Calgary Assessment Review Board

DECISION WITH REASONS

In the matter of the complaint against the 2014 property assessment as provided by the *Municipal Government Act*, Chapter M-26, Section 460, Revised Statutes of Alberta 2000 (the Act).

between:

ARTIS Mactri Ltd., COMPLAINANT
(as represented by Fairtax Realty Advocates Inc.)

and

The City Of Calgary, RESPONDENT

before:

I. Weleschuk, PRESIDING OFFICER
R. Deschaine, 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:	**067029199**
LOCATION ADDRESS:	**800 5 Avenue SW**
FILE NUMBER:	**74726**
ASSESSMENT:	**$99,600,000**

This complaint was heard on 10th day of July, 2014 at the office of the Assessment Review Board located at Floor Number 4, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 8.

Appeared on behalf of the Complainant:

- *S. Storey, Agent – Fairtax Realty Advocates Inc.*

Appeared on behalf of the Respondent:

- *H. Neumann, Assessor – City of Calgary*

Procedural or Jurisdictional Matters:

[1] The Board as constituted to hear and decide on this matter consists of "the provincial member and one other member of a composite assessment review board" as required under Section 458(2) of the Act. Neither party objected to the panel as constituted hearing the complaint and rendering a decision.

[2] Both parties requested that the presentation of the capitalization rate and rental rate evidence for downtown offices, questions, answers and closing statements heard as part of File No. 74729 be carried forward into this hearing. At this hearing, parties will address only site specific issues related to their positions on the capitalization rate and rental rate. This includes Mr. Omura's presentation and participation. The Board agreed to carry forward all evidence, comments, answers, questions and closing statements, as requested and indicated that its questions on these two issues will also be carried forward, as appropriate.

Preliminary Matters:

[3] The Complainant identified some errors in its disclosure document and asked that the cover page, page 4 statement of issues, page 6 the calculation of the requested assessment, and page 16 and 17 the subject Non-Residential Income Approach Valuation be replaced with pages provided via an email sent May 28, 2014. The Respondent noted that the replacement pages were provided after the disclosure period, but that they did not object to the replacement pages as they did not present any new evidence *per se*. With no objection, the Board accepted the replacement pages to the Complainant's disclosure and are a part of Exhibit C1.

[4] The Complainant asked that pages 38-53 inclusive in the Respondent's disclosure document be removed and not considered by the Board. These pages are the 2014 Assessment Request for Information (ARFI) document provided by the owner and dated May 16, 2014. The Complainant stated that this information is post facto the valuation date and the condition date and is therefore not appropriate evidence before the Board. The Respondent responded by stating that the material was part of the disclosure document and was disclosed in accordance with Matters Relating to Assessment Complaints Regulation Section 8, therefore is properly before the Board. The Board agrees that the material was properly disclosed. The Board has no authority to exclude it from this hearing. The material is post facto the valuation and condition dates for the 2014 Assessment, therefore the Board is not sure that it is relevant until it hears the Respondent's evidence. That said, the Board will give it appropriate weight, if the Board finds that it is post facto information. The Board decided to proceed with the hearing and not remove pages 38-53 of the Respondent's disclosure. The Complainant stated that they wanted the Decision to show that they continue to object to the material being considered evidence at this hearing.

Property Description:

The subject property, also referred to as the Trimac House, is located at 800 5 Avenue SW, in the Downtown 2 (DT2) Area. The building constructed in 1982 consists of 23 storeys with 141 underground parking spaces. It has a total area of 246,228 square feet (SF) and is classified as an A- Quality Class Downtown Office building for assessment purposes.

[5] The 2014 property assessment is calculated using the Income Approach. The net operating income (NOI) of $5,727,514 is divided by the capitalization rate of 5.75%, resulting in an assessment of $99,600,000 (rounded). The specific factors used to prepare the assessment for this A- Quality DT2 Office property are presented in the table below.

Sub-components	Area	Rental Rate ($)	Vacancy Rate %	Operating Cost ($/SF)	Non-Recoverable %
Office	239,802 SF	22.00/SF	3.50	19.00	2.00
Recreational	6,132 SF	18.00/SF	2.00	14.00	2.00
Retail Level 1	294 SF	24.00/SF	8.00	20.00	2.00
Parking	141 stalls	5,700/stall	0.00	0.00	2.00

Issues:

[6] The Complainant stated that the 2014 Assessment is incorrect for the following reasons:

- The capitalization rate of 5.75% is not correct. The correct capitalization rate for the subject A- office building is 6.25%.
- The office rental rate of $22.00/SF is not correct. The correct office rental rate for this property is $20.00/SF.

- The rental rate for the recreational space is not correct. The correct recreational space rental rate is $10.00/SF

Complainant's Requested Value: **$83,630,000**

Board's Decision:

[7] The 2014 Property Assessment of $99,600,000 is confirmed.

