

**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:

KS 925 28 Street NE Inc. (as represented by Altus Group), COMPLAINANT

and

The City Of Calgary, RESPONDENT

before:

***W. Kipp, PRESIDING OFFICER
R. Kodak, MEMBER
Y. Nesry, 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:	054 003 991
LOCATION ADDRESS:	2855T – 10 Avenue NE, Calgary AB
HEARING NUMBER:	64055
ASSESSMENT:	\$14,760,000

This complaint was heard on the 29th and 30th days of August, 2011 at the office of the Assessment Review Board located at Floor Number 4, 1212 – 31 Avenue NE, Calgary, Alberta, Boardroom No. 2.

Appeared on behalf of the Complainant:

- C. Van Staden (Altus Group)

Appeared on behalf of the Respondent:

- M. Berzins (Assessment Business Unit)

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

The Complainant's capitalization rate analysis disclosure brief was to be transmitted to the Respondent and the Calgary Assessment Review Board (ARB) in two parts because of the size of the brief. Part one of the brief was inadvertently transmitted twice and part two was not sent. At the opening of the hearing on August 29, 2011, the Complainant pointed out that the full evidence package had been presented at other hearings and that the Respondent was aware of its contents and had prepared its evidence in response to the full brief in other ARB hearings. Mr. Berzins acknowledged that he was aware of the contents of the entire brief and was prepared to deal with the complete capitalization rate analysis evidence. The Board adjourned briefly so that the Complainant could obtain copies of the second part of the brief for the Respondent and Board members.

A critical component of the Complainant's evidence and argument for 20 northeast Calgary industrial property complaints was an "*Industrial Capitalization Rate Analysis 2011 Assessment Year*". This evidence, along with the Respondent's evidence and Complainant's rebuttal evidence was heard at the beginning of the hearing on August 29, 2011. In order to reduce paper consumption, only one copy of the Complainant's disclosure brief (in two parts) and a rebuttal brief was provided to the Board (this is retained in File 61218). For each of the subsequent 19 hearings, the same capitalization rate evidence was carried forward (marked as Exhibits C2A and C2B in each file). For each of the 20 complaint files, the Complainant filed separate site specific evidence briefs. The Respondent had prepared an evidence brief for each of the 20 properties which contained site specific evidence as well as response to the Complainant's Industrial Capitalization Rate Analysis. The 20 complaints at this hearing are identified as:

<u>File No.</u>	<u>Roll Number</u>	<u>File No.</u>	<u>Roll Number</u>
61218	200 743 771	64201	032 041 592
64265	200 212 272	62954	049 017 304
64266	200 335 263	63386	031 014 293
64055	054 003 991	64301	054 006 200
64065	009 001 090	64307	055 162 200
64067	009 001 199	64444	200 346 039
64091	031 022 908	64450	200 745 966
64094	031 024 003	64451	200 776 896
64097	031 024 300	64746	031 002 702
64173	009 023 706		
64186	031 014 095		

Property Description:

It is noted that there are two addresses on documentation in this file. The Assessment Notice shows 2855T – 10 Avenue NE while the Assessment Explanation Supplement shows 2820 – 7 Avenue NE. The address from the Assessment Notice will be used in this decision. The property is an industrial, multi-tenant warehouse property. The building, constructed in 1999, contains 143,154 square feet. 26% of the space is finished as offices. The building footprint represents a site coverage ratio of 41.86% for the 7.85 acre land parcel.

The 2011 assessment is \$14,760,000 (\$103.17 per square foot of total building area).

Issues:

The Assessment Review Board Complaint form filed March 4, 2011 had boxes 3 (Assessment amount) and 4 (Assessment class) checked in Section 4. In Section 5 of the form, there was a list of issues and grounds for the complaint however not all of these were pursued at the hearing.

At the hearing, the Complainant dealt at length with the Industrial Capitalization Rate Analysis conducted by Altus Group. The issue was that industrial properties, particularly larger ones, should be assessed using the income approach rather than the sales comparison approach. This became the first issue in all 20 complaint hearings on the agenda.

For this file, the first issue is that the sales comparison approach utilized by the Respondent does not provide a realistic value for the subject property and it should therefore be assessed using the income approach to value. The second issue is that the subject property is not assessed equitably when compared to other similar properties.

