

**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:

***DUNDEAL CANADA (GP) 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: 067046508

LOCATION ADDRESS: 840 6th Avenue SW

HEARING NUMBER: 67889

ASSESSMENT: \$19,280,000

This complaint was heard on the 10th and 11th 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] No procedural or jurisdictional matters were raised.

Property Description:

[2] The subject property, Atrium II, is a high-rise office building located on the northeast corner of 6th Avenue SW and 8th Street SW in the "DT2" economic zone of downtown Calgary. Constructed in 1978, the subject property is situated on a site of 0.40 acres, with a floor area of 109,622 sq. ft., of which 8,885 sq. ft. is retail space. The subject property has 8 floors, a floor plate of 14,560 sq. ft., and is connected to the +15. 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%. In March of 2007, Atrium II sold for \$36,000,000.

[3] Class B buildings are defined by the Respondent City of Calgary as "(B)uildings competing for a wide range of users with rents in the average range for the area. Building finishes, typically, are fair to good for the area and systems are adequate, but the building does not compete with Class A at the same rental value."

Issues:

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

- (a) whether the characteristics of the subject property are those of a Class B building or a Class B- building;
- (b) whether the assessed office rental rate of \$14 per sq. ft. should be reduced to \$12 per sq. ft.;
- (c) whether the assessed retail rental rate of \$16 per sq. ft. should be reduced to \$14 per sq. ft.;
- (d) whether the assessed vacancy allowance of 14.0% should be increased to 15.0%, and
- (e) whether the cap rate, assessed at 7.50%, should be increased to 8.50%.

Complainant's Requested Value: \$13,750,000

Summary of the Complainant's Submission

Classification

[5] The key issue in this complaint is building classification. The subject property is more comparable to Class B- buildings than Class B buildings. The subject property should be treated like its sister building, Atrium 1. The decision in CARB 1006/2012-P changed Atrium 1 from Class B to B-, adjusted the cap rate from 7.50% to 8.0%, and applied a vacancy rate of 15.0% to both office and retail space. Atrium II is virtually identical to Atrium 1.

[6] The first step the Respondent takes in its analysis is an examination of physical characteristics, then checks on their findings by reviewing the rent rolls. The leases in the subject property suggest a B- building at \$12 per sq. ft. rather than a B at \$14 per sq. ft. The change of classification wrought by CARB 1006/2012-P, i.e., from B to B-, resulted in a concomitant change in the office space rental rate from \$14 to \$12 per sq. ft. We request that the Board respect that decision.

Physical Characteristics

[7] The subject property is an office building in DT2, right next door to its sister building, Atrium I. The assessment of the subject property exceeds its market value. The assessed value does not reflect the subject property's location, quality classification, physical and economic characteristics, and condition, relative to comparable properties.

[8] The subject property should have a quality rating of B-. It is more comparable to a B- building. The biggest change when moving from Class B to Class B- is in rental rates, i.e., \$14 per sq. ft., to \$12. In fact, the Respondent uses rental rates as the dividing line between B and B-, and the further a building is from the downtown core, the less the rental rate. For example, the assessed office rental rate for B- buildings in DT1 is \$15 per sq. ft., and the vacancy rate is 8.0%. In DT2, the office rental rate for B- buildings is \$12 per sq. ft., and the vacancy rate is 14.00%.

Derivation of Cap Rate

[9] 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 derived from "going in," i.e., contractual rents, and cap rates derived from typical rents.

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

[11] 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 nevertheless using a 7.50% cap rate. The cap rate for the subject property should be 8.50%.

Vacancy

[12] With respect to vacancy, the Respondent's vacancy analysis of B and B- buildings at pages 36 and 37 of Exhibit R-4 makes no distinction between office and retail vacancy; they are simply lumped together. Further, the dates of the Assessor's Requests for Information ("ARFIs") used in the analysis are not known, nor is it known what sort of space is included in the buildings in the analysis. If the Respondent's analysis purports to support a vacancy rate of 14.00% for both B and B- buildings, that vacancy rate should apply to both office and retail space.

Cap Rate

[13] There were no sales of B class buildings in 2009, 2010 or 2011. For cap rates, the Respondent relies on the reports of third parties like Colliers and CB Richard Ellis. There is nothing hypothetical about our requested cap rate. There is a spread between cap rates derived from "going in" rates, and cap rates derived from typical rates. Based on this spread, the Composite Assessment Review Board that decided CARB 1006/2012-P increased the cap rate. Again, we ask that the Board respect that decision.

