Self Storage Property Tax Issues in British Columbia

By

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SELF STORAGE PROPERTY TAX ISSUES IN BRITISH COLUMBIA

PART 1 – INTRODUCTION / OVERVIEW

I am grateful to have the opportunity to speak to you today on some of the property tax issues facing self-storage facility owners in British Columbia.

I expect that many if not most of you have had some hands-on experience with property taxes in your home province, and those in B.C. have had at least some discussions with the Assessor in an attempt to reduce your assessments.

We all know that property taxes are an increasingly important fixed cost and bottom line item that businesses have to pay close attention to, in order to remain competitive.

Property taxes have always been contentious in B.C., but as you may have noticed if reading the newspapers, in the last couple of years taxation levels have become a hotbed issue for municipalities and provincial government.

In B.C., property tax bills are determine as follows:

- first, value is determined by BC Assessment based on the property class that you are in

- second, about 70% of your tax bill is municipal taxes, based on the municipally-set tax rate for your property (Business & Other for self-storage facilities) multiplied by its value, and

- third, about 30% of your tax bill is made up of provincial (school and other) taxes, at rates set by the province

Apart from issues arising from valuing property (which is where most of the issues exist for self-storage property owners), issue arise with respect to tax rate setting by municipalities.

This is because municipalities have been given the power to set their own tax rates for each property class. This is done by simply dividing the total amount of tax dollars they need to meet their budget each year by the total assessed property value in each property class, and then applying each of those rates to the values to collect those tax dollars. Municipalities decide what proportion of their tax levy is going to be borne by each class, and while the Province has the power to intervene and change this, the Province seldom does so.

The "tax revolt" in B.C. which many of you may have heard or read about arises from a recent set of B.C. Supreme Court decisions. In those decision, the Court dismissed appeals by Catalyst Paper Corporation and TimberWest Forest Corporation from the tax rate bylaws set in spring 2009 for their properties, which each company claimed were unreasonable because they were out of all proportion with the cost of municipal services each actually consumed. The Court essentially said that it will not get involved in second-guessing municipal councils in setting their tax rates, so long as they do so in a procedurally fair manner. Those cases are off to the Court of Appeal.

As noted earlier, for self-storage property owners, the issue is not usually tax rates (unless a property has a split use and deserves to be split-classified), but instead value.

The next part of my paper outlines the valuation issues for self-storage facilities which have arisen in the two "leading" (and indeed only) substantive Board decisions addressing the valuation of self-storage facilities.

PART 2 – SPECIFIC VALUATION ISSUES FOR SELF-STORAGE OWNERS

There have been two recent Board decisions on self-storage facilities:

Apex Self Storage v. Area 10 (2006 PAABBC 20060348) July 26, 2006, and

Imperial Self Storage v. Area 10 (2007 PAABBC 20070074) April 3, 2007

I have attached copies of these two cases as Appendices for your reference.

These two cases set out the underlying principles for valuation of self-storage facilities.

I touch briefly on each of these principles below.

1. Preferred Approach to Valuation of Self-Storage Facilities

As most of you may know, there are three generally accepted approaches to value:

- ***the direct comparison approach***

  The direct comparison approach is based on the principle of substitution, where the subject is compared to similar properties that have recently sold. As the Board observed in Apex, given the traditional lack of sales evidence of self-storage facilities, it is generally not feasible to consider the direct comparison approach in an actual value estimate. Recent sales will, of course, be important if they exist.

- ***the cost approach***

  As the Board noted in Apex, the cost approach comprises a separate land value plus the contributory value of the improvements. Where (as in Apex) the subject is not brand new, some level of depreciation must be deducted. Unless the Board is given cogent evidence of depreciation, this will be difficult if not impossible. As the Board further noted in Apex, perhaps more importantly, purchasers of income-producing properties that are competing in the market with established businesses typically base their investment decisions on the income-producing potential, not on the cost to build. Therefore, the Board will generally not consider the cost approach an accurate measure of market value for a self-storage facility, preferring instead the income approach.

- ***the income approach***

  As the Board stated in Apex, the income method is based on the premise that income-producing property is generally purchased and sold based on the present worth of anticipated future income benefits. For assessment valuation purposes the method used is the direct capitalization approach, which involves the capitalization of a stabilized income stream by a market-derived capitalization rate. Generally direct capitalization approach is the foundation of valuation appraisals for self-storage facilities.