Complainant's Requested Value: \$13,590,000 (\$95 per square foot of building area)

Party Positions on the Issues:**Complainant's Position:**

Issue 1. Income Approach versus Sales Comparison Approach

It is the position of the Complainant that industrial properties should be assessed utilizing the income approach to value (direct capitalization method). Approximately one half of all Calgary industrial properties are held as income producing investments. This means that there is ample income related data available to the assessor. There have been too few recent sales of industrial properties that were comparable to the subject for a proper application of the sales comparison approach which was the valuation technique employed by the Respondent.

The Complainant provides sale details of one industrial property and concludes that there is limited similarity between this property and the subject so the sales comparison approach

cannot provide a realistic value for the property. Age, site coverage and interior finish were significantly different. Based on the sale, the Complainant suggests that a market value of \$81 per square foot might be indicated for the subject but that is insufficient evidence upon which to base an assessment.

The Altus Group "*Industrial Capitalization Rate Analysis – 2011 Assessment Year*" (Exhibits C2A and C2B) contains a review of the three approaches to value. While assessors are permitted to use any one or more of the three approaches to valuing property, some are better suited to particular property types.

The sales comparison approach (also identified in evidence as the Direct Sales Comparison Approach) works well when there are sufficient numbers of recent comparable property sales transactions to identify value patterns in the market. If sales data is limited, it becomes difficult to establish appropriate benchmarks to estimate values. The key to a successful market sales comparison analysis in a mass appraisal environment is to stratify or classify various types of properties into groups containing common elements. The following characteristics can be used to classify warehouses: Function, Size, Age/Condition, Height, Location, Land/Building ratio. The valuation model developed by the Respondent makes adjustments to sales for a number of factors but there is no provision for any adjustment to reflect ownership/investment economics. This is a major consideration of market participants and it is not possible to achieve a realistic market value estimate without having regard to economic factors as well as physical and locational characteristics.

There may be sufficient sales data for some classes of warehouses and not for others, or the sales data may not "explain" the value of certain elements. Where there is insufficient sales data, another valuation approach should be used.

A list of industrial property sales provided to property owners by the City of Calgary (not included in evidence at this hearing) had no indication that properties had been stratified into groups. The table of sales indicates that over the 18 months prior to the July 1, 2010 valuation date, there was a very limited amount of sales within even the most basic size strata. In all, the City data pertained to 154 industrial property sales that took place between July 2007 and July 2010. For the 18 months from January 2009 to July 2010, there were only 56 sales and for the first six months of 2010, there were only 21 sales. The Complainant stratified sales into size groupings and concluded that over the 18 months leading to the valuation date, there were only one to three sales in each of the groupings of 50,001 to 100,000 square feet (2 sales), 100,001 to 250,000 square feet (3 sales) and over 250,001 square feet (1 sale).

It is the Complainant's opinion that the sales analysis period should be as short as possible and, ideally, no longer than one year. The Calgary industrial market changed significantly over the three year period utilized by the Respondent but this was not appropriately recognized in its sales analysis. In the Complainant's opinion, the market suffered an economic collapse in the fall of 2008. This followed the boom years of 2006-2008. Prices dropped and capitalization rates increased. Mortgage lenders, wary of further market declines, changed their lending criteria. Whereas a purchaser could previously obtain a mortgage loan for up to 75% of property value, new lending policies set the maximum loan amount at 60% of value.

The Respondent maintains that its assessment model based on property sales is reliable

because it has passed the provincial Assessment to Sales Ratio (ASR) audit. Sales verified by the City have ASR's from 0.593 to 1.408. The median of all sales falls within the desirable range from 0.95 to 1.05 which allowed the audit to pass. Of all sales, however, just 23% are actually within the desired range. 26% of the assessments of modelled sales exceed the 1.05 ASR and 51% of assessments modelled are below 0.95 ASR. This further supports the Complainant's position that there are too few acceptable sales upon which industrial assessments can be based.

Having regard to the subject property, the Complainant opined that the sales used by the Respondent support the Complainant's position that market sales are too limited to provide meaningful values in a comparison process. Firstly, most of the Respondent's sales (4 of 5) occurred in 2008 and the time adjustment applied is incorrect. Other differences such as building age (1990, 2007 and 2008 for three properties) do not make for simple comparisons to the subject which was built in 1999.

