

Central Alberta

Regional Assessment Review Board

Decision No.: CARB 0262 609/2014

Complaint ID: 609

Roll No.: 931306

REGIONAL ASSESSMENT REVIEW BOARD DECISION

HEARING DATE: August 14, 2014

PRESIDING OFFICER: Cathryn Duxbury

BOARD MEMBER: Velma Keeler

BOARD MEMBER: Al Gamble

BETWEEN:

TREIT Holdings 10 Corporation

Complainant

-and-

The City of Red Deer

Respondent

This is a complaint to the Central Alberta Regional Assessment Review Board in respect of the following assessment:

ROLL NUMBER:	931306
MUNICIPAL ADDRESS:	3310 50 Avenue
ASSESSMENT	\$28,094,600

The complaint was heard by the Composite Assessment Review Board on the 14th day of August, 2014, in the City of Red Deer.

Appeared on behalf of the Complainant: Stephen Cook, Managing Director, VP
James Phelan, Analyst
Colliers International Valuation & Advisory Services

Appeared on behalf of the Respondent: Rob Kotchon, Assessment Coordinator / Analyst
Anna Meckling, Assessor
City of Red Deer, Revenue & Assessment Services

JURISDICTION

[1] The Central Alberta Regional Assessment Review Board (“the Board”) has been established in accordance with section 456 of the *Municipal Government Act*, R.S.A. 2000, c. M-26 (“the MGA”).

[2] Neither party raised an objection to any Board member hearing the complaint.

[3] No procedural or jurisdictional matters were raised by either party.

PRELIMINARY MATTERS

[4] There were no preliminary matters raised by the parties.

BACKGROUND

[5] The subject property is a full service Sheraton Hotel located at 3310 50 Avenue, in Red Deer. The property consists of 242 accommodation units and includes restaurants, bars, convention and meeting facilities, banquet amenities, and a free standing liquor store. The Respondent determined the assessed value of the subject property using the income approach to value.

ISSUES AND FINDINGS

[6] At issue is whether the assessed value of the subject property is in excess of its market value. During the hearing, the parties’ submissions were primarily focused on the following three matters:

Was it incorrect for the Respondent to assess the hotel component of the subject property separately from the retail component?

If assessing the hotel component of the subject property separately from the retail component is acceptable, did the Respondent apply the wrong lease rate to the 15,921 square feet attributed to Billy Bob’s Saloon?

Was the capitalization rate applied to the subject property too low?

Complainant’s position:

[7] After reviewing the details of the subject property, the Complainant produced charts at pages 14 and 15 of Exhibit C1 that they advised they found on a Government of Alberta website. The Complainant explained that the chart on page 14 shows that hotel occupancy rates have not yet returned to the levels they were at prior to the economic crisis Canada experienced in 2008, and the chart on page 15 shows that the average daily rates reported for hotels have not completely recovered either. The Complainant asserted that the subject property was no exception.

[8] The Complainant has no dispute with the subject property being assessed based on the income approach to value, but argued that the methodology used by the Respondent in previous years has changed in error and without explanation. For the 2013 assessment year the

Respondent determined an assessed value for the hotel portion of the subject property using the stabilized room revenue and an expense ratio, separately from their determination of an assessed value for the retail portion using market lease rates. The two separate assessed values added together result in a total assessed value for the subject property on July 1, 2013 of \$28,094,600. The Complainant suggested that this amounts to a mixing of methodologies that is a frowned upon assessment practice. The Complainant stated that the Respondent is the only municipality in Alberta that employs this methodology.

[9] The Complainant noted that the current assessed value of the subject property at what amounts to \$116,093 per unit is a 20% increase over the previous year's assessment. The Complainant argued that a taxpayer deserves an explanation when there is an increase of that magnitude.

[10] In the past three assessment years, the Respondent used the subject property's actual earnings and losses stabilized over three years without separating the room revenue and expenses from the retail. The Complainant takes the position that the same methodology should have been used for the 2013 assessment year, and that it is unfair that the Respondent only used 18 months of the subject's hotel income in their calculations rather than the three years used for every other hotel in Red Deer. The Complainant also takes the position that the capitalization rate of 9.5% used by the Respondent to determine the subject property's market value on July 1, 2012, a cap rate the Complainant maintained was confirmed by the Board in its decision #CARB 0262 550/2013, should also have been used to determine the subject property's market value on July 1, 2013. The Complainant believes that there is no evidence from the Respondent to substantiate a reduction of the cap rate for hotel properties from 9.5% in 2012 to 8% in 2013.