Legislative Authority, Requirements and Considerations:

[8] Section 4(1) of Matters Relating to Assessment and Taxation Regulation (MRAT) states that the valuation standard for a parcel of land is "market value". Section 1(1)(n) defines "market value" as "the amount that a property, as defined in Section 284(1)(r) of the Act, might be expected to realize if it is sold on the open market by a willing seller to a willing buyer." Section 467(3) of the Act states that "an assessment review board must not alter any assessment that is fair and equitable, taking into consideration (a) the valuation and other standards set out in the regulations". The issues raised in the Complaint may refer to various aspects of the assessment or calculation of the assessed value, and may be addressed by the Board. However, the ultimate test that the Board must apply is whether the assessed value reflects the market value of the assessed property.

[9] The Board notes that the words "fair" and "equitable" are not defined in the Act or its Regulations. Equitable is defined in Black's Law Dictionary (Seventh Edition, West Group, St. Paul, Minnesota, 1999) as "just, conformable to principles of justice and right". For the purpose of this decision, the Board considers an assessment that reflects market value to be "fair and equitable" as the taxpayer is being assessed in accordance with the assessment standard applied to all properties in that property category.

Issue 1: What is the correct capitalization rate for subject A- Quality DT2 property?

Complainant's Position:

[10] The Complainant raised the issue of vertical inequity related to the capitalization rates assigned by the City to the various quality classes of downtown office buildings for the 2014 Assessment, and made the following points:

- This issue was identified during the previous year's assessment complaint process and has not been corrected by the City in the capitalization rates used in this assessment year.

- The capitalization rate assigned to Class AA, A and C Downtown Office buildings is 5.75%, while the capitalization rate assigned to the B Class Downtown Office buildings is 5.00%. The Complainant stated that this is illogical. In theory and in practice, better quality buildings (newer) should have lower capitalization rates than poorer quality buildings. Therefore, the capitalization rate for Class B buildings should be greater than Class AA and A, but less than Class C. The fact that this is not the case clearly shows that the City has made an error in how it calculates the capitalization rate.
- Downtown office buildings sell based on their cash flow; the price paid for a building is based on the contract rents in place, plus the potential purchaser's expectations related to lowering operating costs, etc. The sale price of these buildings, used to calculate the capitalization rate, is therefore the leased fee value of the property, not its fee simple value.
- The City uses the sale price without adjusting this leased fee value to a fee simple value, and therein lies the reason that the City has derived an erroneous capitalization rate for all classes of office buildings in the downtown core.

[11] The Complainant presented a Capitalization Study of Class "B" Downtown Highrise Offices prepared by Mr. Tony Omura, an accredited appraiser (Exhibit C1 with support material also presented in Exhibit C1). Mr. Omura, presented as a witness during the hearing on file No. 74729, summarized his findings and answered questions regarding the study. This is a similar study presented in at some Board hearings in relation to B Class Downtown office buildings for the 2013 Assessment year. The following key points were made by Mr. Omura:

- The premise of the study was to determine the capitalization rate for Class B Downtown office buildings, accepting that, *"the capitalization rate must be higher than "A" class properties the Colliers' survey indicated at 5.25% to 5.75%."* (page 8 of 15 of the Study, Exhibit C1).
- The study used six sales taken from the list of downtown office sales provided by the City (Exhibit C1) in response to a request by the Complainant. A summary of the study and its results is presented on page 8 of 15 of the Study, Exhibit C1.
- The net operating income (NOI) is based on the actual contract rents in place at the time of sale, and averages $26.90/SF. This rate is supported by some Cresa Average Net Rental Rate information that indicates a rental rate of $26/SF for all classes of downtown Calgary office buildings.
- The NOI is taken from sales detail sheets provided by the client and included in Exhibit C1. Where an NOI is not shown on the sales detail sheets, the information was provided by the purchaser. The source material to support the NOI's provided directly by the purchasers was not included in Exhibit C1.
- By using the actual leases in place at the time of sale for each of the Comparable Sales used in the study, a leased fee capitalization rate of 5.75% - 6.50% was derived. This range of rates is supported by the Second Quarter (Q2) Colliers International Capitalization Rate Report presented on page 7 of 15 of the Study, Exhibit C1.

[12] During the hearing on File No. 74729, Mr. Omura stated that by calculating the leased fee capitalization rate, the issue of vertical equity related to the capitalization rates for downtown offices in Calgary is solved. The City's rate of 5.75% for Class AA and A fits with the calculated rate of 5.75% - 6.50%, say 6.25% as used by the Complainant in calculating its requested assessment.

[13] The Complainant offered a number of suggestions as to how the City might address this issue of vertical inequity related to the capitalization rate for downtown office, so that this issue does not occur in subsequent years.

