

**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:

Canadian Property Holdings Inc. (as represented by the Altus Group), COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

***P Petry, PRESIDING OFFICER
D Julien, MEMBER
J Rankin, 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 2011 Assessment Roll as follows:

ROLL NUMBER:	049008295
LOCATION ADDRESS:	3545 32 Avenue N.E.
HEARING NUMBER:	64052
ASSESSMENT:	\$30,800,000

This complaint was heard on the 18th day of July, 2011 at the office of the Assessment Review Board located at Floor Number 3, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 9.

Appeared on behalf of the Complainant:

- *Mr. K Fong*

Appeared on behalf of the Respondent:

- *Mr. S Powell*

Property Description:

The subject property is classified as a neighbourhood shopping centre and is known as London Town Centre. This property has its main frontage and access along 32 Avenue N.E. with secondary frontage but no access on 36 Street N.E. This property is approximately 8 acres in area with 121,932 sq. ft. of rentable space and is anchored by London Drugs on the east and Sobeys grocery store on the west. The London Drugs building was constructed in 1986 and Sobeys was constructed in 2005 with other components of the centre being developed over the period 1991 to 2008.

Preliminary Matter

The Respondent indicated that it had notice that the Complainant's rebuttal disclosure had been received late by the ARB and this evidence was also received approximately one day late by the Respondent. The Complainant indicated that he had not been aware of this but in any case was prepared to proceed without the rebuttal evidence and without arguing this matter.

On this basis the CARB ruled that the hearing would proceed without the rebuttal evidence being admitted.

Issues:

- 1) Is the rental rate of \$17 per sq. ft. that has been applied to the 24,081 square feet of space occupied by London Drugs, a correct and equitable market rate considering lease and assessment data of similar properties?
- 2) Is the capitalization (cap) rate of 7.25% used by the assessor to develop the assessment for the subject property correct and equitable?

Other matters and issues were raised in the complaint filed with the Assessment Review Board (ARB) on March 4, 2011. The only issues however, that the parties sought to have the Composite Assessment Review Board (CARB) address in the hearing on July 18, 2011 are those referred to above, therefore the CARB has not addressed any of the other matters or issues initially raised by the Complainant.

Complainant's Requested Value:

Based on the Complainant's requested rental rate of \$17 per sq. ft for the London Drugs space and a change in the cap rate from 7.25% to 7.75%, the requested assessment for the subject property is \$28,200,000.

Board's Decision in Respect of Each Matter or Issue:

- 1) The CARB decision is to confirm the rental rate of \$17 per sq. ft. for London Drugs as being both correct and equitable.
- 2) The cap rate of 7.25% is also confirmed as being correct and equitable.

Summary of the Party's Positions

Rental Rate

To demonstrate the range of lower rates and the decrease in rates in the area of the subject the Complainant brought forward evidence of lease rates for several properties including a "Habitat for Humanity Society" lease with rates ranging from \$4.50 to \$6.50 per sq. ft., a post-facto lease rate for Michaels Arts and Crafts at \$15.49, a post-facto North West Company L.P sublease at \$13.25, a "Stir Crazy" sublease with an average rate of \$12.80 over the five year term of the lease and information showing the asking lease rate for the old A&B Sound building at 3320 20th Avenue N.E. to be \$7.00 per sq. ft. The Complainant also provided a table of 51 lease rates with start dates ranging from November 1986 to October 2009 showing a median rate of \$15 and a weighted average rate of \$15.29. Given the age to the London Drug component of the subject and the above lease information the Complainant argued that a rate of \$15 per sq. ft. should be applied to the London Drug space of 24,081 sq. ft.

The Respondent argued that the assessment model takes into account the quality and condition of a property when the rental rate is decided. The Respondent had also analyzed the Complainant's rental rate table and suggested that it is not appropriate to consider old lease data when developing a typical rate for application in 2010. The Respondent presented a table showing that the more recent lease activity within the Complainant's data, that being data from the valuation date back two years to June 2008, produces a median result of \$17 per sq. ft. and a mean of \$17.30 per sq. ft. The Respondent argued that on this basis there is no justification to change the \$17 lease rate that has been applied.

Findings and Reasons for the Board's Decision:

Rental Rate

The "Matters Relating To Assessment and Taxation Regulation" (MRAT) under section 2(b) and (c) provides the following respecting assessment of property based on market value:

2 (b) must be an estimate of the value of the fee simple estate in the property

2 (c) must reflect typical market conditions for properties similar to that property

The CARB carefully reviewed the evidence presented by the parties and concluded that older leasing activity presented by the Complainant going back as far as 1986 is unlikely to capture the value in the fee simple estate of properties being assessed as of the valuation date July 1, 2010. When more recent data within the Complainant's evidence is considered, that evidence supports the rate of \$17 per sq. ft. which has been applied to London Drugs. The Board did not find the lease information about certain individual properties to be helpfully as the comparability of these properties with the subject is questionable. The parties agreed that a portion of the A&B Sound building had recently been lease for \$18 per sq. ft. Further it appears to the CARB that the reported asking rate of \$7 per sq. ft. may be an error as a second document provided by the Complainant shows the basic asking rate to be \$25 per square ft. and operating cost to be \$7 per sq. ft. However, whether in error or not the asking rate of \$7 for space in the A&B Sound building is less important than the space currently being negotiated at a rate of \$18 per sq. ft.

