

**CALGARY  
ASSESSMENT REVIEW BOARD  
DECISION WITH REASONS**

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

**between:**

***KUNG MAN LEE PROPERTIES INC., COMPLAINANT,  
as represented by ALTUS GROUP LIMITED***

**and**

***The City Of Calgary, RESPONDENT***

**before:**

***T. Helgeson, PRESIDING OFFICER  
Y. Nesry, MEMBER  
D. Cochrane, 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 2012 Assessment Roll as follows:

**ROLL NUMBER: 067023903**

**LOCATION ADDRESS: 555 4<sup>th</sup> Avenue SW**

**HEARING NUMBER: 68186**

**ASSESSMENT: \$39,460,000**

This complaint was heard on the 11<sup>th</sup> day of September, 2012 at the office of the Assessment Review Board located at Floor Number 4, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 1.

Appeared on behalf of the Complainant:

- *M. Meiklejohn*

Appeared on behalf of the Respondent:

- *R. Fegan*

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

[1] At the outset of the hearing, Mr. Meiklejohn for the Complainant requested that material from the previous hearing (hearing #67889) that was applicable and relevant to this hearing be carried forward. This was agreed to by the assessor, Mr. Fegan, who requested that all the CARB decisions he had submitted during the previous hearing be carried forward. There was no objection to this request from Mr. Meiklejohn. The Board consented to the requests of the parties.

[2] Mr. Meiklejohn further advised the Board that the document entitled "Rebuttal Submission of the Complainant" need not be entered in evidence, and it was not so entered.

**Property Description:**

[3] The subject property, Selkirk House, is a high-rise office building located on the northwest corner of 4<sup>th</sup> Avenue SW and 6<sup>th</sup> Street SW in the "DT1" economic zone of downtown Calgary. Constructed in 1979, the subject property has an assessed area of 220,418 sq. ft., of which 1,587 sq. ft. is main-floor retail space, and 1,832 sq. ft. is second floor retail space.

[4] As assessed, the subject property has been given a quality rating of "Class B-." There is no tax exempt space in the subject property. The assessment is based on the income approach, with a capitalization rate ("cap rate") of 7.50%. The assessment is \$39,460,000, for an assessed rate of \$179 per sq. ft.

**Issues:**

[5] The Board found the issues in this complaint to be as follows:

1. Is the office space of the subject property assessed at rental rate beyond what a Class B- building is capable of achieving?
2. Is the retail space of the subject property assessed at a rental rate beyond what a B- building is capable of achieving?
3. Is the assessed vacancy rate of the subject property too low?
4. Should the cap rate used in the assessment be increased from 7.50% to 9.00% to better reflect risk and its effect on the value of the subject property?

**Complainant's Requested Value:** \$24,590,000

**Summary of the Complainant's Submission**

*Vacancy*

[6] The issues in this complaint are office rental rate, vacancy, and capitalization rate ("cap rate"). The subject property is correctly classified as a B- building, but the assessed values do not relate to it. If there is vacancy on sublease space, it indicates risk, because the sub-lessee might not renew. The current vacancy in the subject property is 12.62%. The level of risk is higher than it was in 2008.

[7] As assessed, the vacancy allowance is 8.00%. The vacancy allowance should be no less than 10%, consistently applied to all types of space, except low profile space.

*Rental Rates*

[8] Office space, currently assessed at \$15 per sq. ft., should be no more than \$12 per sq. ft. At p. 65 of *Exhibit C-1(a)*, there is an analysis of 13 office leases in downtown B- buildings located in DT1, except for the lease in the building at 435 4<sup>th</sup> Avenue SW, which is not a B-building. The weighted average of these leases is \$13.63 per sq. ft., which supports our requested rate of \$12 per sq. ft. for office space.

[9] The parking rate, \$400 per stall, is in line with the CresaPartners study at p. 109 of *Exhibit C-1(a)*, and we do not request a change in the parking rate.

*Cap Rate*

[10] When the market falls, cap rates rise to reflect risk, but there haven't been any current sales of B or B- buildings from which current cap rates can be derived. Nevertheless, a differential, or "spread," exists between cap rates based on "going in" rents, i.e., actual rents, and cap rates based on typical rents, as used in assessments. Typical rents are usually higher than contractual rents, hence result in a higher cap rate.

[11] There were sales of B and B- buildings in 2007 and 2008, which are the valuation years for 2008 and 2009, respectively. Cap rates derived from those sales, i.e., cap rates based on actual rents, and cap rates based on typical rents, reveal that cap rates based on typical rents are 1.0% to 1.50% higher. It is submitted that this differential, or "spread," should hold true for subsequent years.