[11] At page 19 of Exhibit C1, the Complainant provided a chart detailing the subject property's actual earnings and losses in 2010, 2011, and 2012, and the resulting stabilized values. Based on the figures detailed in this chart and a cap rate of 9.5%, the Complainant requests that the assessed value be reduced to \$24,366,000 (\$100,686 per unit). The Complainant noted that the requested assessed value is an 8% increase over the July 1, 2012 assessed value, "and so appears to be very reasonable" [Exhibit C1, p. 19].

[12] In the event the Board accepts that the hotel and retail portions of the subject property may be assessed separately, and that market lease rates may be used to determine the assessed value of the retail spaces, the Complainant asks the Board to reduce the market lease rate applied to the 15,921 square feet attributed to Billy Bob's Saloon. Currently, the Billy Bob's space is assessed at \$26 per square foot, the same rate applied to the 3,454 square foot Curvy Beer Store. The Complainant takes the position that it is absurd to suggest that a retail tenant of 3,454 square feet and a tenant of 15,921 square feet would both be assessed at the same rental rate. In support of the argument that there are economies of scale, the Complainant provided a chart on page 20 of Exhibit C1 which shows that as the assessed area of a property increases, the assessed lease rate per square foot decreases. Based on the principles of economies of scale, and heavily grounded in the \$8 per square foot lease rate applied to the subject property's 50,196 square foot Banquet and Exhibition Hall, the Complainant requests that the lease rate applied to Billy Bob's be reduced to \$10 per square foot. With all other values used by the Respondent remaining the same, including the cap rate, the reduction in the lease rate applied to Billy Bob's results in an alternative proposed assessed value for the subject property of \$25,067,000.

[13] The Complainant disputed the restaurant comparables used by the Respondent to determine the \$26 per square foot market lease rate applied on the basis that some are franchises, many are freestanding, and all are in superior locations to the subject property.

[14] While the Complainant takes the position that the best approach to valuing hotels is the income approach, the Complainant argued that the direct sales approach should be used as a “check” and should support the value derived using the income approach. The Complainant took the Board through a direct sales analysis which the Complainant argued showed that the value the Respondent derived in their income calculations has resulted in a gross over-assessment.

[15] On page 22 of Exhibit C1 the Complainant provided a list of six hotel properties the Complainant argued are comparable to the subject property. The Complainant explained that all six properties are from outside of Red Deer because these types of properties do not sell often within Red Deer. These properties have an average year of construction of 1993, an average number of suites of 124, and sold for an average of \$84,761 per unit. The Complainant determined that these sales produced an average capitalization rate of 10.66%.

[16] The Complainant provided two reports as “acid tests” that their requested assessed value of \$100,686 per unit is reasonable and that the Respondent’s assessed value is excessive: the 2013 Colliers International Hotel Report and the 2013 HVS Transaction Survey. The 2013 Colliers International Hotel Report indicates an average Alberta sale price per unit of \$112,200. After removing the extreme outliers and resort properties, the price per unit drops to \$90,872. The 2013 HVS Transaction Survey indicates an average Alberta sale price per unit of \$108,168. After removing the extreme outliers and resort properties, the price per unit in this report drops to \$92,545. The Complainant also pointed to the cap rates indicated in these reports and noted that they support the 9.5% requested cap rate.

Respondent’s position:

[17] The Respondent advised that they took a different approach in valuing hotel properties in Red Deer for the 2013 taxation year. While still using the income approach to value, the Respondent used a methodology that recognizes that six of the 17 hotels in Red Deer earn significant income from sources other than room revenue. In the case of the subject property, the income from other sources far exceeds its room revenue. To account for this difference between hotel properties, the decision was made to assess the retail portion of hotel properties in the same way retail properties are typically assessed, and separately from the assessment of the hotel portion. The two assessed values added together produce the total assessed value of the hotel properties with retail components. The Respondent confirmed that all six of the 17 hotel properties in Red Deer with a retail component were assessed in this manner.

[18] In assessing the hotel portion of the subject property, the Respondent used the stabilized actual room revenue for the 18 months prior to the July 1, 2013 valuation date and applied a typical expense ratio of 75%. After deducting another 15% for furniture, fixtures and equipment (FF&E), the resulting net operating income was multiplied by the cap rate of 8% to arrive at the assessed value of the hotel portion of the subject. The Respondent confirmed that all 17 hotels in Red Deer had the same 75% expense ratio, the same 15% FF&E deduction and the same 8% cap rate applied.

