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 Sierra Place Ltd., COMPLAINANT
(as represented by Fairtax Realty Advocates Inc.)

and

The City Of Calgary, RESPONDENT

before:

I. Weleschuk, PRESIDING OFFICER
R. Deschaine, BOARD MEMBER
E. Reuther, 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:	**067055202**
LOCATION ADDRESS:	**706 7 Avenue SW**
FILE NUMBER:	**74733**
ASSESSMENT:	**$20,620,000**

This complaint was heard on 8th 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:

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

Procedural or Jurisdictional Matters:

[1] The Board as constituted to hear and decide on this matter was acceptable to both parties.

[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.

Property Description:

[3] The subject property, also referred to as the Sierra Place, is located at 706 7 Avenue SW, in the Downtown 2 (DT2) Area. The original building constructed in 1958 had ten stories. An additional six stories were added in 1979 along with a major renovation. It has a total area of 89,927 square feet (SF) and is classified as a C Quality Class Downtown Office building for assessment purposes. The property also has six parking stalls.

[4] The 2014 property assessment is calculated using the Income Approach. The net operating income (NOI) of $1,186,121 is divided by the capitalization rate of 5.75%, resulting in an assessment of $20,620,000 (rounded). The specific factors used to prepare the assessment for this C Quality DT2 Office property are presented in the table below.

Sub-components	Area	Rental Rate ($)	Vacancy Rate %	Operating Cost ($/SF)	Non-Recoverable %
Office	83,828 SF	16.00/SF	9.00	14.50	2.00
Retail Level 1	6,099 SF	16.00/SF	8.00	20.00	2.00
Parking	6 stalls	3,600/stall	0.00	0.00	2.00

Issues:

[5] 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 B- office building, considering its deferred maintenance, is 6.00%.
- The office rental rate of $16.00/SF is not correct. The correct office rental rate for this property is $14.00/SF.
- The 9% vacancy rate for the office space component is not correct. The correct office vacancy rate is 12%.

Complainant's Requested Value: **$16,000,000**

Board's Decision:

[6] The 2014 Property Assessment of $20,620,000 is confirmed.

Legislative Authority, Requirements and Considerations:

[7] 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.

[8] 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 C Quality DT2 property?

Complainant's Position:

[9] 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.

[10] 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 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 Collier's 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.

[11] 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.

[12] 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.

[13] In argument, the Complainant stated that the capitalization rate for C Class Downtown Offices used by the City is 5.75%, which is derived from one sale. This is too small a sample size and therefore the B Class Office analysis should apply, with the capitalization rate of 6.25% applied to the subject property.

[14] The Complainant also discussed the issue of deferred maintenance, and stated that one could either deduct the cost of the deferred maintenance from the NOI and then determine the value using the Income Approach, or the deferred maintenance could be captured by increasing the capitalization rate. A HVAC Systems Condition Evaluation done by Halsall Associates Limited, dated August 30, 2013 is an update to a similar report prepared in 2010 (both reports presented in Exhibit C1). The 2013 report concludes that there is one immediate issue related to one of the RTU units that is not under automatic control and has caused a number of operations problems to date (page 128, Exhibit C1). A replacement cost strategy and budget is presented on page 141, Exhibit C1, which shows that $1,260,000 will be required over the next five years to address the HVAC upgrades.

[15] The Complainant took the position that the simplest way to incorporate the deferred maintenance issue into the assessment is to incorporate the deferred maintenance into the capitalization rate. When the deferred maintenance is addressed in this fashion, the capitalization rate should be the 6.25% determined in the Omura Report. This approach is used (along with the requested office rental rate, as discussed later in this Decision) to calculate the requested assessment of $16,000,000 (page 260, Exhibit C1).

Respondent's Position:

[16] The Respondent presented its 2014 Capitalization Rate Study – Downtown C Office buildings (page 179, Exhibit R1) which consists of one sale. The Respondent's analysis applies typical rates to derive typical NOI, used to calculate the capitalization rate, which is 5.61%. Based on this analysis, the City used a capitalization rate of 5.75% to calculate the 2014 Assessment for C Class Downtown offices. Exhibit R1 includes support data for the capitalization rate data.

[17] The Respondent also presented a comparison of the assessment to sale values using the City's typical rates including the capitalization rates and the Respondent's requested rates (pg 180, Exhibit R1). The Respondent argued that this analysis demonstrates that the City's income analysis factors used to prepare the 2014 Assessment are a good reflection of the market value of the buildings. This analysis showed a ratio of 0.87% using the Respondent's method and a ratio of 0.68% using the complainant's method.

[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.

[20] Regarding the deferred maintenance issue, the Respondent noted that the cost of the alleged deferred maintenance is about $1.26 million, which on a property valued at about $20 million is just over 6%. This required maintenance over the next five years appears to be typical maintenance that a building of this age requires.

Findings of the Board on this Issue:

[21] 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.

[22] 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 C Class DT2 Offices and the office vacancy rate (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 B Class Downtown Offices. The Board notes that the Respondent's capitalization rate study consists of one sale, but prefers the capitalization rate methodology presented by the Respondent to derive the 5.75%, based on its analysis using typical factors and applied using typical factors.

