Edmonton Composite Assessment Review Board

Citation: John C. Manning v The City of Edmonton, 2013 ECARB 00998

Assessment Roll Number:	8628034
Municipal Address:	9632 54 Avenue NW
Assessment Year:	2013
Assessment Type:	Annual New

Between:

495382 Alberta Inc.

Complainant

and

The City of Edmonton, Assessment and Taxation Branch

Respondent

DECISION OF
Dean Sanduga, Presiding Officer
John Braim, Board Member
Pam Gill, Board Member

Procedural Matters

[1] The parties indicated they had no objection to the composition of the Board. In addition, the Board members indicated they had no bias on this file.

Preliminary Matters

[2] There were no preliminary issues.

Background

[3] The subject property comprises a two storey office complex known as the Kingsdale Professional Centre and is located in the Suburban South Side district in the Coronet Industrial subdivision. The building has an effective age of 1989 and fronts 54 Avenue at its intersection with 97 Street and contains 78% office accommodation, 8% restaurant and 14% warehouse space.

[4] The subject property has been classified by the Respondent as a sub-class of office properties known as SSA (south-side area) sub-class B. This is not the type of

classification permitted under the Municipal Government Act (MGA) wherein the subject property is classified under Section 267 (1) (b) Class 2 - Non-Residential. The city has developed its own classification system for the purposes of assessment grouping for Mass Appraisal purposes.

[5] The subject property has been assessed on the income approach to value and in particular by the overall capitalization rate (OCR) technique. The OCR method estimates the typical net operating income (NOI) per annum which is capitalized by the following formula to produce the assessment.

[6] The OCR is a factor expressed in percentage terms in the equation used in the income approach: Market Value (MV) = NOI divided by the OCR.

[7] The assessed lease rate for the subject offices is $15.00/ sq ft and the assessed OCR is 7.00%. The Complainant had no objection to the restaurant lease rate, the warehouse lease rate, the vacancy rate, the structural allowance, or the vacancy shortfall.

Issue(s)

[8] Has the building been classified in the appropriate sub class?

[9] Is the office lease rate correct?

[10] Is the capitalization rate correct?

Legislation

[11] The ***Municipal Government Act*, RSA 2000, c M-26**, reads:

> s 1(1)(n) "market value" means the amount that a property, as defined in section 284(1)(r), might be expected to realize if it is sold on the open market by a willing seller to a willing buyer;
>
> s 467(1) An assessment review board may, with respect to any matter referred to in section 460(5), make a change to an assessment roll or tax roll or decide that no change is required.
>
> s 467(3) 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,
>
> (b) the procedures set out in the regulations, and
>
> (c) the assessments of similar property or businesses in the same municipality.

<u>Issue #1:- Has the subject building been classified in the appropriate sub-class</u>

Position of the Complainant

[12] The Complainant submitted that the subject property had been improperly and inequitably classified as a class 'B' building as the Respondent has done, presumably based on certain criteria. The Complainant submitted that the subject property should be classified as a class "C" building for the following reasons:

- The office building contains a warehouse component (14%).
- The building is located in an industrial area (Coronet Industrial)
- The building fronts a dead-end road (cul-de-sac)
- The building has no exposure to major thoroughfares (traffic arteries).
- There is no commercial exposure
- The lease rates pertaining to the offices portion of subject building are more in-line with the City's rate for the next lower classification, namely: SSA "C" at $9.00/ sq ft.

[13] The Complainant submitted that the subject property was inferior to a typical class 'B' property and possibly superior to class 'C' property.

[14] The Complainant submitted the rents were low due to it being in a cul-de-sac, it was an industrial location and did not front a busier traffic artery. The Complainant concluded by requesting the Board to place the subject property in the lower class 'C' as the subject property was located in an industrial district, had no exposure to a busy traffic artery and the rental rates achieved for the building were more typical of a class 'C' building.