The income approach to value is another approach widely used by assessors. Typically, it is the direct capitalization technique that is used. That is where an estimate of net operating income is divided by a capitalization rate to yield an indicator of value. There is ample market evidence for use in developing net operating incomes and capitalization rates. Further, an analysis of capitalization rates shows that there is no need to stratify properties by size, location and so on. The only characteristic that seems to influence capitalization rates is building age. The Altus analysis concludes that the appropriate year for the age stratification was 1995. Sales of properties where the building was constructed in 1994 or earlier have higher capitalization rates than properties with a building constructed in 1995 or later. It was also around that time that building construction methods changed (i.e., use of tilt-up concrete panels and greater wall heights). In past assessment years when the Respondent assessed industrial properties using an income approach, it was 1995 that was chosen as the year for capitalization rate change as well. Variances in any of the other characteristics impact on the rent obtainable for building space rather than on the capitalization rate. This contention is supported by market evidence.

In the Altus analysis, the income estimate comprises actual rents from leases in place at the time of sale with vacant space assumed to be leased at market rents. A stabilized typical vacancy loss allowance of 5.0% is chosen for all of the sales being analyzed based on industry market reports from commercial real estate companies and analysts that indicate industrial property vacancies from 6.25% to 8.50%. Potential gross income from rents, reduced by the 5.0% vacancy allowance produces the net operating income (NOI) estimate. That NOI is then divided by the sale price of the property to yield a capitalization rate. A similar analysis using typical (market) rents for 100% of rentable space misrepresents the economics of the investment decision if actual rents are not near typical rents.

Eight industrial property sales were analyzed in the above described manner. Stratification was on the basis of year of building construction. This segregated the eight sales into five sales where the building was constructed prior to 1995 ("pre-1995") and three sales where the building was constructed in 1995 or later ("post-1994"). All of the sales occurred between the dates of April 2009 and April 2010. Capitalization rates for the five pre-1995 building sales ranged from 7.96% to 9.53% with a median of 8.30%. This was truncated to 8.25% which became the requested rate for all sales involving properties where the building was pre-1995. The three post-1994 building sales had capitalization rates from 7.39% to 7.78% with the median at 7.77%. This was truncated to 7.75% and became the requested capitalization rate

for assessment of properties where the building was constructed in 1995 or later.

A second analysis was undertaken using the same eight sales. In this analysis, the income estimate was based on an assumption that all building rentable space was leased at market rents. After allowing for typical vacancy, the indicated median capitalization rates were 8.50% (truncated) for property sales of pre-1995 buildings and 7.50% for sales where the buildings were 1995 or newer. It was argued that this market based analysis provided support for the chosen rates of 8.25% and 7.75%.

The Complainant conceded that there were other sales that could have been included in the analysis, however, there was insufficient verifiable income data available for those other property sales to produce meaningful results. The sampling of eight sales was sufficient to show how sellers and buyers were deciding on sale/purchase prices.

In support of the argument that only the most recent sales could generate reliable capitalization rates, the Complainant set out an additional analysis of sales of industrial buildings with more than 100,000 square feet of area. These sales dated back to December 2006. Generally, the analysis showed that capitalization rates were between 6.25% and 6.5% in 2006-2007. During the first half 2008 peak market era, rates declined to under 6.0%. From the second half of 2008 and through to mid-2010, rates increased to the 7.0-8.0% range. When the same property sales were analyzed using the Respondent's time adjusted sale prices and the Altus selected capitalization rates of 8.25% and 7.75%, indications were that market declines were understated by the Respondent by as much as 27%. For all of the sales that occurred between December 2006 and late 2008, the Respondent's time adjusted prices were from 15% to 27% below prices based on income capitalization. There is no evidence in the Respondent's disclosure to support its time adjustment. It is clear from the analysis that the Respondent's negative time adjustment is far too low. The Complainant opined that similar results would have been achieved by analysis of properties in other size ranges. The over 100,000 square foot stratum was included in Complainant's evidence because the majority of complaints at this hearing are larger properties (over 50,000 square feet). Another observation from this analysis is that properties with the lowest sale price per square foot also have the lowest net operating income per square foot. This shows that investors are cognizant of the economics of property ownership; however the valuation model employed by the Respondent does not make any adjustment for economic factors.