[12] The Respondent has used a 7.50% cap rate even though the economy is in a trough. If risk was the same for Class A and Class B buildings, the rents for B buildings would be different. At the height of the market in 2007 and 2008, rental rates soared to \$38 per sq. ft., and vacancy rates hovered around 2.25%. For the valuation year of 2011, with rental rates for B buildings in DT2 ranging from \$12 to \$14 per sq. ft., and vacancy at 15.0%, the Respondent is using a 7.50% cap rate, even though the cap rate used in the previous valuation year, 2010, was 9.0%. The requested cap rate for the subject property is 9.0%.

[13] Due to the dearth of sales in 2009, 2010 and 2011, the Respondent relies on the reports of third parties like Colliers and CB Richard Ellis for its cap rates. These cap rates are based on actual rents.

[14] There is nothing hypothetical about our requested cap rate. A differential exists between cap rates derived from actual rental rates, and cap rates derived from typical rental rates. Based on this spread, the Composite Assessment Review Board that decided CARB 1006/2012-P increased the cap rate from 7.5% 8.0%. We ask that the Board respect the decision in CARB 1006/2012-P.

#### *Requested Corrections*

[15] Based on our analysis of the market, we respectfully request that the Board make the following corrections to the assessment:

- (a) office space, assessed at \$15 per sq. ft., should be \$12 per sq. ft.,
- (b) retail space, assessed at \$16 per sq. ft., should be \$14 per sq. ft.,
- (c) the vacancy allowance, assessed at 8%, should be 10%, and,
- (d) the cap rate, assessed at 7.5%, should be 9.0%.

With assessment parameters corrected as shown, the requested assessed value is \$24,590,000, or \$111.79 per sq. ft.

#### **Summary of the Respondent's Submission**

##### *Vacancy and Lease Rates*

[16] The assessed vacancy rate for the subject property reflects reality. There is a high demand for office space in Calgary. The three vacant spaces in the subject property were leased in October, 2011.

[17] The real test is to be found in the leases of the subject property shown on p. 57 of *Exhibit C-1(a)*. We invite the Board to consider the current leases in the subject property, i.e., leases that commenced between July 1<sup>st</sup>, 2010 and July 1<sup>st</sup>, 2011. When you do that, you will find a range of values with a midpoint of \$16 per sq. ft., and a mean of \$15.50 per sq. ft. These values support the rental rates relied on in the assessment of the subject property.

[18] In the analysis of leases in downtown B- rent equity comparables found at pages 37 and 38 of *Exhibit R-1*, the median of leases that commenced in 2011 is \$15.00 per sq. ft., the mean is \$15.26, and the weighted mean \$15.77.

[19] We have included Altus' analysis of office leases in downtown B class buildings at p. 31 in *Exhibit R-1*. With *post facto* leases and Dominion Centre leases excluded, the median is \$14 per sq. ft. This supports our analysis, and the assessed value.

*Equity in Assessment*

[20] As for assessment equity, the B- class buildings in DT1 are assessed at an office vacancy rate of 8.0%. Furthermore, according to CresaPartners, as shown at p. 96 of *Exhibit C-1(a)*, the average vacancy rate for Class B office buildings during the second quarter of 2011 is 8.47% for head leases. There is no substantive evidence that would support an adjustment in the vacancy rate.

[21] Further to the matter of equity, all B- class buildings in DT1 are assessed at an office rental rate of \$15 per sq. ft., and a cap rate of 7.50%.

*Cap Rates*

[22] On the subject of cap rates, MGB decision 145/07 confirmed the use of typical rents for the derivation of cap rates. The simple fact is that current rents are less than they were in 2006 and 2007. The only cap rates available are from third party sources. The Complainant's notion that there is a difference between actual rents and typical rents is utter nonsense.

**The Board's Findings in Respect of Each Matter or Issue:***Office Space*

[23] At p. 65 of *Exhibit C-1(a)*, there is a table showing 13 leases in B class buildings in DT1. The Complainant informed the Board that the buildings are actually B- buildings, save for the building at 435 4<sup>th</sup> Avenue SW. In reviewing the leases, the Board finds that the average rental rate of those leases in B- buildings with commencement dates in the period from July 1<sup>st</sup>, 2010 to July 1<sup>st</sup>, 2011, is \$14.50 per sq. ft.

