**Edmonton Composite Assessment Review Board**

**Citation: Liz McLeod MNP LLP v The City of Edmonton, 2013 ECARB 01062**

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| **Assessment Roll Number:** | 9946164 |
| **Municipal Address:** | 5203 86 Street NW |
| **Assessment Year:** | 2013 |
| **Assessment Type:** | Annual New |

Between:

**Liz McLeod MNP LLP**

Complainant

and

**The City of Edmonton, Assessment and Taxation Branch**

Respondent

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**DECISION OF**
**John Noonan, Presiding Officer**
**John Braim, Board Member**
**Judy Shewchuk, Board Member**

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## Procedural Matters

[1] The parties asked the Board to carry forward similar evidence and argument, where applicable, from roll 8976979 to this file. There was no objection to the composition of the panel, nor any declaration of bias.

## Background

[2] The subject is a 4-building industrial warehouse complex built in stages from 1999 to 2006 at 5203 86 Street on the corner of Roper Road. The four buildings measure 30,161 square feet (sf.), 45,392 sf., 92,014 sf. and 63,998 sf. for a total building area of 231,565 sf. on a lot of 737,752 sf. (16.94 acres). The 2013 assessment of $32,551,500 was prepared by the direct sales comparison method with the 63,998 sf. building receiving a "rear building adjustment" due to lack of street exposure.

## Issue(s)

[3] The Complainant identified three issues:

1. Is the subject property fairly assessed in light of sales comparables?

2. Should the assessment be reduced by 27.5% as suggested by an assessment to sales ratio (ASR) study?

3. Does a test of the assessment using the capitalized income approach justify an assessment reduction?

## Legislation

**[4] 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.

## Position of the Complainant

[5] The Complainant provided an overview of the values indicated for the subject property in respect to the issues raised: comparable sales suggested a value of $21.3 million, the ASR study yielded a value of $25.5 million, and an income valuation produced $25.2 million. The requested assessment is $21,303,500 or $92 per sf. In comparison, the 2013 assessment is $140.57 per sf. or $32,551,500.

[6] Five comparable sales were introduced, all large industrial properties with building areas from 125,000 sf. to 400,000 sf. The subject has a building area of 231,565 sq.ft. on a 17 acre lot while the comparables' lots ranged from 7 to 23 acres. The time-adjusted sales prices per sf. of building area ranged from $74.51 to $133.57 with three sales clustered near the $90 level. The five sales produced an average of $95.83 and a median of $90.48 per sf. It was noted that the low sale occupied an inferior location in the east end of the City, 2103 64 Ave, and the high sale appeared to be an outlier but also the smallest property at 124,596 sf. The Complainant concluded $92 per sf. was a fair value for the subject: $21,303,980 rounded to $21,303,500.

[7] The Complainant took issue with the results of the assessment process used by the City in dealing with multiple building properties. The City values each building on its own and aggregates the values to produce the overall assessment. This method fails to recognize economy of scale. Where an investor would consider the income potential of the subject's 231,565 sf., the City values the property's 4 buildings individually, and produces an excessive value estimate. The Complainant introduced a chart of 8 sales of warehouse properties larger than 100,000 sf. that transacted between Jan. 1, 2008 and July 1, 2012, the same date range utilized by the City in preparing 2013 assessments for warehouses. The assessment to sales ratios (ASR) for these produced an average ASR of .955 and co-efficient of dispersion (COD) of 13.153.

[8] However, closer examination of the 8 sales showed a drastic difference in the treatment of single building properties and those with multiple buildings. The 5 sales of single buildings showed an ASR range of .743 to 1.007, with an average of .865 and COD of 12.578. In contrast, the 3 sales that had 2 or 3 buildings on site generated ASRs of .992, 1.046 and 1.275. This subset had an average ASR of 1.104 and COD of 14.462. The difference in averages between 1.104 and .865 showed that multiple building properties were assessed 24% higher than their counterparts with only a single building. The Complainant advised that the subject property was most similar to the 3-building property at 10203 184 Street, the other multiple building sales being of 1979 vintage construction. As the 184 Street property had been assessed at a level 27.5% greater than its time-adjusted sale price, it would be appropriate to adjust downward by 27.5% the subject's 2013 assessment to $25,538,500.