Requested Corrections

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

- (a) the classification of the subject property be changed from B to B-,
- (b) office space, assessed at \$14 per sq. ft., should be \$12 per sq. ft.,
- (c) retail space, assessed at \$16 per sq. ft., should be \$14 per sq. ft.,
- (d) the vacancy allowance, assessed at 14%, should be 15%, and,
- (e) the cap rate, assessed at 7.50%, should be 8.5%.

With assessment parameters corrected as shown, the requested assessed value is \$13,750,000.

Summary of the Respondent's Submission

Vacancy and Lease Rates

[15] The assessed vacancy rate for the subject property reflects reality; there is a high demand for office space in Calgary. The real test is to be found in the leases of the subject property shown on p. 62 of *Exhibit* Pt. of C-1. We invite the Board to consider all the 2011 leases in the subject property, without removing the "Planning Strategies" lease. When you do that, you will find a range of values of \$11 to \$17 per sq. ft., with a midpoint of \$14 per sq. ft.

[16] In the analysis of rent equity comparables found on pages 31 and 32 of Exhibit R-4, there are a total of fourteen leases for \$14 per sq. ft. The median of B building leases is \$14 per sq. ft. for 2011. This establishes that our analysis is correct.

Equity in Assessment

[17] As for assessment equity, the B class buildings in DT2 are assessed at an office vacancy rate of 14%. The subject has an actual vacancy rate of 2.5%. Furthermore, according to Cresa Partners, as shown at p. 89 of *Exhibit Pt. Of C-1*, the average vacancy rate for 2011 is 10.06%, and the average vacancy over five years is 10.0%. There is no substantive evidence that would support an adjustment in the vacancy rate.

[18] Further to the matter of equity, all B class buildings in DT2 are assessed at an office rental rate of \$14 per sq. ft., and a cap rate of 7.50%.

Cap Rates

[19] Speaking 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 "going in" rents and typical rents is nonsense.

The Subject Property

[20] The subject property has a good parking ratio. It is a smaller building, but there doesn't appear to be any leasing problems. We ask that the assessment be confirmed.

Summary of the Complainant's Rebuttal

Moot

[21] Our rebuttal contains material dealing with onus and the *prima facie* case. That part of the rebuttal is now moot due to a preliminary decision of the Board in this matter. The material with respect to onus and the *prima facie* case may be struck from the rebuttal.

Equity Analysis

[22] We direct the Board instead to the equity analysis beginning at p. 32 of the rebuttal, marked Exhibit C-2. The analysis contains nine B class buildings DT2 that we believe to be superior to the subject property, but which have assessed values less than that of the subject property on a per sq. ft. basis. All are larger than the subject property. They have more storeys and larger floor plates, which make them more imposing than the subject property. The greater number of parking stalls also enhances the value of these buildings.

FAR

[23] These buildings also have high floor area ratios. Floor area ratio ("FAR") is a measure of density achieved on a site. Generally, buildings with higher densities are perceived to be more

substantial, and they command higher rents.

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

Building Quality

[24] The Complainant bases its argument for an adjustment in building quality from B to B- on the following building characteristics: FAR, year of construction, the number of storeys, floor plate, site area, connection with +15, and number of parking stalls. According to the Complainant, FAR is important as a measure of density achieved on the site, because buildings with higher densities are viewed as more substantial, hence more desirable.

[25] Nevertheless, of the nine B class properties in DT2 the Complainant offers as superior to the subject, one of the buildings, 630 4th Avenue SW, has fewer storeys than the subject (five, the subject has 8), a smaller FAR (3.62, the subject has an FAR of 6.25), a lesser floor plate (13,500 sq. ft., the subject has 14,560 sq. ft. [source: CresaPartners]), less office space (67,898 sq. ft., the subject has 100,739 sq. ft.), no retail space (the subject has 8,885 sq. ft. of retail space), and fewer parking stalls (47, the subject has 86). And, as it happens, the building at 630 4th Avenue SW was constructed in the same year as the subject property, 1978.

[26] Of the nine properties, 630 4th Avenue SW is clearly the property most similar to the subject property. Furthermore, the subject property appears somewhat superior to 630 4th Avenue SW when measured by the Complainant's list of building characteristics.

[27] The subject property is connected to +15, but is 630 4th Avenue SW so connected? What are the characteristics that make 630 4th Avenue SW a fit and proper B class building, and which of those characteristics are lacking in the subject property to a degree that would justify demoting it to B- class? The Board finds no answer to either of these questions.

[28] The burden of proof rests with the party that proposes the change. The Board finds that the Complainant has not met the burden. There is insufficient evidence to aid the Board in determining whether the classification of the subject property should be changed. The subject property will remain as a Class B building.

Office Space

[29] It appears to the Board that Complainant's argument for a reduction in the assessed office rental rate is predicated on a change in building class from B to B-. If so, that argument is rendered moot by the Board's decision on building classification.