[24] Further to this, the rent roll for the subject property, at p. 57 of *Exhibit C-1(a)*, includes 6 leases with commencement dates between July 1<sup>st</sup>, 2010 and July 1<sup>st</sup>, 2011. Those 6 leases show an average of \$15.50 per sq. ft., and a median of \$16 per sq. ft.

[25] The Board finds that the assessed office rental rate of \$15 per sq. ft. is amply supported by the lease rents of other B- properties in DT1, as well as the office rental rates of the subject property itself. There is insufficient evidence to ground an adjustment to the assessed rental rate of the subject property.

*Retail Space*

[26] Although the Complainant mentions an adjustment to retail rental rates at page 10 of *Exhibit C-1(a)*, no evidence was adduced to support an adjustment in the assessed rate for retail space.

*Vacancy*

[27] The subject property exhibits a vacancy rate of 12.62% as of the valuation date of July 1<sup>st</sup>, 2011. Nevertheless, the rent roll for the subject property shows that as of October 11, 2011, the vacancy had dwindled to 1.43%. In their Q2 2011 report, CresaPartners arrived at a head-lease

vacancy of 8.47% for downtown class B offices. There is nothing to support an adjustment to the office vacancy rate as assessed. With regard to retail vacancy, it appears to be combined with the Complainant's office vacancy argument. Accordingly, the Board confirms the assessed vacancy rates for both office and retail space.

### *Cap Rate*

[28] At p. 136 of *Exhibit C-1(a)*, there is an analysis in tabular form of cap rates based on typical rent rates, i.e., as assessed, and cap rates based on actual rents. The cap rates based on actual rents are from RealNet, City Sales, Colliers, and CB Richard Ellis. The Complainant has averaged the cap rates, both actual and typical, for B+, B, and B- buildings over the assessment years of 2008, 2009, 2010, 2011, and 2012. The table purports to show the differential, or "spread" between the two kinds of cap rates for all three classes of buildings.

[29] In at least one instance, it appears that the Complainant chose the highest cap rate derived from actual rents for the assessment year of 2008, and placed it under the B- heading in the "combined" column. Also, in the 2011 assessment year, the highest cap rate for B- buildings was that of CB Richard Ellis, at 9.50%, and that is the cap rate that appears under the "high", or B- heading, in the "combined" column.

[30] In other cases, it appears that the Complainant averaged the cap rates derived from actual rents, and placed the averages under the appropriate building class headings in the "combined" column. At the bottom of the "combined" column are the averages of the cap rates for B+, B, and B- over the five assessment years.

[31] Similarly, under the "assessed" column, the cap rates used in the assessments for the five year period are listed by year, and their averages also appear at the bottom of the "assessed" column.

[32] At the far right of the table, there is the "spread" column, which shows the spreads, or differentials, between the cap rates based on actual rents, and those based on typical rents. As with the cap rates, the average of the differentials over the five year period is found at the bottom of the columns.

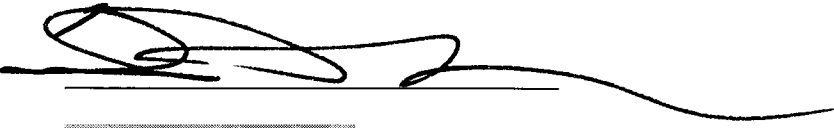
[33] From the Board's review of the analysis, it appears that for B- buildings, all the cap rates based on actual rents are greater than the cap rates based on typical rents, i.e., as used in assessments. For example, under the "combined" column, the average (high) cap rate for B- buildings is 8.46%, while the average high cap rate for B- buildings found under the "assessed" column, is 7.90%.

[34] This outcome is diametrically opposed to what the Respondent's argument is grounded upon, i.e., that cap rates based on typical rents are higher than those based on actual rents, and that the spread, or differential, between the two supports cap rates for assessment purposes that are 1.0 to 1.50 higher than "third party" cap rates currently used in assessments. In the result, the Board finds no evidence to support the Complainant's request for an increase in the cap rate to 9.0% (as shown in "Income Approach Requested" at p. 55 of C-(a)).

**Board's Decision:**

[35] The Board confirms the assessment of the subject property as \$39,460,000.

DATED AT THE CITY OF CALGARY THIS 24 DAY OF OCTOBER 2012.



Presiding Officer

**Exhibits**

**C-1(a), Evidence Submission of the Complainant**

**C-1(b), RealNet Reports, Office Sales**

**R-1, Respondent's Assessment Brief**

<u>Appeal type</u>	<u>Property type</u>	<u>Property sub-type</u>	<u>Issue</u>	<u>Sub-issue</u>
CARB	Office	High Rise	Income Approach	Land & Improvement

*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*

*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.*