[9] An income valuation of the subject was presented to show a value conclusion of $25,207,531. Recent leasing activity, namely six leases dated 2011 and 2012 from the subject, showed an average rent per sf. of $8.07. These leases accounted for just over half the available area in three of the buildings. The fourth building had been assigned a lease rate of $6.50 since a November 2011 lease had been signed for half that building's area at the same rate. An operating cost of $4.50 per sf. had been determined for the income proforma, with the rent roll indicating most tenants paid approximately $4.60. Allowances of 3% for vacancy and 2% for non-recoverables were applied, and the net operating income of $1,638,489 had been capitalized at 6.5%. The capitalization rate had been determined from 8 sales of 100,000 sf.+ using Network information for the individual property's rent rate, and the same allowances and operating costs as had been used for the subject's income valuation. The resulting cap rates at time of sale were plotted and a trend line drawn to show a declining cap rate from 2009, which extrapolated to 6.5% at valuation date.

**Position of the Respondent**

[10] The Respondent noted the factors found to affect value in the warehouse inventory, in order of importance: total main floor area (per building), site coverage, effective age, condition, location, main floor finished area and upper finished area. For multiple building accounts, each building is analyzed for its contributory value to the property. Among the reasons for this methodology is the fact that the cost of construction of two 50,000 sf. buildings is typically higher than a single 100,000 sf. structure. Multiple buildings offer the opportunity to rent out smaller bays at rates typically higher than for large spaces. There is also the potential for subdivision, which can increase sale and rental options, and site configuration may be improved by splitting space between multiple buildings.

[11] The Respondent advanced three sales comparables, one of which was common to the Complainant's presentation, though different values were concluded: $140.09 per sf. vs. $133.57 from the Complainant. [Note: The Board asked the Respondent to clear up the confusion over the building size on this comparable at 18507 104 Ave by consulting the assessment detail report. The Respondent was able to produce for the Board the 2010 Account Detail Report which verified that at time of sale the building area was just under 118,800 sf. Subsequent to sale, some of the main floor warehouse had been converted to office and sales space, and mezzanine office had been added, so that in 2013 the footprint remained at 118,800 sf. but total building area was now 124,596 sf.] The other two Respondent comparables were multi-building properties like the subject, and sold at time-adjusted prices of $157.14 and $254.86 per sf. It was noted that the $157 sale was only 85% industrial, also having a bank, restaurants, and showroom space. Nevertheless, this was a very good comparable, located just to the east and on the other side of

the subject's Roper Road location. The third sale, at $255 per.sf., was noted to benefit from a high and long term lease with the federal government, and consequently sold at the high end of the market.

[12] The Respondent also introduced 5 equity comparables, all properties with 2-5 buildings, most of newer construction than the subject, and similar site coverage. Various attributes of the comparables were highlighted to show characteristics inferior or superior to the subject. The last two equity comparables were said to demonstrate overall comparability to the subject, and they were assessed at $146.85 and $151.03 respectively, versus the subject's $140.57 per sf. of total building area.

[13] The Respondent presented an article prepared by Avison Young for a July August 2012 brochure that spoke to competition between investors and owner/users in the industrial building market. The conclusion was that owner/users were willing to pay a premium of $20 to $50 per sf and a chart illustrated the price differences for six properties, three each bought by investors and owner/users. A 2012 market overview prepared by the Network showed that over 60% of industrial properties sold to owner/users in the 2010-2012 timeframe. Given the lack of rental income information from owner/users, this supported the City's decision to use the direct sales comparison approach for the industrial inventory.

[14] Critiquing the Complainant's materials, the Respondent pointed out several instances where the sales were noted to have a significant amount of vacant space or below market lease rates, which may have negatively influenced the sale price. As well, there were two examples where between the time of sale and the most recent valuation date, changes occurred such as the addition of mezzanine office space or the conversion of main floor area to office.