[14] The Omura Study concludes a capitalization rate of 6.25%, for B Class Downtown Offices, which are very similar to the subject property. Therefore, a capitalization rate of 6.25% is appropriate for the subject property.

[15] In the closing statement, the Complainant stressed that the price for downtown office buildings is based on the revenue the respective buildings generate. The sale price is not a fee simple value, but rather a leased fee value. If typical rates are applied to the leased fee sale price, the resulting calculation of the capitalization rate is incorrect. The Omura Study, suppported by third party industry data, confirms that the correct capitalization rate for A- Class Downtown Offices is 6.25%.

Respondent's Position:

[16] The Respondent presented its 2014 Capitalization Rate Study – Downtown A Office buildings (page 139, Exhibit R1) consisting of five Comparable Sales including two portfolio sales. The Respondent's analysis applies typical rates to derive typical NOI, used to calculate the capitalization rate, which results in a mean of 5.45% and median of 5.63%. Based on this analysis, the City used a capitalization rate of 5.75% to calculate the 2014 Assessment for A-Class Downtown offices. Exhibit R1 includes support data for the capitalization rate data.

[17] The Respondent noted that one of the Comparable Sales used in the capitalization rate analysis is the subject building, which sold in May 2012 for $100,907.000.

[18] In response to the issue of vertical inequity between the capitalization rates assigned to various classes of downtown office buildings, the Respondent stated that the capitalization rates were derived from an analysis of sales for each quality class. Furthermore, that the capitalization rates used to prepare the 2014 Assessments were good indicators of the market value of these properties, regardless of whether the rates conformed to theoretical expectations or patterns.

[19] The Respondent argued that the City is required to prepare assessments using mass appraisal, which requires the use of typical rates. The capitalization rate presented by the Complainant and derived using actual NOI is the actual capitalization rate, not the typical capitalization rate. The Respondent noted that the Omura study uses a rental rate that averages $26.90/SF, while the City uses $22/SF as its typical for B Class DT2 offices in its analysis. The Respondent also noted that it is not clear how the NOI applied to the Comparable Sales used in the Omura Study were derived, as they were apparently taken from third party sales detail sheets or were provided via personal communication, the latter not in evidence before this Board.

Findings of the Board on this Issue:

[20] Each party presented its capitalization rate analysis. The Complainant's capitalization rate is based on actual rates while the Respondent's rate is calculated using typical factors. Both approaches are acceptable methodologies, provided that they are applied correctly and consistently.

[21] The Board notes that the calculation of the requested assessment applies all the typical rates used by the City to prepare its 2014 Assessment except for the rental rate for A- Class DT2 Offices and recreation space (see discussion below) and the capitalization rate. The Complainant uses the capitalization rate of 6.25% derived using actual factors (NOI based on leases in place) and then applies this rate to an NOI derived using primarily the City's 2014 typical rates. The Board finds this calculation to be an inconsistent application of the rates, as has been addressed in various Board and court decisions (i.e. *Westcoast Transmission Company Limited v. Assessor of Area 9 – Vancouver BC 235, (1987) B.C.J. No. 1273*). As a result of this inconsistent methodology, the Board does not accept the capitalization rate of 6.25% requested by the Complainant as correct for the purpose of calculating the 2014 Assessment for A- Class Downtown Offices.

[22] The Board notes that the Complainant did not specifically dispute any of the typical factors used by the City in its capitalization rate study, nor how the typical capitalization rate was derived. Rather, the Complainant argued that the sale prices represented the leased fee estate, and so resulted in an inconsistent use of typical rates applied to a lease fee sale price. In other words, the Complainant's argument was not with the detail but the concept.

[23] The ultimate issue before the Board is whether the assessed value reflects the market value of the subject property. While neither party relied on or specifically presented evidence on the sale of the subject property, the Board notes that it is a useful benchmark on which to evaluate the correctness of an assessment.

[24] The Board notes the issue of vertical inequity raised by the Complainant, but this is not an issue that the Board has any jurisdiction over. The Board has authority to review the assessment complaint related to the property before the Board, and either confirm or change an assessment that does not reflect market value, or is not fair or equitable (Section 467 of the Act). How the City creates its assessment models and derives its input factors for those models is outside the scope of the Board. For this reason, the Board cannot address some of the broader issues and suggestions presented by the Complainant related to the City's assessment policies and procedures.

Issue 2: What is the correct office rental rate for the subject A- Quality DT2 property?

Complainant's Position:

[25] The Complainant presented its Class B Current Market Lease analysis on page 18-21 of Exhibit C1. This analysis consists of leases signed since January 1, 2012 in five office buildings that form a part of the portfolio owned by the subject owner. The Complainant stated that they only have access to data from buildings owned by their client, but that this is a representative sample of A- to C Quality Downtown Office space. This analysis supports the $20/SF requested office rental rate.