The CARB therefore concluded that the assessed rate applied to the London Drugs component of the subject property and the assessed rates applied to other similar properties are equitable. The evidence does not support a change from the rental rate of \$17 per sq. ft.

Summary of the Party's Positions

CAP Rate

The Complainant argued that the cap rate for each sale in the cap rate analysis should be developed using the same information considered by the buyer and seller at the time of the transaction. That is to say that the current year's actual income should be used including adding in value for vacant space based on recent leases in the subject property or other indicators of leasing activity in similar properties. The Respondent on the other hand applied what is termed "typical income" in deriving their cap rate for these properties. The Complainant argued that this results in factious net income and cap rates that are not reflective of the true considerations by the parties to the transactions. Generally the Respondent's analysis is based on higher than actual incomes and therefore produces lower and unrealistic cap rates. In support of their argument the Complainant's submission made reference to the following decisions and included specific excerpts which were suggested as being evidence that the approach used by the Complainant is correct:

- 1) Westcoast Transmission v Assessor Area No. 9 (Vancouver) (1987) BCSC No. 1273
- 2) Bentall Retail Services et al v Assessor Area No. 9 (Vancouver) (2006) BCSC No. 424
- 3) Several Municipal Government Board (MGB) decisions including MGB 039/05, 044/05, 045/05

The Complainant, using the approach referred to above, provided an analysis of five shopping centre sales which resulted in a mean rate of 7.87% and a weighted mean rate of 7.70%. Based on this analysis the Complainant proposed that the CARB should adjust the cap rate from

7.25% to 7.75%.

In the "Legislative Authority for Property Assessment" section of the Respondent's submission the Respondent addresses the Westcoast Transmission decision suggesting that the decision supports the need to be consistent in the development and application of cap rates. Reference is also made to MGB and Assessment Review Board (ARB) decision which speaks to the need for consistency and the requirement to rely on data that will produce market value in the fee simple estate of a property. The Respondent indicated that while the position taken by the Complainant may be correct from a appraisal perspective it is not appropriate in the context of assessment as it ignores the requirements of MRAT respecting the Assessors obligation to base the assessments on typical market conditions and that assessments must be of the fee simple estate in that property.

The Respondent referred the CARB to a recent decision of the CARB (CARB 1320/2011-P) wherein a similar argument had been advanced by the same Complainant. In that case the Board concluded that the assessed value is not necessarily the same as an appraised value and the process in developing values for the income approach must be developed and applied in a consistent manner. The Respondent argued that CARB decision 1302/2011-P is correct and urged the CARB in the case at hand, to arrive at a similar decision and confirm the assessment at \$30,800,000.

Findings and Reasons for the Board's Decision:

CAP Rate

The Complainant argued that lease fee interests and fee simple interest are essentially the same and that the cap rate analysis completed by the Complainant is aligned with various authorities on such questions. The excerpts from the Westcoast Transmission case are only understandable when read within the full context of that case. The CARB is of the view that the Westcoast Transmission decision in fact supports the concept of consistency in the process used to develop and apply cap rates and also supports the use of typical data to determine the NOI in both the development and application of the cap rate. A more complete extract from that decision is provided below:

"For this process to work, it is evident that the appraiser must make some choices about the concepts to be used, and then to use them consistently. "Income", for example, can mean a number of different things. It may mean a gross or net income, or a "triple net" income. The appraiser normally will select a net income, recognizing a standard list of expenses to be deducted from the gross.

The appraiser could also use an actual net income, or a calculated income generated on certain standard expectations about the use of the building over time. Actual incomes from any building will vary over short time frames, as tenants move in and out, or as unusual expenses occur. Buildings are not typically bought for short time frames. And thus appraisers attempt to deduce what a typical income would be over a long term (in current dollars), before they calculate a capitalization rate from any sale. They call this, variously. A stabilized net income, or an economic net income, as opposed to an actual net income at the snapshot date of valuation.

Actual incomes are also affected by the abilities of the management of the day. A better manager might reduce expenses. Or raise rents successfully, and realize a greater return from the building. When estimating what a building would sell for to a new owner and manager, the qualities of the existing management are eliminated from the analysis.

In valuation theory, the value of an income producing property is merely the present value of future expected income to be generated by the property. The future being looked at is the long term future, and when the appraiser capitalizes an existing or present income, he does so on the premise that the figure being capitalized is representative (in current dollars) of the long term stabilized situation, not of some temporary or short term situation. Appraisers explain this by saying that they are "capitalizing the income in perpetuity."

