

Central Alberta

Regional Assessment Review Board

Decision: **CARB 0262-710/2016**

Complaint ID 710

Roll No. 30000931306

COMPOSITE ASSESSMENT REVIEW BOARD DECISION

HEARING DATE: July 26, 2016

PRESIDING OFFICER: B. Hisey

BOARD MEMBER: D. Moore

BOARD MEMBER: R. Schnell

BETWEEN:

TREIT HOLDINGS 10 CORPORATION

Complainant

-and-

CITY OF RED DEER

Respondent

This decision pertains to a property assessment complaint submitted to the Central Alberta Regional Assessment Review Board in respect of a property assessment prepared by the Assessor of The City of Red Deer as follows:

ROLL NUMBER: 30000931306

MUNICIPAL ADDRESS: 3310 – 50 Avenue

ASSESSMENT AMOUNT: \$36,602,500

The complaint was heard by the Composite Assessment Review Board on the 26th day of July 2016, at The City of Red Deer, within the province of Alberta.

Appeared on behalf of the Complainant:

James Phelan, Agent for Colliers International Realty Advisors Inc.

Appeared on behalf of the Respondent, The City of Red Deer (“The City”):

Maureen Cleary and Jason Miller, Revenue & Assessment Services for The City of Red Deer

DECISION: The assessed value of the subject property is confirmed.

JURISDICTION

- [1] The Central Alberta Regional Assessment Review Board [“the Board”] has been established in accordance with section 456 of the *Municipal Government Act*, RSA 2000, c M-26 [“MGA”], and City of Red Deer Bylaw No. 3474/2011, *Regional Assessment Review Board Bylaw*.

PROPERTY DESCRIPTION AND BACKGROUND

- [2] The subject property is a full service hotel known as the Sheraton. It is located on 10.71 acres at 3310 - 50 Avenue in Red Deer, Alberta. The facility has 241 accommodation units, several restaurants, bars, convention/meeting rooms, banquet amenities, and a freestanding liquor store.
- [3] The original 2 storey, 48 room West Wing was constructed in 1957. Since that time the dining room, conference center, tower, liquor store, exhibition hall, and executive suites have been added.
- [4] The current assessment has been determined using the income approach to value.

PRELIMINARY MATTERS

- [5] The Board Chair confirmed that no Board Member raised any conflicts of interest with regard to matters before them.
- [6] Neither party raised any objection to the panel hearing the complaint.
- [7] A point of clarification was made by the Complainant. Any reference made to assessed value in the brief should be interpreted as the value of the property as of July 1, of the previous year. For example, 2015 Assessed Value is the valuation as of July 1, 2014.
- [8] The Board confirmed the submissions of the parties and entered the following Exhibits into the record:
- A1 - Hearing Materials including Complaint Form and Notice of Hearing
 - C1 - Complainant’s Brief (199 pages)
 - C2 - Complainant’s Recalculation Sheet (1 page) was accepted later in the hearing
 - R1 - Respondent’s Brief (155 pages)

ISSUES

- [9] The Board considered the parties' positions and determined the following questions are to be addressed within this decision:
1. Is it correct to use two capitalization rates for the subject property? What is/are the applicable rate(s)?
 2. Have the appropriate stabilized rates been utilized to determine the net operating income, reflecting a fair and equitable assessment?

POSITION OF THE PARTIES

Position of the Complainant

- [10] The Complainant presented the subject property as a full service hotel contained within four parcels of land. Although the hotel/retail facilities are spread over multiple parcels, the Complainant contends they cannot be sold off to multiple purchasers. The property is integrated in its layout and there is no excess liquidity between the retail conference, restaurant, and hotel portions of the hotel. The Complainant takes issue with the fact that the municipality has assessed the hotel rooms with a capitalization ("cap") rate of 9.75%, and the balance of the structure at an 8.00% cap rate.
- [11] The current assessed value of \$36,602,500 is a 4.5% increase over the previous valuation of \$35,034,100. The Complainant proposes a reduction to \$28,141,000 in keeping with the reduced net operating income ("NOI") in 2015 for the subject property.
- [12] The Complainant described the areas and uses within the facility. The Complainant stated the effective year of construction to be 1977, although it was later determined the City had used an effective age of 2000 in the 2015 assessment. This issue was contentious, as no new construction had been undertaken in 2015. However, the Complainant noted the first building was constructed in 1955 followed by numerous improvements and additions. The Complainant further noted that the previous assessments referred to an effective age of 1977, and no renovations had occurred in the 2015 assessment valuation period.
- [13] The parking lot for the facility was also shown, and the deduction used for this part of the development was provided. The Complainant stated this was for information purposes, and not a point of contention in this appeal.
- [14] The Complainant then reviewed the pro-forma for the subject property detailing the 2013 income year assessment. It was noted that one cap rate had been previously utilized for assessment of the property and that the owner could not sell various portions of the facility to multiple purchasers. The Complainant stated this limitation was due to the inability to access some of the spaces independently. Several of the retail areas could only be accessed from internal corridors. It was again pointed out that the facility worked as a singular integrated development.
- [15] The Complainant moved on to discuss the hotel cap rate analysis applied to the facility, and was disappointed with the HVS study provided by the Respondent. The Complainant felt there had not been adequate information provided regarding how the cap rate was determined by the City, so they provided their own research and conclusions on this.