[26] The Complainant referred to the vacancy rate for the subject property of 21.5% as indicated on the rent roll (Exhibit C1), noting that such a high vacancy negatively influences rental rates.

[27] In response to the 2014 A- Class DT2, 3, 9 Office Rental Analysis presented by the Respondent (Exhibit R1), the Complainant argued that the rental rates did not capture any inducements or tenant improvements that are a typical part of the rental market and result in the effective rent rate being less than the contract rent. Therefore, this analysis overstated the effective rent being received by the owner of A- Class office properties.

Respondent's Position:

[28] The Respondent presented its 2014 A- Class DT2, 3, 9 Office Rental Analysis on page 126 in Exhibit R1. This analysis consists of 17 leases commencing between July 1, 2012 to June 30, 2013. This analysis indicates a mean of $24.89/SF, a median of $27.00/SF and a weighted mean of $22.05/SF. This analysis supports the $22.00/SF rental rate applied to A-Class Office space in DT2.

Findings of the Board on this Issue:

[29] The Board notes that the rental evidence presented by the Complainant includes a spectrum of office qualities, from A- to C. Therefore, it is not a specific analysis of the market rent that applies to A- Class DT2 Office space. Furthermore, the Board notes that the only lease signed in the subject building since January 2012 is for $23/SF.

[30] The Respondent presented its rental rate analysis that is specific to A- Class Offices located in DT2, 3 and 9, which supports the $22.00/SF rental rate used to prepare the 2014 Assessment. The Board prefers the evidence presented by the Respondent, as it is specific to the subject property type and represents a larger sample size, therefore a better reflection of market rate. The Board is not persuaded by the Complainant's argument regarding the weaknesses in this analysis.

[31] The Board finds that the rental rate for A- Class Office space in DT2 is $22.00/SF, as used to prepare the 2014 Assessment.

Issue 3: What is the correct rental rate for the recreational space in the subject property?

Complainant's Position:

[32] The Complainant stated that the owner of the building converted common space, formerly used as a restaurant area when the building was occupied by one tenant, into recreational space. The gymnasium is apparently available only to building tenants, as an amenity. The Complainant met with the City Assessors and indicated that some of the common space was going to be converted into recreational area and does not dispute the area assigned as recreational space. However, the common space was not assessed in previous years. The recreational area is still essentially common space, in that it is there for the benefit of the tenants. If the area was not converted to a gymnasium, it would not be leasable space. The gymnasium is not leased to or operated by a third party, but is managed as part of the overall building. For these reasons, the Complainant stated that the appropriate rental rate for this recreational space is half the typical rental rate for office space, or $10/SF.

[33] The Complainant questioned the Respondent on its two recreational space lease comparables, and argued that both comparables represent commercial fitness facilities that are available to the general public. One of the leases was identified as the Bow Valley Club. These are not similar to the subject space and therefore the $20/SF rate is not appropriate.

Respondent's Position:

[34] The Respondent presented two recreational leases, one in a B Class DT2 Office and the other in a Class A2 DT1 Office, with recent leases at $20/SF and $21/SF respectively. These two leases support the $18/SF rental rate assigned to recreational space in the downtown for the 2014 Assessment.

Findings of the Board on this Issue:

[35] The Board notes the Complainant's position that the subject recreational space is not a commercial operation and is not shown on the rent roll as leased space. The quantum of the requested rental rate, being half the requested office rental rate, is not sufficient evidence to establish the requested rental rate of $10/SF for the recreational space.

[36] The Board notes the two recreational lease comparables presented by the Respondent are commercial fitness operations, so are of a different nature than the subject recreational space. That said, this is the only leasing evidence before the Board. Therefore, the Board finds that the correct rental rate for the recreational space is $18/SF.

Board's Reasons for Decision:

[37] The 2014 Property Assessment of $99,600,000 is confirmed. The 6.25% capitalization rate is derived by the Complainant using actual NOI and then applied to typical rates derived by the City to calculate the Complainant's requested assessment. This is an inappropriate and inconsistent application of the Income Approach methodology, therefore the Board prefers the Respondent's capitalization rate as used to prepare the 2014 Assessment. The Board finds that the rental rate for A- Class DT2 Office space is $22/SF, as supported by the evidence presented. In the absence of any rental evidence to the contrary, the Board concludes that the rental rate for the recreations space of $18/SF used to prepare the 2014 Assessment is correct.

DATED AT THE CITY OF CALGARY THIS 7 DAY OF August 2014.

I. Weleschuk

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.

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Subject	Type	Sub-Type	Issue	Sub-Issue
CARB	Downtown Office	A- Class DT2	Capitalization Rate	Rental Rate – office Rental Rate - recreational