

**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:

I.G. Investment Management Ltd., COMPLAINANT (as represented by Altus Group Limited)

and

The City of Calgary, RESPONDENT

before:

***J. Dawson, PRESIDING OFFICER
R. Roy, 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:	200149508
LOCATION ADDRESS:	37 Richard Way SW
HEARING NUMBER:	63695
ASSESSMENT:	\$8,670,000

This complaint was heard on the 2nd day of September, 2011 at the office of the Assessment Review Board located at Floor Number 3, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom 12.

Appeared on behalf of the Complainant:

- *D. Chabot* *Agent, Altus Group Limited*

Appeared on behalf of the Respondent:

- *M. Ryan* *Assessor, The City of Calgary*
- *J. Toogood* *Assessor, The City of Calgary*

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

No objections on procedure or jurisdiction were raised.

This Board had one Assessment Review Board panel member absent however a quorum had been established as permitted in the Act;

458(2) The provincial member and one other member of a composite assessment review Board referred to in section 453(1)(c)(i) constitutes a quorum of the composite assessment review Board.

All parties were asked if they had any objection to the makeup of the panel and no objection was received therefore hearing continued as scheduled.

Property Description:

The subject property is located in the Lincoln Park area of the southwest quadrant of the city. The land consists of 76,964 square feet of assessable land with a three storey multi-tenanted building built in 2000 of an A+ quality. The Income Approach was utilized by the Respondent calculating; a Net Operating Income of \$650,992 using a *capitalization rate* of 7.5%, a 10.5% vacancy rate, and a *market rental rate* of \$22.00 per square foot for office space. The result is a total current truncated assessment of \$8,670,000.

Issues:

The Complainant identified two matters in section 4 on the complaint form; 1) an assessment, and 2) an assessment class, as being incorrect. After reviewing the complaint form the Complainant confirmed there was the single matter of an assessment amount to be dealt with during this hearing. These are the relevant reasons for appeal found in section 5 of the complaint form;

- i. The assessment of the subject property is in excess of its market value for assessment purposes.
- ii. The assessment of the subject property is unfair and inequitable considering the assessment of comparable properties.

Additional issues raised by the Respondent;

- iii. Changing the manner in which typical *market rental rate* is calculated will create atypical situations and prevent comparability with previous years.

- iv. A change in the typical *market rental rate* requires a corresponding change in the *capitalization rate* and essentially balances to the same assessment.

Complainant's Requested Value: \$6,500,000 (complaint form)
\$7,830,000 (disclosure document and hearing)

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

Is the assessment of the subject property in excess of its market value for assessment purposes? Is the assessment of the subject property unfair and inequitable considering the assessment of comparable properties?

The Board finds the assessment of the subject property is at market value. The Board found the assessment to be correct, fair and equitable.

What seems to be the key issue in this hearing is; "What components make up typical *market rental rates*?"

The Complainant built a prima facie case for the Board to find that the typical *market rental rate* is the face rent (unless already adjusted) less *tenant inducement* (if present). The Complainant further purported that a further reduction must be made for a *leasehold improvement* (if present). The argument from the Complainant is that improvements or value added by or for the tenant will not be valuable to a future tenant or the current landlord therefore the improvement should not be assessable for property assessment purposes. The Board did find it necessary to seek direction through legislation, regulation and industry sources.

In answering this core question, the Board sought answers in the Act's *Matters Relating to Assessment and Taxation* (MRAT) regulation, wherein it is written;

- 2 *An assessment of property based on market value*
 - (a) *must be appraised using mass appraisal,*
 - (b) *must be an estimate of the value of the fee simple estate in the property,*
and
 - (c) *must reflect typical market conditions for properties similar to that*
property.

In pondering the regulation above the Board determined there are a few key terms that need complete understanding in order to properly make a judgment; 1) *market value*, 2) *mass appraisal*, and 3) *fee simple*.

The Board sought interpretation of *market value*, *mass appraisal*, and *fee simple* in the ©1956 *International Association of Assessing Officers Glossary for Property Appraisal and Assessment* wherein it defines;

Market Value *The most probable price (in terms of money) which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: The buyer and seller are typically motivated;*

Both parties are well informed or well advised, and acting in what they consider their best interests; A reasonable time is allowed for exposure in the open market; Payment is made in terms of cash (in Canadian dollars) or in terms of financial arrangements comparable thereto; The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Mass Appraisal *The process of valuing a group of properties as of a given date, using standard methods, employing common data, and allowing for statistical testing.*

Fee Simple *In land ownership, complete interest in a property, subject only to governmental powers such as eminent domain.*

In other words, as this Board understands this to mean; the *market value* in *mass appraisal* using the *fee simple* estate includes the **complete interest** with any **typical** improvement or value added for or by the tenant, whether or not it is used for their use only during their tenancy.