- [16] The income approach was also discussed showing the stabilized income/expense items over 3 years which was similar to last year's numbers for this hotel.
- The NOI was shown to be \$4,162,403 (C-1, page 22).
 - The Edmonton and Calgary standards for stabilizing the NOI and expenses was reviewed, which the Complainant believed were more appropriate than the method used by The City of Red Deer.
 - Calculations were provided to support the proposed reduction of \$28,141,000 or \$116 per door.
 - Upon questioning by the Respondent, this figure was later revised (corrected to be a NOI of \$4,233,647), and recalculations were submitted as C2, requesting a revised reduction of \$29,709,313, or \$123,275 per door.

[17] The Complainant then went through a table of fourteen sales comparables for what they consider to be similar Alberta hotels with cap rates and stabilized NOI's for these transactions. The Complainant suggested that these sales comparables supported a higher hotel cap rate for the subject property.

[18] The Complainant also provided excerpts from CARB 0262 651/2015, referring to sales comparables evaluated by that Board which supported the requested cap rate increase.

[19] The Board was then directed to review the acid test for correctness, which was the revenue per available room ("RevPAR"). There has been a 10% decrease in revenue for the hotel, yet the City has increased the assessment by 4.5%, further evidence of an excessive increase to the current assessment.

- [20] The Complainant proceeded with a presentation of ten sales comparables (C1, page 40) to support the requested proposed cap rate, and verify the reduced assessment:
- sale 1 is post facto (Four Points by Sheraton)
 - sale 2 is a strong comparable (Best Western Cedar Park Inn)
 - sale 6 is a full service hotel like the subject (Lac La Biche Inn), and
 - sale 10 is a limited service but has a similar location (Comfort Inn and Suites).

The Complainant argues that these properties strongly support the current assessment is in excess of market value. The Complainant also clarified how the adjustments regarding various characteristics (inferior/superior) were determined to create a "ladder" of comparables, which is used to predict where the subject should fit into the group. The Complainant agreed that this method is qualitative only, not quantitative. The Complainant concluded that the 2nd best comparable is the Best Western Cedar Park but has a superior location, after the post facto Four Points Sheraton sale.

[21] A market overview from HVS and Colliers was also provided with charts indicating slippage in hotel rates (C1, pages 83 – 93), that supported the concerns regarding the downturn of the hotel industry in Alberta, again, questioning the appropriateness of an assessment increase in a depressed market.

[22] In summary, the Complainant suggested that the City had no evidence to support the assessed retail values as required by Section 460 (7) of the MGA, and Section 8 of *Matters Relating to Assessment Complaints* ("MRAC"). Further, it was noted that the information provided by the Respondent for cap rates (HVS study) was later suggested to

be riddled with errors, questioning the ability of the Respondent to appropriately determine a cap rate for the subject property.

- [23] The Complainant concluded that the current assessment was in excess of market value, and that the City erred in classifying the subject as a full service hotel, then applying two different cap rates to the facility, one for a limited service hotel, and another for the conference and retail component.
- [24] A reduction to the adjusted proposed assessment of \$29,709,313 for the current assessment was requested.

Position of the Respondent

- [25] The Respondent provided an economic profile for the city of Red Deer, showing that it is Alberta's 3rd largest city, and described it as a major economic center. An overview of the subject property followed, presenting the Sheraton as a significant high-class conference facility, which is not similar to standard hotels.
- [26] The Respondent gave a review of the property assessment methods and related legislative applications. The Respondent further provided an explanation of mass appraisal and the income approach, which they used to determine market values. Using the accommodation units based on a nightly room rate of \$229, a potential growth income calculation was provided to the Board. The hotel component of \$21,157,300 plus \$15,446,200 for the retail portion of the facility resulted in an overall assessment of \$36,602,500.
- [27] The Respondent then confirmed that other cities use their own calculation methods, but each is separate and acts independently as legislated. Supporting the premise that independently assessing different uses is accepted by other Boards, a recent CARB decision 0262 609/2014 was provided. The Respondent noted that in this decision, the Board determined that separately assessing hotel and retail spaces was acceptable.
- [28] The Board was next directed to a chart shown on page 38 of R1, that detailed how the City stabilized income and expense over 3 years by applying typical rental retail rates to appropriate areas, utilizing typical market incomes with a vacancy allowance, and an expense ratio. The Sheraton information had been stratified into both hotel and retail portions.
- [29] The Requests for Information ("RFI's") from the Sheraton were supplied to the Board, and were transcribed by the City (R1, page 38), to show that if actual incomes were used for the assessment, it would have increased the current assessment amount to \$42,242,100 (or \$175,278 per room).
- [30] The Respondent referred to the Alberta Municipal Affairs Assessment Unit Hotel/Motel Property Assessment in Alberta Handbook ("PAAH"), quoting the following:

