



Downtown High-Rise Office 2012 Assessment Brief

Property Tax Account:

Municipal Address:

Legal Description:

2012 Assessment:

\$

Hearing Date:

MASS APPRAISAL

Mass appraisal is a methodology for valuing individual properties which involves the following process:

- properties are stratified into groups of comparable property
- common property attributes are identified for the properties in each group
- a uniform valuation model is calibrated for each group using market information incorporating the property attributes

Mass Appraisal and Single Property Appraisal

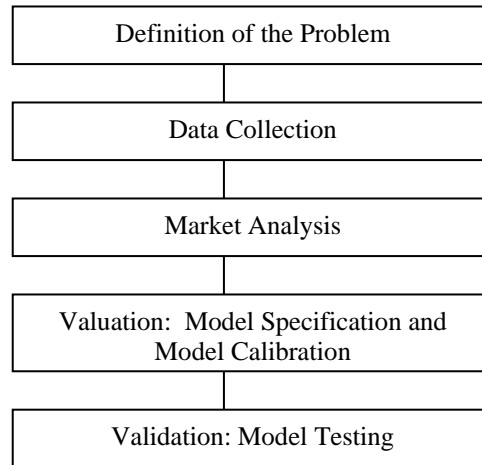
The appraisal process recommended by the Appraisal Institute of Canada is essentially the same for mass appraisals and single-property appraisals. The differences between mass appraisal and single-property appraisal are due to differences in scale. The following two quotations indicate how the International Association of Assessing Officers distinguishes between mass appraisal and single-property appraisal:

... *“single-property appraisal is the valuation of a particular property as of a given date: mass appraisal is the valuation of many properties as of a given date, using standard procedures and statistical testing.”*

... *“Also, mass appraisal requires standardized procedures across many properties. Thus, valuation models developed for mass appraisal purposes must represent supply and demand patterns for groups of properties rather than a single property.”*

The International Association of Assessing Officers, *Property Appraisal and Assessment Administration*, Chicago, Illinois, 1990, pg.88-89.

The appraisal process, as followed for both mass appraisal and single-property appraisal, consists of the following stages:



PROCESS	MASS APPRAISAL	SINGLE APPRAISAL
Definition and purpose	Mass appraisal is used to determine the assessment base for property taxation in accordance with legislative requirements.	The client specifies the nature of the value to be estimated, including rights to be valued, effective date of valuation, and any limiting conditions.
Data Collection	Mass appraisal requires a continuing program to maintain a current database of property attributes and market information.	The extent of data collection is specific to each assignment and depends on the nature of the client's requirements.
Market Analysis	Mass appraisal is predicated on highest and best use.	Market analysis includes the analysis of highest and best use.
Valuation Model Specification and Calibration	Valuation procedures are predicated on groups of comparable properties.	The subject property is the central focus of the valuation procedures. The analysis of comparable properties is restricted to a few properties – generally six or less.
Validation	The testing of acceptable analysis and objective criteria.	The reliability of the value estimate is more subjective. Acceptability can be judged by the depth of research and analysis of comparable sales.

Mass Appraisal Approaches

The cost approach, sales comparison approach, and income approach were explored.

Cost Approach:

The cost approach involves adding the depreciated replacement cost of improvements to the estimated value of land (derived from sales). The cost approach is only employed to derive market estimates for properties whose market values are not accurately predicted by the income approach.

Sales Comparison Approach

In the sales comparison approach, market value is estimated by comparing the subject property to similar properties that have recently sold, are listed for sale or are under contract. A major premise of the sales comparison approach is that the market value of a property is directly related to the prices of comparable, competitive properties.

For the purpose of the 2012 Annual Assessment, the sales comparison approach was employed in two ways. First, this approach was used in developing inputs for the attributes used within the income pro forma, such as rental rates, operating costs, vacancies, parking rates and capitalization rates.

Second, the sales comparison approach was used to establish upper and lower threshold valuation ranges per square foot for all properties within the inventory experiencing chronic vacancy.