Starting with the assessment and typical vacancy allowance, capitalization using a 7.75% rate indicates that the building rent would have to be \$8.41 per square foot in order to arrive at the \$14,760,000 assessment.

A study of recent leases in northeast Calgary industrial buildings (including four in the subject) leads to the conclusion that the market rent rate for the subject should be of the order of \$7.50 per square foot. With weight on the leases in the subject, a \$7.75 per square foot rent rate is inserted into the income approach formula, along with 5% typical vacancy and the 7.75% capitalization rate, the indicated assessment is truncated to \$13,590,000 (\$95 per square foot of building area). The business assessment rent is also \$7.75 per square foot (found from 17 comparables) so this also suggests an assessment of \$13,590,000.

The most realistic valuation, based on market rents, leads to an assessment of \$13,590,000.

Issue 2 Equity

In the absence of reliable sales information, similarities do exist between the subject and other properties and comparisons can be made in relation to assessments (equity).

Details of seven similar property assessments are provided. These are all northeast Calgary properties with building areas that bracket that of the subject (126,114 to 192,851 square feet). Ages of three of the buildings are similar to that of the subject. The other properties have site coverage ratios that are somewhat similar to the subject (37.47% to 46.18% versus 41.86%). The 2011 assessments of these properties range from \$72 to \$102 per square foot. From the comparables, the Complainant concludes that the subject assessment should be \$13,900,000 which is based on \$97 per square foot of building area.

Respondent's Position:

Issue 1. Income Approach versus Sales Comparison Approach

It is the Respondent's position that the sales comparison approach is the superior valuation method for industrial properties. Not all industrial properties are income producing properties and comparison is one of the tools that buyers and sellers use whether a property produces income or not.

A number of Calgary Assessment Review Board (ARB), Composite Assessment Review Board (CARB) and Municipal Government Board (MGB) decisions are in evidence. These decisions support the Respondent's reliance on the sales comparison approach and they support the Respondent's position that the Complainant's application of the income approach, including the derivation of capitalization rates, is flawed.

Decisions of the various Boards, among other things, confirm that assessments must reflect market value of the "fee simple" interest in property. The Complainant's capitalization rate analysis produces capitalization rates that are derived on the basis of "leased fee" ownership. The sales comparison approach generates a value of the fee simple interest. The Complainant has not discredited the sales approach but has only put forward its alternative – the income approach.

With respect to the Altus capitalization rate study, the Respondent argues that the sales sampling of just eight sales is insufficient to accurately determine capitalization rates for application to all Calgary industrial properties. Also provided is a chart of information to show that the rental information used by Altus is either incorrect or unsubstantiated. Leases in place at the date of sale for some of the properties show that rents, in some cases, are set as long ago as 1999 and are therefore not reflective of current rents. The data in the chart is verified by Assessment Request For Information (ARFI) responses from property owners or managers and would have been the information available to the Respondent as at the valuation date of July 1, 2010.

As further support for its contention that the capitalization rates in the Altus study are too high, the Respondent provides a market survey report by Colliers International wherein, for the second quarter of 2010, industrial capitalization rates ranged from 6.75% to 7.25%. The

Respondent is aware that the rates in this study are only an amalgamation of opinions of market participants but wonders how these market participants can be so wrong if the Altus 7.75% and 8.25% rates are correct.

In the Respondent's application of the sales comparison approach, five sales of industrial properties are provided. Two of the sale properties are in northeast Calgary industrial parks while the other three are located in southeast industrial areas. One property has a building older than the subject (1990) and two others are significantly newer (2007 and 2008). Four of five sales occurred in 2008, from 18 to 25 months prior to the valuation date. The fifth sale occurred in April 2010. Time adjustments from -3.58% to -5.84% are applied to the 2008 sales to arrive at unit prices from \$100 to \$135 per square foot of building area (the 2010 sale at \$128 per square foot is not time adjusted because it occurred within three months of the valuation date and market conditions had not changed during that period of time). Two of the properties have single tenant buildings while the other three are occupied by multiple tenants. Positive adjustments are made to southeast Calgary property sales prices when comparing to properties in northeast industrial areas. Also, negative adjustments are made to single-tenant properties when comparing them to multi-occupancy properties. The mean average of the sales, at \$115 per square foot of building area, supports the assessment of \$103 per square foot.