The Board considered the meaning and difference between *tenant inducements* (TI) and *leasehold improvements* (LI). A *tenant inducement* is defined by the ©1998 Alberta Assessors' Association, *Office Valuation Guide – June 1998*, (R1 page 29) as being:

Tenant Inducements

In order to establish the typical net market rent in situations where the tenants receive inducements, it is necessary to analyze the terms and conditions of these inducements.

Landlords often offer inducements to tenants in order to attract them into a building. Generally speaking, the value of inducements is higher in times of higher vacancies. Inducements can consist of one or more of the following:

- *Leasehold improvements.*
- *Cash payments for various reasons.*
- *Periods of free rent.*
- *Lease buy-outs.*

Inducements affect both the net income received by the owner and the effective rent paid by the tenant. For example, a five year net lease for 2,500 square feet at a rental rate of \$20 per square foot per annum is a fairly straightforward rental arrangement (total rent over five years = \$20 x 2,500 x 5 = \$250,000). If, however, the tenant negotiates one year of free rent or a \$50,000 "signing" bonus, then the effective rent paid by the tenant is something less than \$20 per square foot stated on the rent rolls. Instead of paying \$250,000 over the five year lease the tenant now pays \$200,000, or (without considering the time value of money) an average rate of \$16 per square foot.

The Board notes that *leasehold improvement* allowance is characterized as a *tenant inducement* and can lead to one thinking it must be removed from the typical *market rental rate*. Adding to that confusion is the term *tenant improvement* which is also sometimes referred to as TI. The Board has chosen the term *leasehold improvement* to help alleviate the confusion and also sought its definition in the ©1998 Alberta Assessors' Association, *Office Valuation Guide – June 1998*, (R1 page 30):

Leasehold Improvement Allowances

The most common form and application of inducements is the provision of leasehold improvements by the landlord either through actual construction or through a direct cash payment to the tenant.

Since the valuation procedure presented in this guide is based on the net effective rent for finished space, the income analysis incorporates the value of leasehold improvements. Because of this approach, inducements that are attributable to leasehold improvements should not affect

the net market rents used in the assessment of a property. Therefore, no deduction or adjustments to the Base Rent should be made for inducements attributable to leasehold improvements.

The Board determined that the term adjustment assumed that the face lease had the value of such improvement already included, therefore *tenant inducements do not* change the value under *fee simple* and need to be factored out and *leasehold improvements do* change the value and need to be factored in when calculating a typical *market rental rate*. In coming to that conclusion the Board also considered the definition of *market rental rate* as found in ©2001 *Real Property Association of Canada (REALpac) Terminology Standards, First Edition* (C1b page 74) wherein we find;

Market Rental Rate *Market Rental Rate is the most probable Rent which a leased property should bring for the relevant lease term in a competitive and open market under all conditions requisite to a fair lease transaction, the lessee and lessor each acting prudently and knowledgeably, and assuming the Rent is not affected by undue stimulus between the parties. Implicit in this definition is the consummation of a lease transaction as of a specified date and the passing of occupancy from lessor to lessee under conditions whereby:*

- i. Lessee and lessor are typically motivated;*
- ii. Both parties are well informed or well advised, and acting in what they consider their best interests;*
- iii. A reasonable time is allowed for exposure in the open market;*
- iv. Payment is made in terms of cash (in Canadian dollars) or in terms of financial arrangements comparable thereto;*
- v. The Rent represents the normal consideration for the leased property in its highest and best use, unaffected by special or creative leasing incentives or allowances granted by anyone associated with the lease transaction; and,*
- vi. The prospective lessee is not then in occupation of or has no obligation in respect of the building.*

The Board finds that *tenant inducements must* in fact be deducted however tenant improvements or *leasehold improvements must not* be deducted or *must* be added back in the face rent to calculate a typical assessable *market rental rate*.

The Board found one needs to be mindful to the fact there is no restriction under *fee simple* and the current tenant *does* find value in their improvements completed for their use. The tenant *does not* have an encumbered right to enjoy their leasehold improvement under *fee simple*, therefore any enhancements when completed certainly *do* add value to the tenant and therefore to the *fee simple* estate.