All sales and listings within the downtown inventory were reviewed and analyzed as of the date of sale. Those sales reflecting high occupancy were reviewed and used as checks against valuations determined via the income projections. *Sales reflect the condition of a property as of the sale date and thus may not always be equivalent to their assessed value.*

Income Approach

For the purpose of the 2012 Annual Assessment, viable income-producing properties were valued based on their income potential using 2011 market *net rental lease rates*, not *effective net lease rates*. The income approach is the approach of choice, as it best reflects the typical actions of buyers and sellers when purchasing income-producing properties. This approach estimates the value of a property by determining the present value of the projected income stream. Direct capitalization is the method of choice employed to value the majority of properties within the Downtown High-rise Office inventory. This involves capitalizing the derived net income by an overall rate determined from comparable market sales.

The International Association of Assessing Officers (IAAO) *Standard on Mass Appraisal of Real Property*, Chicago Illinois, 2002, sets out the recommended uses of the three approaches. Section 4.6.3 of the IAAO standard states:

The income approach is the most appropriate method to apply when valuing commercial and industrial property if sufficient income data are available. Sales comparison models can be equally effective in large jurisdictions with sufficient sales. When a sufficient supply of sales data and income data is not available, the cost approach should be applied. However, values generated should be periodically checked against available sales data. Cost factors, land values, and depreciation schedules must be kept current through periodic review.

The Income Approach was deemed the best method of establishing equitable valuation estimates. Ample information provided by owners with regard to both income and expense information also reinforced this decision.

Definitions

To provide a clear understanding of the terms and applicable definitions used throughout the income approach, the following definitions are supplied for ease of review for the reader.

Typical Market Rent:

The rent currently prevailing in the market for properties comparable to the subject property is the typical market rent, otherwise known as current economic rents. Current economic or market rents are used to form the basis of the valuation as opposed to actual rents because in many cases, actual rents reflect historical revenues derived from leases negotiated before the valuation date.

In determining gross potential income, the valuator is not bound by the contractual rent between the landlord and tenant, but must determine rental income on the basis of what is typically paid in the market at the time of valuation. This rent is known as “market” or “economic” rent.

Base Rent / Net Rent:

The stipulated or contract rent exclusive of additional charges to the property (e.g. taxes, insurance, utilities, and maintenance). Base Rent does not include GST.

Triple Net Rent:

A rental structure where the tenant (lessee) pays all charges to the property (e.g.: taxes, insurance, utilities, maintenance) in addition to the stipulated or contract rent. Structural repairs are excluded from the tenant responsibility.

Effective Net Rent:

A rental term identifying the rental amount (usually in dollars per square foot of leased area) after adjustments have been made accounting for free rent periods, plus the present value of tenant improvement allowances and other inducements such as free parking.

Potential Gross Income (PGI):

Potential gross income is the current market rent which would be collected if the property were fully occupied at the date of valuation. In estimating PGI, the appraiser distinguishes between market rent and contract rent. Market rent is the rate prevailing in the market for comparable properties and is used in calculating market value by the income approach. Contract rent is the actual amount agreed to by landlord and tenant. If the leases are long term, contract rent is important in calculating investment value.

For short-term leases, the appraiser/assessor should determine whether it is reasonable to assume that contract rent will equal market rent when the leases are renegotiated.

PGI is derived by multiplying all Gross Leaseable Areas (GLA) in the office building by the current market rent for that space (Office, Retail, & Storage). Parking Income (Surface and Underground) per stall per year is included.

$$\boxed{\text{ALL GLA}} \times \boxed{\text{MARKET RENT FOR SPACE}} = \boxed{\text{PGI}}$$

Stabilized Vacancy and Collection Loss:

This is a deduction from the potential gross income for typical vacancy and collection losses, assuming current market conditions and typical management.

Vacancy losses are best described as an allowance for vacant space. Collection losses are considered unpaid rents that the landlord is unlikely to recover. These allowances are usually expressed as a percentage of potential gross income although variations can occur where they are applied to only certain rental properties.

Effective Gross Income (EGI):

The anticipated income from all operations of real property adjusted for vacancy and collection loss.

$$\boxed{\text{PGI}} - \boxed{\text{STABILIZED VACANCY \& COLLECTION LOSS}} = \boxed{\text{EGI}}$$

Operating Expenses (OE):

These are periodic expenditures necessary to maintain the real property and continue the production of the effective gross income.