**Complainant's Rebuttal**

[15] The Complainant produced information about the sale comparable at 8103 Roper Road, advanced by the Respondent as a good comparable with 11 buildings built in stages in close proximity to the subject. While 8 of the buildings were industrial flex structures, the 2013 assessment information for this property also showed one mixed retail/office units building, a bank, and a neighbourhood shopping centre. Information from Respondent disclosure on another roll showed median bank rents in shopping centres/retail at $32 per sf. Newer constructed banks had a median rent of $35.01 and those built in 2001 and earlier had a median rent of $28 per sf. Restaurant space was typically valued at similarly high rates, far higher than the rent generated from industrial warehouse space. The Complainant ventured that the 15% of this comparable's space that was not industrial in nature might generate as much as 35-40% of the property's rent. As such, it was not a good comparable. As well, the property had a significant amount of lab space which the Complainant advised was different from typical industrial flex space in that labs needed specialized HVAC and exhaust systems. An excerpt from the Marshall & Swift manual showed a per sf. cost for good lab space of $204.51 versus $45-$64 for average and good industrial flex. This significant difference in cost would surely be reflected in different rent rates, another reason to discount this sale as a comparable.

[16] In support of the Complainant's use of a sale at 10203 184 Street, a 3-building complex on three separate titles, the rebuttal evidence included the 35-page "Standard on Verification and Adjustment of Sales" text published by the International Association of Assessing Officers (IAAO). From section 5.6 of that text was highlighted, "If the appraiser needs to include multiple-parcel sales, it should be determined whether the parcels are contiguous and whether the sale is a single economic unit or multiple economic units." The Complainant asserted this

property acted as a single economic unit: besides the current sale cited, it had been previously acquired in a single transaction by the current vendor.

[17] With regard to the Avison Young brochure in the Respondent evidence regarding the property comparisons meant to show that owner/users paid a premium in excess of what investors paid for similar properties, Network sheets for the 6 sales were produced. Significant differences between the investor-owner/user pairings were pointed out, most notably dealing with disparity of site coverage. As to the Network breakdown of transactions accounted for by investors and owner/users, it was pointed out that the numbers showed owner/users in the last three years acquired properties 1/10$^{th}$ to 1/3$^{rd}$ the average size of investor acquisitions, and the average dollar value of these transactions was similarly wide. For instance, in 2012, the average owner/user transaction was \$2,443,602 versus \$9,796,698 for the average property bought for investment purposes. This reinforced the notion that large industrial properties such as the subject and others in excess of 100,000 sf., comprised a different market with mostly investor participation, and the driving factor in this market was the ability of a property to generate income. Consequently, the use of the income approach was validated.

## Decision

**[18]** The Board reduces the 2013 assessment from \$32,551,500 to \$29,244,500.

## Reasons for the Decision

[19] The argument between Complainant and Respondent over the assessment of multiple building properties recurs annually. The Board recognizes the strong points of both positions, notably that it costs more to construct such a complex, but an individual renter of a typical bay may not care whether he has no, 5 or 20 immediate neighbours.

[20] The Board found the Complainant's ASR study interesting, as it dealt with all the industrial property sales greater than 100,000 sf. from 2009 to valuation date, July 1, 2012, with 2 exceptions. The Complainant's point that these large properties are treated differently when multiple buildings are involved is partly correct. Of the 5 sales where only one building was involved, only one had an ASR very close to 1. The rest ranged from .743 to .914. Of the three sales that involved multiple buildings, two ASRs were close to perfection: .992 and 1.046. The third was 1.275 and was the basis for the request of a 27.5% reduction. The Board is not convinced that because one large industrial property was over-assessed in relation to its sale price, that the subject's assessment must be altered. As pointed out, two of the three large multiple building properties were very accurately assessed compared to their time-adjusted sale prices. Nevertheless, the Board takes to heart the lesson that there is opportunity for the assessment model to produce a high value for a multiple building property, especially in relation to a single building property that has similar total area. This panel decided to resolve the multiple building versus single building assessment argument on an individual case by case, on the basis of the best evidence available.