In arriving at the correct typical *tenant inducement* value, the Board carefully analysed all the evidence and noted the Respondent had calculated a business assessment for the subject property and arrived at a value of \$19 per square foot. For business assessments, the Respondent must find the value to the landlord instead of finding the *fee simple* estate or the value to the tenant and the landlord. This calculation for business assessment purposes is based on the *Court of Queen's Bench of Alberta (QB) decision; Calgary (City) v. Canadian Natural Resources Limited, 2010 ABQB 417*, wherein the Respondent must calculate the value of a typical *net effective rent* with all *tenant inducements and leasehold improvements* removed.

The Board in reviewing the QB decision determined that for business assessment purposes

tenant inducements and leasehold improvements must both be deducted. Further the Respondents' business assessment for the subject is \$19.00 and deemed to be the typical *net effective rent* representing both *tenant inducements and leasehold improvements* removed. However without evidence to establish a specific value for *tenant inducements* or *leasehold improvements* the Board is forced to accept the Respondents value as assessed to be the typical *market rental rate* for this area of the city. The Board has no way of knowing how much, if any, of the \$3.00 difference between business assessment and typical *market rental rate* is attributable to either a *tenant inducement* or a *leasehold improvement*.

The Board further pondered what would constitute *tenant inducements* and *leasehold improvements* and offers the following as a guide:

Tenant Inducements:

- *Cash payment(s) to convince a tenant to sign a lease, whether an initial term or renewal*
- *Cash payment(s) for a tenant to paint or decorate which provides no tangible alteration to premises but rather changes the appearance for corporate identity purposes or maintains the premises with a routine refresh, whether an initial term or renewal*
- *Free rentals period(s) for any purpose except where it reimburses for a leasehold improvement*

Leasehold Improvements:

- *Cash payment(s) for any major maintenance item such as; new HVAC, windows, siding, roof, etc.*
- *Cash payment(s) to permit a tenant to reconfigure space with non-maintenance improvements such as; interior walls, dropped ceiling, flooring, etc.*
- *Landlord built and paid for, major maintenance and non-maintenance improvements as listed above, usually already reflected in the face rent.*

The Complainant failed to provide the Board evidence on what portion, if any, is assigned to *tenant inducement* and what portion, if any, is *leasehold improvement*. Without evidence to support the Complainant's valuation the Board is forced to accept the assessment from the Respondent.

Does changing the manner in which typical *market rental rate* is calculated create atypical situations and prevent comparability with previous years?

The Board finds the current methodology employed by the Respondent results in inequity and atypical assessments as there is no analysis done by the Respondent to bring the face rental rolls provided by the Taxpayers to the same common *market rental rate*.

The Respondent argued that changing their procedure will make comparability between years difficult resulting in the need to recalculate past years' typical *market rental rates*. The Board disagrees in that if all properties are assessed in the same manner on a going forward basis then there would be just one correction year and no recalculation will be required.

The Board finds the current practise rather disturbing as it does not treat all properties consistently. In making our decision the Board had understood that the Respondent makes no adjustment of any kind to the face rental rate of the rental rolls when calculating the typical *market rental rate* for assessment purposes yet the Board's findings clearly indicate *market*

rental rate represents the normal consideration unaffected by incentives or allowances or in other words less *tenant inducement*.

The Board further understood from oral evidence that many times the face rent has been reduced on the rent rolls to reflect one form of inducement or another. The Board understood that sometimes a lump sum payment or free rent is provided to the tenant as an inducement thereby not reducing the face rent on the rent rolls, and still other times no form of inducement has been provided.

In order to evaluate these leases equitably, the *market rental rate* needs to be brought to a common value wherein *tenant inducement* **must** be deducted, and *leasehold improvements* **must** remain in or be added back in the face rent.

The Board in finding the methodology of the Respondent in error also found no evidence from the Complainant to arrive at a different value therefore was forced to confirm the values provided by the Respondent as typical.

The Board provides these examples to illustrate the current inequity or atypical situations;

Example 1: A five year net lease for 2,500 square feet at a face rental rate of \$20 per square foot per annum. The tenant negotiates one year of free rent or a \$50,000 "signing" bonus, the net effective rent paid by the tenant is now less than the \$20 per square foot face rent. The Board would deem this to be a tenant inducement rather than a leasehold improvement therefore must be removed from the face rent to calculate the market rental rate. Currently the Respondent does not reduce this inducement and calculates an inaccurate market rental rate of \$20 per square foot. In this case, instead of paying \$250,000 over the five year lease the tenant now pays \$200,000, or (without considering the time value of money) an average market rental rate of \$16 per square foot.