[30] If the Board is wrong in this, it is noted that the average rate of office leases in B quality buildings in DT2 (as shown at p. 73 of Exhibit *Part of C-1*) that have a start date in the one year period from July 1st, 2010 to July 1st, 2011, is \$13.00 per sq. ft. The rent roll for the subject property shows 19 leases with a mean of \$16.80 per sq. ft., and a median of \$14 per sq. ft.

[31] For office leases in the subject property that commenced during the period from July 1st, 2010, to July 1st, 2011, the average rate is \$13.35 per sq. ft., and the median is \$13 per sq. ft. These figures are typical of office rental rates in B class buildings in DT2, as assessed. There is no evidence to support a reduction in the office rental rate.

Retail Space

[32] Based on the rent roll at p. 63 of Exhibit Part of C-1, the subject property has 6,783 sq. ft. of "office retail" space on the main floor, and another 1,873 sq. ft. on the main floor occupied by a Thai restaurant. The office retail space is rented at \$9.14 per sq. ft., as averaged, and the restaurant space is rented at \$22.00 per sq. ft. There is no evidence to assist the Board in distinguishing rental rates between building classes, or between economic zones. The assessed retail rate is confirmed at \$16 per sq. ft.

Vacancy

[33] The subject property exhibits a current vacancy rate of only 2.50%. There is nothing to support an adjustment to the vacancy rate as assessed, office or retail.

Cap Rate

[34] The Complainant's cap rate relied on to produce the requested assessment is 8.50%, based on a change in classification for the subject property from B to B-. The Board notes that the cap rate for both B and B- buildings is 7.50%, whether located in DT1 or DT2.

[35] At p. 143 of *Exhibit* Part of C-1, 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 those of RealNet, City Sales, Colliers, and CB Richard Ellis.

[36] The Complainant has averaged the cap rates, from both actual and typical rents 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 types of cap rates for all three classes of buildings.

[37] It appears that in at least one instance, the Complainant chose the highest of the cap rates derived from actual rents (for the assessment year of 2008), and placed it under the B- heading in the "combined" column. In other cases, it appears that the Complainant averaged the cap rates derived from actual rents, and placed the averaged cap rates 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.

[38] Similarly, under the "assessed" column, the cap rates used in the five assessment years are listed by year, and their averages appear at the bottom of the "assessed" column. The column showing the spreads, or differentials, is at the far right of the table. The "spread" column is said to show the differences, or spreads, between the two types of cap rates. The averages of the spreads for each building class over the five year period appear at the bottom of the columns.

[39] For B class buildings in assessment year 2008, the cap rate in the "combined" column is less than the cap rate in the "assessed" column. The spread is 0.38. Similarly, in assessment year 2009, the cap rate in the combined column is less than the cap rate in the "assessed" column by 0.60. These results appear to support the Complainant's position that cap rates based on typical rents are greater than cap rates based on actual rents, at least for B class buildings over a period of two years, but do they support the Complainant's contention that the differential applies for subsequent years?

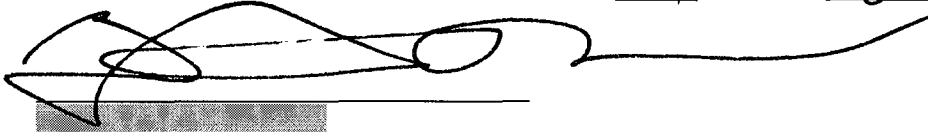
[40] For the 2010 assessment year, the cap rate for B properties in the "combined column" is .13 greater than the cap rate in the "assessed" column. For assessment year 2011, the cap rate for B class in the "assessed" column is 0.25 greater than the cap rate in "combined", but in assessment year 2012, the cap rate has slipped back by 0.25.

[41] At the end of the five year period, the average of the B class cap rate differentials becomes 0.17., i.e., the assessed cap rate is, on average, 0.17 greater than the "combined" cap rate. Is this due to the Respondent's use of actual rents in assessments, is it due to the use of typical rents? The Board is unable to answer that question because there is no evidence with respect to when the Respondent began using cap rates based on actual rents, if indeed it ever did. In the result, the Board finds the Complainant's evidence in support of an adjustment to the cap rate inconclusive.

Board's Decision:

[42] The Board confirms the assessment of the subject property at \$19,280,000.

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



Presiding Officer

Exhibits

C-1, Complainant's Evidence Submission, Office Sales

Part of C-1, Evidence Submission

C-2, Rebuttal Submission of the Complainant

R-4, 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

- (a) *the assessment review board, and*
- (b) *any other persons as the judge directs.*