Position of the Respondent

[15] The Respondent did not directly address the issue in the Summary of Issues listed by the Complainant, but did refer to it whilst addressing the OCR issue (R-1, page 23/24). The following extract is located in the last paragraph:

> *The lower subclass of suburban properties receives the higher rate of capitalization. Sales data used by the City has shown a clear hierarchy of cap rates from A to C Office Classes. In general a lower quality class will warrant a higher cap rate. OCR reflects the risks a general investor is willing to undertake; the higher cap rate reflects the higher risk; lower quality properties generally*

carry a higher level of risk due to less efficient mechanical systems, inferior locations, less stable tenants are attracted by the property, less amenities, etc.

Decision

[16] The decision of the Board is to confirm that that subject property is a class 'B' property.

Reasons for the Decision

[17] The Board was not persuaded by the evidence of the Complainant. The Board finds the combination of the industrial location; the lack of commercial exposure and the lower than typical market rates for class 'B' offices was initially convincing. However, neither party provided any parameters or information with regard to the differences in the four classes AA – highest class, class A, class B and class C, the lowest rating. Therefore by default the Board finds for the Respondent that the subject remains as a class B property until sufficient data can be produced to rationalize a change.

Issue #2:- Is the office lease rate correct?

Position of the Complainant

[18] The Complainant filed this complaint on the basis that the assessment of the subject property was much higher than the market value. In particular, a red flag was initially raised when the potential gross income, as calculated by the Respondent, was noted to be substantially higher than the actual gross income being achieved for the subject property, in spite of there being several recent leases (relevant to valuation day) in the subject property.

[19] The Complainant maintained that the subject property had under-performed the rental rates ascribed to it by the Respondent. In support of this contention the Complainant stated that the Respondent had calculated the NOI of the subject property to be $472,504 effective July 1, 2012 whereas the actual NOI for the 5 preceding years (Exhibit C-1, page 1) was as follows:-

1. 2008 $102,799
2. 2009 $151,615
3. 2010 $187,388
4. 2011 $170,932
5. 2012 $275,424

[20] In further support that the potential office lease rate of the subject property was below the rate attributed by the Respondent, the Complainant provided a chart and supporting documentation, that represented the most recent (past 3 years) leasing activity in the subject building (C-1, page 2). The chart showed that between March 2010 and August 2012 the triple net lease rates actually achieved. The range was from $8.25/ sq ft to $14.58/ sq ft with an average of $10.50/ sq ft, as opposed to the assessed rate of $15.00/ sq ft.

[21] Four leases were recorded on second floor office space in 2012 as follows:

1. Jan 2012	#204	$8.50/sq ft
2. June 2012	#206	$10.99/ sq ft
3. August 2012	#211	$10.80/ sq ft
4. August 2012	#202	$14.58/ sq ft

[22] The Complainant submitted that the average of these most recent leases ($11.22/ sq ft), in conjunction with the other lease rates supplied (Average: $9.79/ sq ft), indicated a rate of $11.00/ sq ft was applicable to the subject office space. The Complainant then reconstructed the Respondent's Suburban Office Summary (R-1, page 20), substituting the $11.00/sq ft rate for the $15.00/ sq ft applied by the Respondent for the office portion. The NOI resulting from the reconstruction was $361,879 and if the 7% cap rate was applied to the NOI, this would result in an assessment of $5,169,500, compared to the assessment NOI of $472,504 and an assessment of $6,750,000.

Position of the Respondent

[23] The Respondent provided a survey (exhibit R-1, page 67) of approximately 47 recent, (18 months) South Side class B lease rates (SSA "B" Rents) that were time adjusted and resulted in a range of values from $8.80/ sq ft to $19.69/ sq ft. The average of the sales was $14.76/ sq ft and the median was $14.94/sq ft. Based on this survey the Respondent selected a rate of $15.00/ sq ft to be applied to all the office properties in class B in the same district.