[19] The Respondent acknowledged that using only 18 months of actual room revenue was unique to the subject property. For all other hotel properties, three years of stabilized actual income is normally used. The reason the subject property was treated differently is because the subject property had only been operating under the Sheraton brand for the 18 months prior to the valuation date. The Respondent felt it would be unfair to include income earned under the previous Capri brand because the name and quality recognition between the two brands are nowhere near the same, and because of the extensive renovations the hotel underwent to bring the hotel up to the Sheraton standard. The Respondent argued that the jump in income in the year following the change in branding bears this out. Regarding the Complainant's income calculations, the Respondent observed that the Complainant used income from years the subject operated as the Capri, and failed to use the subject's income for the first six months of 2013. The Respondent maintained that these two errors artificially deflated the income used in the Complainant's income approach calculations.

[20] For the six hotel properties in Red Deer that have additional leasable space such as meeting rooms, banquet halls, retail stores, restaurants, or bars, the additional space was assessed separately by applying a market rent rate, and adjusting for vacancy, operating costs and non-recoverables. The resulting net operating income was capitalized using the same cap rate applied to the hotel portion of the property. The market rent rates applied to the different leasable spaces within the subject property are detailed in the report found on page 8 of Exhibit R1. The Respondent confirmed that these same market lease rates were applied to the similar spaces found in the other hotel properties with additional leasable space.

[21] Regarding the \$26 per square foot lease rate applied to the 15,921 square feet attributed to Billy Bob's, the Respondent produced evidence to show that the 15,921 square feet is not one contiguous space. Rather, it is comprised of Billy Bob's, Bellini's Nightclub, and at least one other completely separate space. The Respondent explained that they simply lumped the square footage together for reporting purposes. To support the \$26 per square foot lease rate applied, the Respondent produced a chart on page 14 of Exhibit R1 detailing the actual lease rates for 13 restaurant and bar properties in Red Deer. The average actual lease rate of these 13 properties is \$28.36 per square foot.

[22] To support the 8% cap rate applied to the subject property, the Respondent first used the time adjusted 2008 sale price of the subject, which produced an 8.19% cap rate. The Respondent observed; however, that the time adjusted 2008 sale price does not consider the significant changes that have occurred which have added to the value of the property and would drive down the cap rate.

[23] The Respondent then took the Board through their cap rate analysis, which includes all non-residential sales transactions that occurred in Red Deer between July 1, 2012 to July 1, 2013. The Respondent explained that a cap rate analysis using only Red Deer hotel sales is not possible given that these properties do not sell often. The Respondent argued; however, that examining all the non-residential sales occurring in Red Deer during the relevant time period provides an indicator of how investors feel about the local market. This analysis, the details of which are found on page 41 of Exhibit R1, produced a cap rate range of 6.21% to 8.89%. The Respondent also provided evidence that hotel cap rates are on the decline.

[24] The Respondent advised that after analyzing all of the data, they set the cap rate range used for hotel assessments in Red Deer at 8% to 12% for the 2013 assessment year. The

Respondent emphasized that the subject property is the number one hotel property in Red Deer, and is unique in having the largest amount of banquet and meeting space available in central Alberta. It is the only hotel in Red Deer with a free standing liquor store. Given the clear superiority of the subject property over all other hotels in Red Deer, the Respondent assessed the subject property with a cap rate of 8%.

[25] Finally, the Respondent pointed to market reports in the hotel industry as further support for the 8% cap rate applied to the subject property. Based on the data in the reports produced by the Respondent, the Respondent argued that the 8% cap rate applied to the subject may actually be high.

[26] The Respondent maintained that looking at specific hotel sales occurring outside of Red Deer is risky because of the many factors that affect sale prices, and the lack of information available about those sales. The Respondent noted that many transactions listed in hotel sales reports do not identify a cap rate at all due to lack of information, and those that do must be examined closely.

[27] The Respondent disputed the six sales used by the Complainant for a variety of reasons, including that only two of them are full service hotels, three are in remote locations, none of them have the same name cache as a Sheraton Hotel or the amenities, and none of them even come close to achieving the gross income per room the subject does. The Respondent also noted that in considering the subject's year of construction as a comparable, the Complainant erred by not factoring in the \$12,000,000 spent in 2011 on renovations to bring the subject up to the Sheraton standard. The Respondent observed that the subject property owner spent more for the 2011 renovations to the subject than four of the Complainant's comparables total sale prices.