[23] 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.

[24] The Board also notes that the requested capitalization rate is 6.25%, because the Complainant somehow incorporated the deferred maintenance indicated in the Halsall Report. No evidence was presented by the Complainant to demonstrate how this adjustment was made to the capitalization rate by recognizing the deferred maintenance.

[25] The ultimate issue before the Board is whether the assessed value reflects the market value of the subject property. The sales data provided by the Respondent refers to the B Class Office properties. No evidence related to market value was presented by either party.

[26] Regarding the deferred maintenance issue raised by the Complainant, the Board reviewed the 2013 and 2010 Halsall Reports and did not find any reference to the HVAC budgets being characterized as deferred maintenance. The Halsall Reports appear to be routine types of building evaluations used to set up maintenance budgets. The Board is not convinced that the $1.26 million cost in upgrades to the HVAC system is deferred maintenance. The Board reviewed the Edmonton Assessment Review Board Decision No. 0098 95/10 presented by the Complainant in Exhibit C1 and referenced in the closing statement and finds that this Decision is not helpful in distinguishing normal maintenance from deferred maintenance. The explanation for deducting the cost of replacing the roof from the assessment value is not discussed in detail in this Decision.

[27] 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 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 C Quality DT2 property?

Complainant's Position:

[28] The Complainant presented its market rental rate analysis on page 19 of Exhibit C1, which consisted of a summary of recent leases signed in the subject property, supported by the subject rent roll. The Complainant noted that the most recent lease, signed in July 2013 was for $12/SF, and that the only other 2013 lease was at $18/SF. This supports the requested rental rate for C Class Office space of $14/SF.

[29] The Complainant referred to the vacancy rate for this type of office property, and specifically the vacancy in the subject building, noting that it influences rental rates.

[30] In response to the 2014 B 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 B Class office properties.

Respondent's Position:

[31] The Respondent presented its 2014 C,C- Class DT2, 3, 9 Office Rental Analysis on page 122-123 in Exhibit R1. This analysis consists of 41 leases commencing between July 1, 2012 to September 1, 2013. This analysis indicates a mean of $16.48/SF, a median of $16.00/SF and a weighted mean of $17.13/SF. This analysis supports the $16.00/SF rental rate applied to C Class office space in DT2.

Findings of the Board on this Issue:

[32] The Board notes that the rental evidence presented by the Complainant is specific to the subject property, therefore does not represent a market rent.

[33] The Respondent presented its rental rate analysis that is specific to C Class Offices located in DT2, which supports the $16.00/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.

[34] The Board finds that the rental rate for C Class Office space in DT2 is $16.00/SF, as used to prepare the 2014 Assessment.

Issue 3: What is the correct office vacancy rate for the subject property?

Complainant's Position:

[35] The Complainant took the position that the office space in the subject building is less desirable due to age and deferred maintenance. As a result, its vacancy rate should be higher than the typical rate of 3% used by the City. The Complainant noted that the current vacancy rate, based on the subject rent roll presented in Exhibit C1, is 21.00%. The Cresa Class B Office Vacancy Study for Second Quarter 2013 shows the vacancy in the subject building at 26.71% (headlease vacancy). Based on this evidence, the Complainant argued that an office vacancy rate of 12% should be used in the assessment calculation.

Respondent's Position:

[36] The Respondent did not present a vacancy analysis specifically for C Class Office in DT2, as it did not have any information for this property type. The City presented its 2014 B-Class DT2, 3 and 9 Office Vacancy Rate analysis on page 163 in Exhibit R1, indicating a vacancy of 2.89%. The City also presented its 2014 C/C- DT1, 8 Office Vacancy Rate analysis (pg 164, Exhibit R1) which indicates a vacancy of 16.44%. Based on these two analyses, the City applied a 9% vacancy rate to Class C DT2 Office space in the 2014 Assessment.

Findings of the Board on this Issue:

[37] The Board notes that the Complainant's requested office vacancy rate reflects the actual vacancy rate in the subject property. The Complainant did not establish that there is a chronic vacancy issue with the subject building, which may support the use of a vacancy rate other than the typical rate for this property type.

[38] The Board notes the lack of specific vacancy evidence related to Class C DT2 Offices, The best evidence before the Board is that of the Respondents, which supports a vacancy rate of 9%. The Board finds the vacancy rate of 9% is supported by the limited evidence presented.

Board's Reasons for Decision:

[39] The 2014 Property Assessment of $20,620,00 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. The Board prefers the Respondent's capitalization rate methodology as used to prepare the 2014 Assessment. Furthermore, the Complainant then adjusts this capitalization rate to accommodate the deferred maintenance. This adjustment is not supported by any evidence. The Board finds that the rental rate for C Class DT2 Office space is $16/SF, as supported by the evidence presented. The Board finds that the C Class DT2 Office vacancy rate of 9.00% 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	C Class DT2	Capitalization Rate	Rental Rate – office Vacancy Rate – office Deferred Maintenance