Example 2: A five year net lease for 2,500 square feet at a face rental rate of \$20 per square foot per annum. The tenant negotiates one year of free rent or a \$50,000 "signing" bonus, however the landlord agrees to reduce the rental rate paid to factor for the free rent. The net effective rent paid by the tenant and the rent roll is now \$16 per square foot. The Board would deem this to be a tenant inducement not a leasehold improvement therefore must remain off the face rent to calculate the market rental rate. Currently the Respondent does reduce for this inducement and calculates an accurate market rental rate of \$16 per square foot as this is the figure on the rental roll. In this case, over the five year lease the tenant pays \$200,000.

Example 3: A five year net lease for 2,500 square feet at a face rental rate of \$20 per square foot per annum. The tenant negotiates a leasehold improvement of \$50,000 paid in cash by the landlord for actual work performed to improve the space for their tenancy; the net effective rent paid by the tenant is still the face rent of \$20 per square foot. The Board would deem this to be a leasehold improvement therefore it must remain within the face rent to calculate the market rental rate. Currently the Respondent does not reduce for this improvement therefore calculates an accurate market rental rate of \$20 per square foot. In this case, the tenant still pays \$250,000 over the five year lease and finds value in the leasehold improvement.

Example 4: A five year net lease for 2,500 square feet at a face rental rate of \$20 per square foot per annum. The tenant negotiates a leasehold improvement of \$50,000, however the landlord agrees to reduce the rental rate paid to factor for actual work performed by the tenant to improve the space for their tenancy; the net

effective rent paid by the tenant is still the \$20 per square foot however, the rental rolls now show a rent of \$16. The Board would deem this to be a leasehold improvement therefore it must remain, or added to the face rent to calculate the market rental rate. Currently the Respondent does not add this improvement to the market rental rate and calculates an inaccurate market rental rate of \$16 per square foot. In this case, the tenant still pays \$250,000 over the five year lease and finds value in the leasehold improvement however the Respondent does not capture this value.

Example 5: *A five year net lease for 2,500 square feet at a face rental rate of \$20 per square foot per annum. No tenant inducement or leasehold improvement is negotiated. Currently the Respondent makes no adjustment and calculates an accurate market rental rate of \$20 per square foot as this is the figure on the rental roll. In this case the tenant pays \$250,000 over the five year lease.*

The Board finds that the Respondent has erred in their calculations of typical *market rental rate* calculations as presented at this hearing and purported to be the same throughout the city. The Board further finds that the Respondent has the ability through Assessment Request for Information (ARFI) forms to arrive at the proper *market rental rate* for property assessment purposes. The Complainant failed to convince the Board what a typical *market rental rate* would be therefore was given no other choice but accept the Respondent's calculated typical *market rental rate*.

Does a change in the typical *market rental rate* require a corresponding change in the *capitalization rate*?

The Board finds that all inputs which influence an assessment must be derived in a consistent approach.

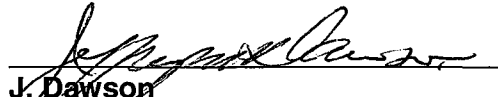
The Respondent argues that one cannot change the manner in which typical *market rental rate* is calculated in the Income Approach without changing the other inputs which use the typical *market rental rate* to derive the input. What is at issue here is both the typical *market rental rate* and *capitalization rate* are derived using rent rolls and if the manner in which a typical *market rental rate* is changed as this Board has determined then the same change must be made to the *market rental rates* used in determining the *capitalization rate*.

The Board finds the Respondent correct in the general nature of their argument; however, neither the Complainant nor the Respondent provided the ARFI for this assessment, neither the Complainant nor the Respondent provided an analysis in which to derive a typical *market rental rate*, and neither the Complainant nor the Respondent provided a study to assess the *capitalization rate*. Without any evidence for the Board to consider the only option for the Board is to accept the Respondent's assessment.

Board's Decision:

After considering all the evidence and argument before the board, the complaint is denied, and the assessment is confirmed at \$8,670,000.

DATED AT THE CITY OF CALGARY THIS 29th DAY OF September 2011.


J. Dawson
Presiding Officer

APPENDIX "A"**DOCUMENTS PRESENTED AT THE HEARING
AND CONSIDERED BY THE BOARD:**

NO.	ITEM
1. C1a	Complainant Disclosure pages 1 through 69
2. C1b	Complainant Disclosure pages 70 through 147
3. R1	Respondent Disclosure
4. C4	Complainant Rebuttal

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.*

Municipal Government Board use only: Decision Identifier Codes				
Appeal Type	Property Type	Property Sub-Type	Issue	Sub-Issue
CARB	Office	Low Rise	Income Approach	Net Market Rent / Lease Rates
				Capitalization Rate