[28] The Respondent also disputed the reliability of the cap rates reported by the publications relied on by the Complainant. During questioning, the Respondent pointed out sales reported in the Complainant's materials that had different cap rates reported for the same sale depending on which report one looks at. For one sale, the forecasted income was used, not the actual. The Respondent got the Complainant to concede that they could not explain many of the factors that went into the calculation of the cap rates listed because they were not the authors of any of the reports.

[29] To demonstrate the Respondent's assessed value of for the subject at \$28,094,600 is actually very conservative, the Respondent spent considerable time taking the Board through the owner's financial statements, which show a significantly higher book value for the subject than the Respondent's assessed value of \$28,094,600. An appraisal of the subject referred to in these financial statements, places the appraised value as even higher than the book value.

Board Findings:

Was it incorrect for the Respondent to assess the hotel component of the subject property separately from the retail component?

[30] The Board finds no error in the Respondent's assessment of the subject's hotel component separately from the retail component.

[31] The Complainant's main objection to the subject's current assessed value is that the change in the way the subject's net operating income was calculated resulted in an increase of 20% over last year's assessment. The Board is not persuaded that the Respondent's calculations were in error solely on the basis that the method used to calculate the subject's net operating income changed or that the assessed value of the subject property rose by 20%. The Complainant alleged that no other municipality employs the methodology used by the Respondent for the 2013 assessment year. Even if that fact alone was sufficient to persuade the Board that the Respondent's methodology may be incorrect, the Complainant provided no evidence to substantiate the allegation, and no indication that the Complainant has first-hand knowledge of the methodologies employed by every municipality in Alberta.

[32] While the Board is troubled by the Respondent's use of only 18 months of stabilized income in the calculation of the hotel portion of the subject property, the Board is similarly troubled by the Complainant's failure to consider the subject property's income from the first six months of 2013. In any event, the Board is persuaded by the Respondent's evidence and argument that given the amount of income that is derived from the subject property's retail space, it is fair and equitable that the Respondent assess the subject's hotel component separately from the retail component as they did with all other Red Deer hotels in similar circumstances. The Board finds no issue with the Respondent's decision to separately assess the hotel and retail components of the subject property, and does not agree that this is "mixing methodologies" as the Complainant suggested.

If assessing the hotel component of the subject property separately from the retail component is acceptable, did the Respondent apply the wrong lease rate to the 15,921 square feet attributed to Billy Bob's Saloon?

[33] The Board is not persuaded that the lease rate applied by the Respondent to the 15,921 square feet attributed to Billy Bob's Saloon is incorrect.

[34] The Complainant based their request for a reduction to the lease rate applied to the 15,921 square feet attributed to Billy Bob's Saloon on the principle of economies of scale. However, the Board accepts the Respondent's evidence that the 15,921 square feet attributed to Billy Bob's Saloon is in fact several separate spaces, as opposed to one large contiguous space.

[35] While the Complainant was able to point to differences between the comparables used by the Respondent to arrive at the \$26 per square foot lease rate applied and the subject property, the Complainant provided no comparables at all. Rather, the Complainant grounded their request for a \$10 per square foot lease rate on the \$8 per square foot lease rate applied to the subject property's 50,196 square foot Banquet and Exhibition Hall. The Board does not consider the 50,196 square foot Banquet and Exhibition Hall space comparable to restaurant and bar space and is not persuaded that the \$26 per square foot lease rate should be changed.

Was the capitalization rate applied to the subject property too low?

[36] The Board finds that the cap rate applied to the subject property is not too low.

[37] The Board is not persuaded by the six comparables used by the Complainant to support their requested value or their cap rate, because the Board does not consider them comparable.

As pointed out by the Respondent, only two of them are full service hotels, three are in remote locations, none of them have the same name cache as a Sheraton Hotel or the amenities, none of them come close to achieving the gross income per room the subject does, all but one are considerably smaller, and the Complainant failed to consider the impact of the 2011 renovations on the effective age of the subject.

[38] Regarding the two reports the Complainant submitted as “acid tests” that support their requested 9.5% cap rate, the Board finds these reports unreliable for that purpose. More than one cap rate is reported for the same sale, and actual income is not used in every instance. In addition, there is insufficient information provided within the reports to indicate how the net operating incomes were determined, and because the Complainant was not the author of the reports, they were unable to provide any clarification in this regard.