[24] The Respondent provided a second chart (R-1, page 68) that was a reconstruction of the rent roll provided by the Complainant, effective June 31, 2012 for the subject property. The chart demonstrated that 3 of the Respondent's 20 leases were used by both parties and the same three leases were also used in the "model", which produced a typical rate of $15.00/ sq ft. One of the leases was a renewal that both parties used and was also incorporated into the "model". Four of the remaining leases were not used as they were described as outdated and two of the leases were post facto. The remaining leases had no comments as they were either vacant or too old to be considered valid for comparison purposes.

[25] The Respondents provided a city wide chart (R-1, page 66) of Suburban Valuation Rates of all office classes (AA, A, B, and C) that showed the typical rental rate: typical vacancy rate: typical structural allowance: typical office and CRU rates and the typical cap rates for each of the seven suburban valuation districts throughout the city. For the SSA district "B" class offices the rates were all at $15.00/ sq ft for the office space. The chart clearly demonstrated that all the class B office properties in the SSA district have been assessed equitably as far as the lease rate is concerned.

Decision

[26] The decision of the Board is to reduce the rental rate of the office portion from $15.00/ sq ft to $11.00/sq ft.

Reasons for the Decision

[27] The Board finds that the rental rate analysis (R-1, page 67) demonstrates that rental rates in the SSA class "B" range from $8.80/ sq ft to $19.69/ sq ft with the subject falling within the range at $15.00/ sq ft. The Board finds that the rate is equitable, in the sense that it has applied the $15.00/ sq ft to all class B properties in SSA. However, the Board noted that the range is wide, the highest being 124% higher than the lowest and found that the range is too wide to be equitable. Should a property that has a market rate of $8.80/ sq ft subsidize, for assessment purposes, a property that has an assessment rate of $19.69/ sq ft? Conversely, should a property that has a lease rate of $19.69/sq ft benefit from the application of a lower rate, namely $15.00/ sq ft? In the eyes of the Board this is not equitable and the Board finds that it would be more equitable to apply a lower rate than $15.00/ sq ft to the subject property, based on the leasing activity in the subject property during the 18 months preceding valuation day. The rationale lies in the historical performance of the subject property (see paragraph #19, 20, & 21 above) wherein the subject property lies at the lower end of the scale.

[28] The Board accepts the principle that new leases in the same building provide the most meaningful evidence. The Board noted that only one of the leases in the subject building had achieved a rate of $14.58/ sq ft in August 2012, which is close to the typical rate of $15.00/ sq ft as contended by the Respondent. A second lease, in the same month, was executed at a rate of $10.80/ sq ft. Two additional leases in the same building: one in January and the other in June 2012 were executed at $8.50/ sq ft and $10.99/ sq ft respectively. Together the four leases provide the most meaningful evidence available, closely followed by the 2011 leases in the subject building that commenced: April 2011 at $12.25/ sq ft: June 2011 at $8.25/ sq ft and June 2011 at $10.15/ sq ft. As demonstrated (R-1, page 67) even the application of the Respondent's time adjustment factors to the above leases ($13.30/ sq ft: $8.80/ sq ft and $10.41/ sq ft respectively) would not bring the lease rates close to $15.00/ sq ft. The one exception is the post facto lease which the Respondent did not use due their internal policy.

[29] The Board was not persuaded by the evidence of the Respondent with respect to the lease rate applied to the subject property. The Board accepts that all the rental properties provided in their chart are class B buildings in the SSA but is not persuaded that the rental rate of $11.00/ sq ft should properly be applied to the subject property, due to a combination of the location factors affecting the subject property as noted above (paragraph #12) and, more important, the recent leasing activity in the subject property. The location of the comparable leases is unknown to the Board and consequently fairly meaningless as there were no parameters provided by the Respondent to enable the Board to make a useful and appropriate comparison. The Respondent did provide time adjustments for each of their leases, which is certainly useful, but the Board was still left in doubt as to the comparability of those leases to the subject space, in terms of location, exposure, high rise, low rise, elevator access, etc.