"If the hotel property contains a large retail or office component, these parts of the property should be valued separately as discussed in the Shopping Centre and Office Valuation Guides. The totals of all such values should be added together to form the total property value." (R1, page 39)

The Respondent noted that The City of Red Deer has followed required legislative procedure. After stabilizing the income and expenses from the three years prior to the valuation date of July 1, 2015, the stabilized allowable expenses are then deducted from the stabilized income. The City has deducted 40% vacancy, and 3% reserve deduction and a further 15% for furniture, fixtures, and expenditures ("FF&E"). The balance is then capitalized for the final assessment.

- [31] The Respondent then reviewed the history of the Sheraton hotel from the date of purchase by Temple Holdings 10 Corporation, in 2008 for \$40,000,000. Showing improvements and upgrades since that time to be \$17,211,000. The Respondent suggested that using the total value of these items, the subject property could be worth \$57,211,000 (translating to \$237,593 per room). The publically reported purchase price by Temple Hotels Inc. from the 2015 financial statements was \$51,749,000 (or \$214,726 per room).
- [32] An evaluation of limited and full service hotels was next provided by the Respondent, referring to the services and amenities that have expanded at the Sheraton over the past decade. The Respondent stated that full service hotels such as the subject property have abundant provision of food and beverage services for guests and groups. Therefore, the Sheraton with its added features (including restaurants, lounges, group meeting spaces, banquet facilities, spa, extended room services and boutiques), distinguish it as a full-service hotel.
- [33] The Respondent then gave an overview of the cap rates for various hotels within the City of Red Deer, showing how similar buildings were stratified and grouped according to various qualitative and quantitative attributes (R1, pages 42-43).
- [34] The Respondent provided the only arms-length sale of a hotel in Red Deer since July 1, 2012. The Travelodge sold in June of 2014, for \$7,000,000 and provided a 9.7% cap rate that supports the figure used by The City of Red Deer for the current assessment of the subject property (R1, pages 44-45).
- [35] To further support the hotel cap rate, the Respondent provided seven sales that occurred outside the municipality showing a median assessment value of 9.75%. Each sale comparable was reviewed and suggested adjustments to these properties were explained. The cap rate, sale date, number of rooms, net operating income, size of meeting/convention space, amenities and year of construction were provided as information for these discussions (summary provided in R1, page 55).
- [36] The Respondent then submitted to the Board a letter from an expert hotel appraiser, Mr. Russel Reynolds, regarding an opinion for the cap rate applied to the Sheraton Hotel (resume of Mr. Reynolds is included in R1, page 93). This letter provided added explanations regarding calculation of cap rates for hotels with renovations (to ensure comparing "apples to apples"). Mr. Reynolds suggested that the Sheraton Four Points Edmonton Airport is an appropriate comparable sale (sold in November of 2015) with a stabilized cap rate of 8.75%. Upon questioning by the Complainant, the Responded stated they had no knowledge whether an inspection was made by Mr. Reynolds of the subject property (letter included in R1, page 56-58).

- [37] The Respondent moved on to suggest that the Complainant relied on the HVS report for transaction volumes to demonstrate a drop in values. As identified on page 128-131, there were discrepancies in calculations. The Respondent showed a re-calculation, but stated these reports are inaccurate, and should not be relied on for the following reasons:
- some information may be missing, estimates are provided and price per door may vary considerably (as evidence of this the Respondent directed the Board to page 134 which showed the HVS Alberta sale transactions for 2013).
 - average sales can vary considerably by removing outliers; one transaction can represent a large percentage of final numbers, such as the Westin in Calgary.

The Respondent contends this does not provide the whole story and should be considered unreliable.

