.00, Storage - $6.00 (all are per square foot rates). The indicated net operating income of $1,001,774 yielded a capitalization rate (on the estimated fee simple price) of 6.52 percent.

[19] The conclusion drawn by the Complainant is that the "C" property capitalization rate should be 6.25 percent and not 5.75 percent as determined by the Respondent.

Respondent's Position:

[20] The Respondent's evidence disclosure, filed on August 5, 2014 and marked by the CARB as Exhibit R1 was filed with the CARB administration and the Complainant on the prescribed filing date (see paragraph 2).

[21] The vacancy study for DT1,8 analyzed nine "C" buildings. If the Andrew Davison and CalFrac buildings are removed, as suggested by the Complainant, the vacancy rate only increases a small amount – from 16.44 to 16.59 percent.

[22] The leasehold estate in the Burns Building sold in August 2012 and subsequently, a major rework of the building interior was undertaken. The vacancy in early 2013 is not typical for the building or its class. Further, the Burns Building is a historically significant asset which presents greater ownership risk from a purchaser's perspective. It is not a common valuation practice to add a land value to the sale price of a leasehold estate to arrive at a fee simple estate value.

[23] The capitalization rate from the sale of the Centennial Building was found using standard analysis procedures with a focus on typical net operating income as at the valuation date nearest to the sale date. In this instance, that was July 1, 2012.

Board's Reasons for Decision:

[24] The Complainant argued that government owned/occupied buildings, owner-user properties and single tenant buildings should be removed from any vacancy study. The CARB agrees that government properties do not compete for tenants in the marketplace. Single tenant buildings, on the other hand, compete for tenants whether it is a single tenant or a number of smaller tenants that take the space. While there might be greater risk of a high vacancy if the single tenant should vacate, the building could still be leased to a new single tenant or configured to accommodate more than one tenant. An owner-user building could be put onto the rental market at any time, either in whole or in part. Single tenant and owner-user properties should remain in the vacancy study.

[25] The Respondent's DT1,8 vacancy study surveyed nine "C" buildings in DT1,8. One of those was the city owned and occupied Andrew Davison building and if it is removed from the study, the weighted average vacancy rate rises to 22.2 percent. The CARB sets the "C" DT1,8 vacancy rate at 22.0 percent. It is recognized that the subject building will be 100 percent vacant if and when the current tenant moves out. In the meantime, it is 100 percent occupied. The purpose of assigning a typical vacancy loss allowance is to account for potential vacancy on a year over year basis and to recognize that most properties experience periods of lower and higher vacancies over the course of their lives.

[26] The Centennial Building sale is the only "C" property sale that occurred in downtown during the analysis period leading up to the July 1, 2013 valuation date. The CARB recognizes that it is common practice for the Respondent and others to rely upon data from transactions that occurred during an analysis period of one or two years but that practice has potential to produce faulty results if unknown circumstances affected a property sale price. While there is no obligation to extend the period of time for market analysis, there is no reason to limit the analysis to one or two years when there is minimal data available (i.e., just one property sale). A market analysis extending further backwards in time by one, two or more years is possible. A thorough analyst should want to have as much information available as possible even it means having to make adjustments to some of the older data. This leads the CARB to the conclusion that the adjusted sale of the Burns Building leasehold estate is worthy of analysis. The sale was an indicator of the actions of market participants. While the leasehold estate sale is perhaps a weaker indicator than an open market, arms-length transaction involving a fee simple estate sale, it is nevertheless an indicator that assists an analyst in measuring market activity. It is not possible to definitively allocate weight to the two available sales (Centennial Building fee simple estate and Burns Building leasehold estate) without evidence showing whether fee simple and leasehold estate sales are perceived differently in the market from the perspective of investment risk etc. The CARB finds that there is no support for any change to the 5.75 percent capitalization rate currently being applied to office buildings in this class.

[27] The CARB gave careful consideration to the Complainant's issue of the proper net operating income to use in a capitalization rate extraction process. The Complainant's argument is logical. The best analysis of a sale comes from consideration of all factors that were prevalent at the date of sale. The Complainant's analysis used only typical rents (as reported by the Respondent) as at the date of each sale. The difference is that the Complainant's methodology picked the rent from the date of sale rather than from a "nearby" valuation date. The CARB finds this to be a superior method of measuring factors that would have impacted the decisions of the participants in the sale transaction. It is the same data that is used but the focus changes from a nearby valuation date to the actual date of sale.

[28] While the CARB finds the Complainant's analysis method to be superior, it does not accept the outcome of the analysis of the Centennial Building. After a thorough analysis of office

rent rates around the January 2012 date of sale, the rent indicators were of the order of $13.00 per square foot but the Complainant found $14.00 to be the rate. The CARB has no compelling evidence or argument to stray from the indicated $13.00 rate in the analysis. The rate of $13.00 per square foot is coincidentally the same as the rate which has been used by the Respondent in analyzing the sale. The outcome is that the capitalization rate of 5.61 percent is accepted as the most realistic and reasonable rate.

DATED AT THE CITY OF CALGARY THIS 10 DAY OF SEPTEMBER 2014.

W. Kipp

W. Kipp

Presiding Officer

APPENDIX "A"

DOCUMENTS PRESENTED AT THE HEARING AND CONSIDERED BY THE BOARD:

NO.	ITEM
1. C1	Complainant Disclosure
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	VACANCY CAPITALIZATION RATE