For these reasons, economic net incomes are universally used by appraisers in arriving at a capitalization rate for the building which has sold. This is so even though there are occasions when an appraiser testifies that the actual net income should be used, because it is the best estimate in fact of the economic income of a particular property.

I stated above that the concepts used, in developing capitalization rates for application to the subject, should be used consistently. Thus it makes no sense to develop a capitalization rate on one set of assumptions about long-term vacancy rates, long term rents, and long term expenses, and then apply that rate to the income of the subject property if it is not derived in the same way."

It is clear that in the Westcoast Transmission case the court raises some concerns that can arise through the use of actual net income and concludes that typical or economic net income is universally used. There is also an acknowledgement that on occasion actual net income may be argued as being the best estimate of a property's economic income respecting a particular property. In the current case before the CARB the Complainant suggested something very similar by offering the opinion that the Cranston Market sale in their cap rate analysis may be the better sale as it is a relatively new building with only recent leases used in the make-up of its actual net income.

With respect to the Bentall Retail Services decision the CARB acknowledges that the court in this case upheld the B.C Appeal Board's decision wherein it fashioned its own methodology. The B.C Appeal Board does however conclude at paragraph (91) as quoted by the court in its decision at paragraph 43 the following:

"(91) The actual rent generated, should be used for comparative purposes, and the capitalization rate of the comparable property should be adjusted if the actual rent is significantly above or below market rent. In this way, the risk factor of the comparable is properly weighed relative to the subject of the appraisal."

The Bentall decision suggests that the B.C Appeal Board applied an approach which is consistent with the Westcoast Transmission decision; however the case does not indicate the specific income data or any adjustments to that data that the Board may have made. Therefore the Bentall decision appears to support the use of actual income adjusted to typical market rents

where the actuals are significantly above or below market.

With respect to the previous MGB and CARB decisions the Board first of all notes that it is not bound by those decisions. We also believe that while these decisions lean both ways on the question of how cap rates should be developed, these decisions are reflective of the evidence and arguments before each tribunal. In our review it appears to the CARB that more recent decisions generally support use of typical or market values for all factors in deriving the cap rate as this is the requirement placed on the Assessor when applying the cap rate. To do otherwise would be inconsistent and would leave the process open to the potential of not producing a valid estimate of the fee simple interest in the property being assessed.

In the case before the CARB the Complainant brought forward five sales which were analyzed to develop the recommended cap rate of 7.75%. Actual income was adjusted for vacant space as referred to earlier along with typical values used by the City of Calgary for factors such as vacancy allowance; shortfall allowance and non-recoverable allowance were applied to calculate the net operating income (NOI) for each sale. The cap rate produced ranged from 7.36% to 8.66% and a mean of 7.87% and a weighted mean of 7.70%. These values formed the basis for the Complainant's recommended cap rate of 7.75%. The lease detail relied upon by the Complainant was not available to the CARB and therefore we have not been able to determine how current the lease data may have been nor do we know the detail respecting any adjustments that the Complainant said were made. The CARB notes that in the case of the sale of Cranston Market where the Complainant indicated that the leases are new and reflective of the current market, the resulting cap rate of 7.36% is only marginally higher than the cap rate of 7.25% used by the assessor.

The CARB reiterates that the use of actual lease data, in place at the time of sale, has the potential of capturing only the value of the lease fee estate held by the owner at that time. This approach will often not capture the leasehold value held by the tenant by virtue of holding a long term lease with rates well below current typical or market rates. Because of this the CARB has placed no weight on the Complainant's cap rate analysis which is used to support the recommended cap rate of 7.75%. The cap rate of 7.25% used in reaching the current assessment of the subject therefore stands.

Finally, the Complainant has made no attempt to show that their recommended cap rate produces an improved estimate of market value for the sold properties within the stratum. MRAT section 6(1) provides the following:

"Valuation standard for a parcel of land and improvements

6 (1) when an assessor is preparing an assessment for a parcel of land and the improvements to it, the valuation standard for the land and improvements is market value unless subsection (2) or (3) applies."

The CARB finds that in this case even if the cap rate analysis were to have being found to be sound, the Complainant's analysis has not gone far enough. The CARB is not prepared to accept one end value over another based solely on a change to one interdependent factor of the income approach. The analysis must include a confirming market analysis that shows the resulting value being recommended is a better estimate of the properties market value than that of the assessment, keeping in mind that market value is a value within a reasonable range and not an absolute value.

Summary

The CARB concluded that there was insufficient evidence to justify a change from the current rental rate of \$17 for the London Drugs space and that the cap rate of 7.25% would not be changed based on the Complainant's analysis. The assessment for the subject property is therefore confirmed at a value of \$30,800,000.

DATED AT THE CITY OF CALGARY THIS 29 DAY OF July 2011.



Presiding Officer
Paul G. Petry**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 in accordance with the Municipal

Government Act as follows:

470(1) *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.*

470(2) *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).*

470(3) *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*