[21] The income approach advanced by the Complainant opens another avenue of opposing views, and again, there is no all-encompassing rule that every proforma is a blind alley or clear-sailing thoroughfare. It is the assessor's prerogative to choose the appropriate valuation method

but the result of such method may be challenged by a reasonable result generated by a different approach. Here, the Respondent pointed out some flaws in the calculation of the capitalization rates used by the Complainant to construct a trend line. There were several examples where a "net income per unit" (sf.) had been utilized from the Network sheet, but that number already recognized a vacancy allowance. It was wrong to further apply both vacancy and structural/non-recoverable allowances. In questions, it was determined that some slight variations to the capitalization rates derived were appropriate. Nevertheless, the Board sees the result of the study, 6.5% as within the ballpark. The Complainant applied a rent rate of $8 per sf. for 3 of the subject buildings, and $6.50 per sf. for the fourth, advising these rates were indicative of recent leasing activity. The value conclusion was $25,207,500 from a Net Operating Income (NOI) of $1,638,469. The Board performed a few calculations of its own. From the December 1, 2012 rent roll summarized by the Complainant, the Board noted an actual rent of $1,814,126 from a leasable area of 226,465 sf. That area is about 5000 sf. less than the Respondent's measure of 231,565 sf total building area. It was not clear from the actual rent roll how much space was vacant, but for this exercise the Board simply took the actual rent, deducted a 2% allowance for structural, and a "vacancy shortfall" of $23,150. ($4.63 operating cost X 5000 sf.) The resulting NOI was $1,754,693. Capitalized at 6.5%, the value estimate is $26,995,384. Using that same actual NOI, the Complainant's requested assessment of $25,207,500 would imply a cap rate of 6.96% and the Respondent's value of $32,551,500 implies a cap rate of 5.4%.

[22] The Board examined the sales comparables and found an obvious few wanting. One of the Respondent's comparables (5605 70 St.) had a time-adjusted sale price some $100 per sf. greater than any of the others. It was not comparable as it benefitted from a very high lease rate. The Respondent's comparable at 8103 Roper Road would have been ideal due to its location and multiple buildings. Unfortunately, 15% of the property was non-industrial, and some portion of the balance was lab space. Both attributes would be expected to inflate the value of that property as compared to typical industrial space like the subject. That left one comparable from the Respondent, the property at 18507 104 Ave, which was also one of the five presented by the Complainant. The low sale from the Complainant at $74.51 was excluded because of its inferior location, as noted. Another Complainant comparable, 10203 184 St., carried baggage in the form of a low lease rate of $4.85 per sf. on almost 75,000 sf. or 44% of its building area. The lease ran for a further two years after the date of sale, prompting the Board to discount that sale by reason of the low lease. The Board was disinclined to reject it for the argument advanced by the Respondent, that the sale comprised 3 buildings on 3 separate titles: the Respondent values multiple building properties **as if** each building were on separate title.

[23] After winnowing the sales comparables described above, the Board was left with three, two presented by the Complainant with values of $88.27 and $90.48 per sf., and one sale common to both parties at a corrected value of $140.09 per sf. The high price was generated from a sale at 18507 104 Ave., a property about half the size of the subject. The low price was associated with a 400,00 sf building on a 23.35 acre lot. Regarding that sale at a time-adjusted $35,289,000 the Board observed that the price was a mere 10% above the subject's assessment of $32,551,500. For an extra 10%, one would acquire an additional 6.4 acres and almost 170,000 sf. of building in comparison to the subject. Given the wide discrepancy of value shown by these three sales, the Board was unable to find instruction beyond the conclusion that the subject's assessment was high in relation to the market comparables.

[24] Consequently, the Board defaulted to the income approach to arrive at an estimate of value. The Board believed the Complainant's argument that the market for large properties of this size is dominated by sophisticated REITs and pension funds. Whether the cut-off is 100,000

sf., 90,000 sf., or some lower number, the subject's 231,000 sf. more than qualifies. Using the actual rental income from the subject, and the allowances previously explained, the Board determined a NOI of $1,754,693. While the Complainant argued a 6.5% capitalization rate would be appropriate, the Board decided to apply a more conservative 6%. Most of the sales analyzed in the cap rate study dated to 2009 and 2010. The most recent sale was dated August 2011, and the cap rate for that transaction was 6%.

Heard August 6, 2013.

Dated this 6th day of September, 2013, at the City of Edmonton, Alberta.

John Noonan, Presiding Officer

**Appearances:**

Walid Melhem
for the Complainant

Amy Cheuk, City of Edmonton Law Branch
Luis Delgado
Marcia Barker
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 Act, RSA 2000, c M-26.*