Common Area Maintenance (CAM)

CAM charges reflect the costs of operating the interior and exterior common areas of a High-rise Office and therefore include expenses as follows: Maintenance, Operation, Cleaning, Utilities, Heating, Insurance, Admin – recoverable, Garbage & Snow removal, Management Fees.

In a High-rise Office operating on triple net leases, CAM charges reflect all recoverable expenses.

Vacant Space Shortfall

This is an expense related to the cost of carrying vacant space (Office /or Retail). The owner of a property has to carry the CAM costs associated with vacant space. Though the space is vacant there are still costs associated with the space that the owner must pay, e.g. some operating expenses, heating, security, property taxes, etc.

$$\boxed{\text{GLA}} \times \boxed{\text{STABILIZED VACANCY \& COLLECTION LOSS}} \times \boxed{\text{CAM}} = \boxed{\text{VACANT SPACE SHORTFALL}}$$

Net Operating Income (NOI):

The actual or anticipated (before income tax) net income from the operation of the property after deducting all expenses from the effective gross income but before debt servicing costs. The term is often abbreviated to net income and sometimes stated as net income before recapture.

$$\boxed{\text{EGI}} - \boxed{\text{OE}} = \boxed{\text{NOI}}$$

Overall Capitalization Rate (OAR):

A rate reflecting the relationship between a single year's anticipated net operating income (or an average of several) and the total price or value. The OAR converts net operating income into an indication of property value. The rate in its basic formula is found by dividing net operating income by the sale price of a comparable property.

$$\boxed{\text{NOI}} \div \boxed{\text{OAR}} = \boxed{\text{ASSM'T}}$$

Generally speaking, properties achieving lower capitalization rates demonstrate the following attributes:

- The building exhibits a track record of high occupancy levels
- Lease rates are either at or close to accepted market levels
- The ability to attract and retain tenants is considered strong
- The overall area is well maintained
- Lower risk on investment

At the opposite end of the spectrum, properties with higher capitalization rates exhibit the following traits:

- The building consistently exhibits high levels of vacancy
- Covenants are less secure
- The building may require some capital outlay to correct deferred maintenance
- Higher risk on investment

Basic Categories of a Pro forma

$$\boxed{\text{ALL GLA}} \times \boxed{\text{MARKET RENT FOR SPACE}} = \boxed{\text{PGI}}$$

$$\boxed{\text{PGI}} - \boxed{\text{STABILIZED VACANCY \& COLLECTION LOSS}} = \boxed{\text{EGI}}$$

$$\boxed{\text{EGI}} - \boxed{\text{OE}} = \boxed{\text{NOI}}$$

$$\boxed{\text{NOI}} \div \boxed{\text{OAR}} = \boxed{\text{ASM'T}}$$

Downtown High-Rise Office

The Downtown High-rise Office Buildings are referenced by the Real Estate community as the Financial and Government Sectors:

1. Government Sector is the area located from the west side of 105 Street south of 104 Avenue, east of the former CP railway and north of 97 Avenue.
2. Financial Sector is considered to be from the east side of 105 Street south of 105 Avenue, east of 97 Street, and north of 100 Avenue.

The groupings simply identify that there is a higher concentration of Financial or Government tenants located in each sector. Either tenancy is found throughout each area. As well as identifying the sector, the Real Estate Community classes the Office High-Rise buildings as A, B, or C. The City follows this nomenclature in its valuation.

The Downtown High-rise Office assessments provide an estimate of market value for the buildings located in the City of Edmonton's downtown core. The City collects rental and income information through annual survey returns. This information is used for analysis purposes to predict assessed values. Current review is based on property and market conditions in 2011.

SUMMARY

Downtown High-rise Office properties are assessed using the Income Approach via the Direct Capitalization method. This approach adjusts for attributes to arrive at a typical market value for properties in the inventory.

The resulting assessments were tested. The results indicated that our model predictions of value meet Provincial Quality Standards as set out in the *Matters Relating to Assessment and Taxation Regulation, AR 220/2004*.

The assessment models, the process utilized, and the results are submitted annually to the Assessment Services Branch of the Department of Municipal Affairs for audit purposes.

The audit is used to determine the accuracy of our predictions relative to the market place, and is a direct reflection on the accuracy of our models.

The City of Edmonton has met all governing legislation including regulations and quality standards.