Issue 2 Equity

There are seven properties described in a table of equity comparables in the Respondent's evidence. Four of these are in northeast Calgary industrial parks, two are in the south-central area and the other one is in the southeast. Three of the comparables represent one building on a multi-building site. All but one of the buildings are smaller than the subject. All of the buildings are either newer (2007) or similar in age (2000-2002) to the subject. Site coverage ratios range from 32% to 51% (subject at 42%). Like the subject, all of the properties are multi-tenant properties. 2011 assessments reflect from \$102 to \$125 per square foot of building area. These rates support the \$103.17 per square foot rate of the subject assessment.

Complainant's Rebuttal:

Through questioning of the Respondent and/or rebuttal evidence, the Complainant established that most if not all of the ARB, CARB and MGB decisions are not based on the same comprehensive capitalization rate study that is in evidence before this Board.

The Respondent criticizes the Altus study as being based on only eight sales but the subsequent chart (Page 29 of Exhibit C2A) has information on 17 sales. Those sales clearly show that older sales cannot be relied upon in the determination of capitalization rates for use in making 2010-2011 assessments because of significant changes in market conditions during 2008-2009. The chart also shows that property characteristics such as location, building size and so on are reflected in rents obtainable for the properties and not in the capitalization rates generated on a sale. Having regard to the number of sales, the Complainant points out that in CARB decision 0756/2010-P, the CARB accepted the Complainant's income approach wherein only five sales were used to extract a capitalization rate.

CARB decision 1436/2010-P confirms the Complainant's position that the Respondent's time adjusted prices on industrial sales were unaccepted. None of the evidence before this Board

contains any support for the time adjustments applied by the Respondent. Page 29 of Exhibit C2A is therefore the only evidence dealing with that issue. MGB Board Order 037/09 is further confirmation that where sales comparison and cost approaches are not supported with good evidence, the income approach is the superior valuation method.

In the Altus study, the dual analyses of the sales used for capitalization rate extraction show that actual rents were set at dates very close to the sale date and are therefore reflective of market rents. The value of the fee simple estate and leased fee estate are similar if contract (actual) rents approximate market rents.

Board's Decision:

The 2011 assessment is confirmed at \$14,760,000.

Reasons for the Decision:

Legislation requires this Board to consider all evidence before it and to adjudicate a fair and equitable assessment on any property for which there is a complaint. There are three common valuation approaches and an assessor is able to use whichever approach is deemed to be most appropriate. Once an assessor has made the choice, it is up to a Complainant to convince the Board that there is a better valuation method for a particular property.

This Board does not choose one valuation approach over any other for the assessment of industrial properties. It is the amount of the assessment that the Board must consider. Calgary CARB decision 0522/2010-P stated *"If any party can satisfy the Board, to the extent required by law, that in application of any applied approach to value errors have been made that have resulted in an incorrect assessed value, then it is those errors, supported by market based evidence, that should be given consideration."* This Board concurs with that finding and will place most weight on the market evidence regardless of which valuation approach is used.

In this case, the Board places greater weight than the Complainant did on the leases within the subject property. If the average rent rate of \$8.07 per square foot is input into the formula, the indicated property value is approximately \$99 per square foot of building area. From the equity perspective, consideration of comparables from both parties tends to support a rate around that of the subject assessment.

Given the above, the Board finds that both equity and income approach indicators are within a reasonable range that supports the \$103.17 per square foot rate indicated by the assessment.

DATED AT THE CITY OF CALGARY THIS 28 DAY OF September 2011.



W. Kipp
Presiding Officer

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

NO.	ITEM
1. C1	Complainant Disclosure
2. C2A	Complainant Industrial Capitalization Rate Analysis – Part 1
3. C2B	Complainant Industrial Capitalization Rate Analysis – Part 2
4. C3	Complainant Industrial Capitalization Rate Rebuttal Brief
5. R1	Respondent Disclosure

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.*

For Administrative Use

Appeal Type	Property Type	Property Sub-Type	Issue	Sub-Issue
CARB	Warehouse	Warehouse Single Tenant	Income Approach	Lease Rates Capitalization Rate
			Sales Approach	Equity Comparables