[30] The Board is of the opinion that the classification of the property in an appropriate sub-class, and the lease rate, are interrelated. However with respect to the lease rates the Board finds the leases in the subject building are the most meaningful. No evidence was provided to enable the Board to determine the specific locations within the building and the Board accepts the principle that the floor level and the specific location pertaining to any floor are factors that contribute to the differences in rates achieved in any one building. The Board concludes that the best evidence of lease rates is provided by the Complainant at $11.00/ sq ft.

Issue #3- Is the capitalization rate correct?

Position of the Complainant

[31] The Complainant submitted that the capitalization rate (cap rate) of 7% was too low and should be closer to 7.75%. In support of this, the Complainant provided a chart of four sales of properties that were deemed to be comparable to the subject property (C-1, page 3). Two of the sales were located on the south side in the Roper and Pleasantview districts: one in the north-west district of Bonaventure and one in Westmount. The Complainant submitted that all the comparables were in commercial locations that are superior to the subject, as they each had direct exposure to a busy traffic artery. The sales took place between January 2010 and January 2012, with two of the sales taking place in January 2012. The cap rates from these 4 sales were:- #1 = 7.30%: #2 = 7.30%: #3 = 8.38%: and #4 = 7.77% respectively.

[32] The Complainant submitted that sale #1 and sale #3 were class AA buildings: sale #2 was a class A building and sale #4 a class B building like the subject property. The Complainant submitted that the first three sales were superior to the subject property in both location and classification and as such the cap rate of the subject property should be higher than the comparables as they were superior properties in both classification and location. As such these 3 sales suggest the assessed cap rate is low and provides indirect support to the requested cap rate. Sale #4 was a class B building and had a cap rate of 7.77% which directly supports the requested cap rate of 7.75%.

Position of the Respondent

[33] The Respondent submitted that assessors are legislated to produce assessments using Mass Appraisal, which involves using typical lease rates, typical vacancy, typical operating expenses and structural allowances to produce a typical net operating income (NOI) to which is applied a typical cap rate to produce the assessment (R-1, page 23). In general the lower the NOI the lower the cap rate will be and vice versa. The Respondent stated that the lower class of suburban properties receive a higher cap rate: lower quality properties also carry a higher risk due to less efficient mechanical systems, inferior locations, less stable tenants, less amenities etc.

[34] Cap rate studies are carried out frequently and the Respondent provided the latest results in chart form:

a. Classes AA and A assessed with an OCR of	6.75%
b. Class B assessed at OCR of	7.00%
c. Class C assessed at OCR of	7.50%

[35] In support of this contention the Respondent provided two charts entitled Suburban Capitalization Rate Analysis (R-1, pages 49 and 50). The first chart exhibited a total of 16 sales three of which were deemed to be on the outer limits of the range and as such were excluded from the analysis. They were all class B properties that were located throughout the city that sold between August 2009 and March 2012 and were time adjusted to valuation day. The cap rates for the thirteen sales ranged from 5.32% to 8.54% with an average of 6.98% which supports the assessed rate of 7%. There was one common sale at 10238 – 124 Street and the Complainant calculated a cap rate of 7.77% and the Respondent 6.98% for this property.

[36] The second chart exhibited the same sales as the first chart and also included the Complainant's other 3 cap rate sales (deemed to be on the outer limits) as noted above. The Complainant's cap rates (from The Network) were provided together with the Respondent's cap rates that resulted from using typical income, typical vacancy, etc. The Respondent submitted that the Complainant could have used 12 class B suburban office sales that traded between 2009 and 2012 but instead chose to use two class AA office comparables and one class A comparable. The cap rates resulting from the Respondent's analysis were derived by using typical rental rates, etc. as they were legislated to use. For the four sales used by the Complainant the Respondent calculated a different cap rate as follows:

Comparable Sale	Complainant	Respondent
5651/81 – 70 Street	7.30%	6.36%
6020 – 104 Street	7.30%	6.60%
13151 – 146 Street	8.38%	6.85%
10239 – 124 Street	7.77%	6.98%

[37] The Respondent submitted that the cap rates from the Complainant's four sales actually support the assessed cap rate when "typical" rates (lease, vacancy, operating expenses, structural allowances, etc) were used instead of actual as used by the Complainant.