[39] Regarding the Complainant’s assertion that the use of a 9.5% cap rate for the subject property was confirmed by the Board in its decision #CARB 0262 550/2013, the Board notes that a review of the decision indicates that the cap rate applied was not in dispute between the parties.

[40] The Complainant asserts that there is no evidence from the Respondent to substantiate a reduction of the cap rate for hotel properties in Red Deer from 9.5% in 2012 to 8% in 2013. The Board disagrees. On the contrary, the evidence produced by the Respondent suggests that the 8% cap rate applied may be too high. While the Respondent’s use of non-residential properties other than hotels in its cap rate analysis is not ideal, for the reasons noted above, the Board finds it more reliable than the evidence provided by the Complainant.

Conclusion

[41] While the Board finds in the Respondent’s favour on all three issues identified above, the Board finds it necessary to note that they did find an error in the Respondent’s calculations.

[42] While the Board finds that assessing the subject’s hotel component separately from the retail component is not a mixing of methodologies, the Board did find a mixing of methodologies within the Respondent’s separate calculation of the assessment of the hotel portion of the subject property. The Respondent used the actual stabilized room revenue but a typical expense ratio when determining the net operating income of the hotel component. The Board understands that when actual income is used, so then should actual expenses be used. The Board understands that the converse holds true as well, if typical expenses are used, so then should typical income be used.

[43] As a result of the Respondent’s having mixed actual values with typical ones in their determination of the net operating income of the hotel portion of the subject, the Board was disinclined to accept their net operating income analysis. However, the difficulty faced by the Board is that the Board cannot then simply choose the proposed assessed value provided by the Complainant. As stated above, the Board is troubled by the Complainant’s failure to use the income and expenses of the subject property for the first six months of 2013 in its net operating income calculations, and does not accept the Complainant’s 9.5% cap rate. Neither can the Board choose the net operating income of the Complainant and the cap rate of the Respondent because the resulting assessed value would be an increase over the current assessment.

[44] Section 467 of the MGA guides decisions of assessment review boards, and provides in part:

467(1) An assessment review board may, with respect to any matter referred to in section 460(5), make a change to an assessment roll or tax roll or decide that no change is required.

...

(3) An assessment review board must not alter any assessment that is fair and equitable, taking into consideration

- (a) the valuation and other standards set out in the regulations,
- (b) the procedures set out in the regulations, and
- (c) the assessments of similar property or businesses in the same municipality.

[45] The onus is on the Complainant to provide sufficient evidence to justify a change to the assessment. Notwithstanding the Respondent's error in mixing actual and typical values in assessing the hotel component of the subject, the Board was not persuaded that, in the end, the assessed value of \$28,094,600 is unfair, inequitable or in excess of market value. The Board notes that the Complainant's financial reports suggest a book value far in excess of the assessed value of the subject, and the appraisal of the subject referred to therein is higher yet. Based on the evidence provided by the parties, the Board was not convinced that the assessed value determined by the Respondent should be altered.

SUMMARY

[46] For the reasons noted above the assessed value of the subject property is CONFIRMED at \$28,094,600.

Dated at the City of Red Deer, in the Province of Alberta this 15th day of September, 2014 and signed on behalf of the Presiding Officer for all three panel members who agree that the content of this document adequately reflects the hearing, deliberations and decision of the Board.



Sonya Parsons, Board Officer, on behalf of
Cathryn Duxbury, Presiding Officer

This decision can be appealed to the Court of Queen's Bench on a question of law or jurisdiction. If you wish to appeal this decision you must follow the procedure found in section 470 of the *Municipal Government Act* which requires an application for leave to appeal to be filed and served within 30 days of being notified of the decision. Additional information may also be found at www.albertacourts.ab.ca.

APPENDIX "A"

Documents Presented at the Hearing
 and Considered by the Board

<u>NO.</u>	<u>ITEM</u>
1. C1	Complainant's Disclosure
2. R1	Respondent's Disclosure
3. C2	Complainant's Rebuttal

FOR MGB ADMINISTRATIVE USE ONLY

Decision No. CARB 0262 609/2014			Roll No. 2131705	
<u>Appeal Type</u>	<u>Property Type</u>	<u>Property Sub-Type</u>	<u>Issue</u>	<u>Sub-Issue</u>
CARB	Other Property Types	Hotel/Motel	Income Approach (Types 1 to 6)	