- [38] Upon questioning from the Complainant, it was suggested that the retail space opening up into hallways is very unique. It was acknowledged by the Respondent that the retail areas could not be sold separately from the hotel, but could be leased, as are numerous spaces in the Sheraton. The Respondent stated that several other retail spaces in Red Deer cannot be sold off separately, and are subject to lease rental rates. The Respondent also stated that the Sheraton is the only hotel with retail and conference facilities this large in Red Deer. Given that in the Respondents analysis, the hotel component of the subject is assessed as a limited service hotel and the conference/retail component is assessed separately, it was considered that the benefit for this attribute was provided to the subject property assessment.
- [39] Further to questions by the Complainant regarding a change in the effective building date, the Respondent clarified that as part of the 2015 assessment review, all renovations were added to their updated computer program which automatically calculated the effective year to 2000 (prior assessments did not recognize the impact of these renovations on the effective age of improvements). The Respondent acknowledged that they recognize renovations have been done and that they were aware of this in the past couple years, but the effective date was not officially adjusted in their records until they updated their computer program. No information was provided on how the calculation was done to determine the new effective age of 2000.
- [40] In closing, the Respondent requested the Board confirm the 2015 assessment of \$36,602,500.

BOARD FINDINGS and DECISION

- [41] The Board finds the Respondent has followed mass appraisal methods and legislated requirements for the calculation of the current assessment. The use of direct sales to support and verify the assessment also shows appropriate due diligence for this process.
- [42] The Board is satisfied that legislation does not expressly mandate a municipality to apply a single capitalization rate to one property, but provides direction through various documents such as PAAH to interpret and apply appropriate methods of valuation.
- [43] Once the Board determined that an application of two cap rates for the subject property was appropriate, the retail rate of 8% was considered. There was insufficient evidence to accept or reject this rate. Therefore the retail cap rate of 8% is confirmed.

- [44] The Board acknowledges the expert opinion from Mr. Russel Reynolds, as independent information supporting the 9.75% cap rate applied to the hotel portion of the subject property. The Board notes that the Complainant provided no independent evidence of its own to counter or refute the information contained in the Reynolds report.
- [45] The Board was persuaded by the RFI provided by the owner and used by the Respondent to establish the stabilized rate over a 3 year period. Notwithstanding a determination of proper application or stabilization method, and using the Complainants own argument, if actual numbers from the owners RFI were used for calculations, the assessment would be higher when applying a 9.75% cap rate (R1, page 38).
- [46] The Board acknowledges a hotel cap rate of 9.75% is reasonable based on the sales comparables and market value evidence. The favorite comparable for the Respondent being the Clarion at 7.4%, and a "strong" comparable noted by Complainant was the Best Western Cedar Inn at 10.11%. Both parties however suggested the property was unique and all sales had issues making them somewhat dissimilar from the subject.
- [47] Colliers statement in R1 page 153, that stated an average price per room improved to \$118,660 versus \$93,700 in year prior (2014), conflicts with the HVS trending information on C1 page 14 which states the price per room fell from \$105,437 to \$90,655. The Board determined that this information is conflicting, and unreliable.
- [48] Section 1(1)(n) of the MGA states that "market value" means the amount that a property, as defined in section 284(1)(r), might be expected to realize if it is sold on the open market by a willing seller to a willing buyer.
- The Board was provided with evidence that the subject property was purchased by Temple Holdings 10 Corporation, in 2008 for \$40,000,000.
 - The subject property was added to and upgraded since that time, with \$17,211,000 worth of improvements, translating to an investment of \$57,211,000 (or \$237,593 per room).
 - The publically reported purchase price by Temple Hotels Inc. from the 2015 financial statements was \$51,749,000 (or \$214,726 per room); approximately \$35 million more than the current assessment.

The Board supports the premise that the market value of the subject property could reasonably be less than the sale and improvement costs. However, the assessed value in this instance is substantially less than this amount.

- [49] The Board finds the discussion on effective age does not have a significant impact on the outcome of the assessment for the purpose this decision. The effective age can change regardless of the year built. The same opinion is offered regarding a year over year increase, and in itself, it is not reason to alter the assessment.
- [50] Section 467(3) of the MGA states that an assessment review board must not alter any assessment that is fair and equitable. Proving the incorrectness of an assessment is the responsibility of the individual alleging it. The Board was not presented with sufficiently compelling evidence on which a change to the assessment could be based. Therefore the assessment is confirmed.

DECISION SUMMARY

[51] The Board finds that the value of the property assessment is CONFIRMED.

[52] Dated at the Central Alberta Regional Assessment Review Board, in the city of Red Deer, in the Province of Alberta this 22 day of August, 2016 and signed by the Presiding Officer on behalf of all the panel members who agree that the content of this document adequately reflects the hearing, deliberations and decision of the Board.



Brenda Hisey
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 MGA 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

Documents Presented at the Hearing and considered by the Board

<u>NO.</u>	<u>ITEM</u>
1. A1	Hearing Materials with Complaint Form and Notice of Hearing
2. C1	Complainant submission (199 pages)
3. C2	Complainant Revision to C1 page 39 (1 page)
4. R1	Respondent submission (155 pages)