[38] In rebuttal the Complainant submitted that the sales information provided by the Respondent (R-1, page 49) was substantially different to that provided by The Network (R-2).

[39] The Complainant provided the appropriate network documents which normally include an analysis of the income information and a cap rate. Nine of the 13 sales had no income information and the remaining 4 sales had income information that was relevant to the date of sale. The Board noted that the Respondent's cap rates, with respect to the 4 sales with income information were on average over 1% lower than the rate calculated by The Network. The Complainant submitted that The Network checks with the vendor and/or the purchaser just as the Respondent's do. The Complainant submitted that cap rates calculated by The Network were more accurate as they related to the time of sale whereas the Respondent calculated a typical NOI based on valuation day and then applied a dated sale figure to derive the cap rate, which was therefore less meaningful.

Decision

[40] The decision of the Board is to confirm the overall capitalization rate of 7.00%.

Reasons for the Decision

[41] The Board was not persuaded by the evidence of the Complainant as the first sale comprised a two building office/warehouse complex with 47,888 sq ft of offices and 59,802 sq ft of warehouse. This equates to 55% offices and 45% warehouse compared to the subject property that has 78% offices and 14% warehouse in one building. As such the subject property is not considered a good comparable.

[42] The Board placed little weight on the second and fourth sales of the Complainant as they were class AA and class A respectively which is superior to the subject. Additionally they were in superior locations to the subject. The Cap rate for the fourth

sale at 124 Street was 6.98% as calculated by the Respondent and 7.77% as calculated by the Complainant.

[43] The Board was then left to consider the relative merits of the two different approaches used to analyze the respective capitalization rates. The Complainant had analyzed the cap rate based on the sale price as at January 2012 using market (or typical) rents for the vacant space in the subject building but had used actual rents for the lease space. The Board noted this sale was close to valuation date and although not time adjusted by the Complainant, the Board found that minimal, if any, adjustment would be applicable. Details of the leases (such as the rental rates and the unexpired terms) were not available. As such the Board was unable to determine what adjustments would be required to make the rental rates typical as at the time of sale.

[44] The Board then looked at the cap rate as analyzed by the Respondent. Again the Board looked at time adjustment and noted that a factor of 1 had been applied indicating there was no time adjustment necessary as it was relatively close to valuation date. The Board noted that the NOI as applied by the Respondent was less than what was actually being achieved. A similar notation was made with respect to the Complainant's other three sales and had been clearly identified in the Complainant's Rebuttal (C-2). All the NOIs were estimated to be less than the actual being achieved. This would result in lower cap rates than were applicable at the date of sale, which poses a problem for the Board.

[45] The Board was not persuaded by either party that their cap rate method was correct and therefore by default the Board finds for the Respondent as the onus lies with the Complainant to prove the Respondent was incorrect.

Decisions

[46] The decision of the Board is to confirm that that subject property is a class 'B' property.

[47] The decision of the Board is to reduce the rental rate of the office portion from $15.00/ sq ft to $11.00/sq ft.

[48] The decision of the Board is to confirm the overall capitalization rate of 7.00%.

[49] The Board reduces the 2013 assessment to $5,137,000.

Heard commencing October 1, 2013.
Dated this 6th day of November, 2013, at the City of Edmonton, Alberta.

Dean Sanduga, Presiding Officer

Appearances:

Peter Smith
for the Complainant

Amy Cheuk
Moreen Skarsen
Vasily Kim
for the Respondent

This decision may be appealed to the Court of Queen's Bench on a question of law or jurisdiction, pursuant to Section 470(1) of the Municipal Government A