The following table is the Board's calculation of net operating income (NOI) in Apex, provided here for illustrative purposes:

Self Storage Warehouse					
Potential Gross Income	61,675	sq.ft. (net)	@	$16.54	$1,020,105
less		vacancy	@	15%	$ (153,016)
Effective Gross Income					$ 867,089
less		expenses	@	40%	$ (346,836)
Net Operating Income Self-Storage Warehouse					$ 520,253
plus Net Additional Revenue					$ 48,777
Total Net Operating Income (NOI)					$ 569,031

<u>2. Use of Net (Versus Gross) Leasable Area</u>

The first question is whether value should be based on rent for gross or net leasable area. In Apex, the Board found that it should be based on net leasable area, particularly where (as is common for self-storage facilities) there are significant common areas that do not generate revenue.

In Apex, there was some difficulty determining net leasable area, so the Board and Assessor accepted the net leasable areas of other self-storage facilities in Coquitlam as provided by taxpayer.

<u>3. Appropriate Market Rental Rate</u>

The next question is whether it is appropriate to use an average rental rate, or unit-specific rental rates, to capitalize income. In Apex, the Board found that unit-specific rental rates must be used.

Both the taxpayer and Assessor relied on rental research compiled by Candace Watson. They also looked to appraisal reports and surveys as a source of asking rates for vacant units at other rental facilities.

The Board could not, however, determine whether (as the Assessor proposed) rates for the subject should bear a premium over rates for other older facilities, and found that the subject rents were the best evidence.

The Board was not prepared to accept the Assessor's calculation of rent, which was a straight average rents for the 10 types of units in the facility, which the Board considered flawed because it ignored the rental rate differences between the unit types. The Board found that the correct approach was to apply the rental rate for each unit type, which would reflect lower relative rents for larger units compared to higher rents for small units, to come up with a weighted average rent.

4. Appropriate Vacancy and Expense Allowances

The next question is the appropriate allowance for vacancy in the facility and the appropriate allowance for expenses.

(a) Vacancy Allowance

The appropriate level of vacancy allowance is perhaps one of the most contentious ongoing issues in valuation of self-storage facilities, which often take a long time to fully lease up, and often do not achieve 100% occupancy, particularly if there is an abundance of space elsewhere in the area.

In Apex, the taxpayer said that there was an over-supply of self-storage space in the market in 2004 due to the introduction of two new facilities (the subject and the Maple Leaf Self Storage in Port Coquitlam). The taxpayer noted that in mid 2004, the four established facilities in Coquitlam had vacancy rates between 2% and 10%, while in October 2004, the subject had a vacancy level of 67%.

The taxpayer noted that the range of vacancy levels used by the Assessor on other self-storage valuations for assessment purposes was between 10% and 15%. The Taxpayer concluded that a 15% vacancy allowance was appropriate, given the length of time the subject was taking to lease-up, and the fact it was competing with other new facilities.

The Assessor said that there is a need for a long-term stabilized vacancy rate. The Assessor produced market vacancy studies, proposing that a 10% vacancy rate was representative of a long-term stabilized market. The assessor said that this rate included the years of initial lease-up when new properties can experience higher vacancy levels, and that the subject's new nature and superior features should place it at the low end of the range of vacancy rates.

Siding with Apex, the Board found that while the subject was part of a larger market and thus a stabilized long-term vacancy rate was appropriate, the subject had no proven history and was taking longer to lease than originally anticipated. This indicated either a problem with the subject facility or an industry wide shift. Since both taxpayer and Assessor agreed that the market in 2004 and 2005 had excess capacity given the additional new facilities already opened and proposed, the Board found that a stabilized vacancy of 15% was the more appropriate estimate of the long term vacancy based on the market evidence available at the time, as well as the yet unproven nature of the subject.

The Board revisited the question of long-term vacancy rates in its decision in Imperial Self Storage.

There, the actual vacancy for the property from its February 2000 opening to December 2006 were as follows:

- 93.9% vacancy in February 2000, dropping over the next two years to 11.3% in February 2002
- Declining to 3.3% in April 2003
- in May 2003, with addition of about 25,000 sq. ft of leasable area, vacancy increased to 20.6%
- decreased to 14.7% by June 2003, and remained at 14 – 17% until July 2004
- increased to 20.4% from August 2004 and rose to 36.2% in March 2006
- declined to 29.8%.
- remained at 30% from September 2006 to December 2006

Candace Watson's vacancy survey for the Tri-Cities (Coquitlam, Port Coquitlam and Port Moody) indicated:

- 28.9% vacancy in 2005
- 17.9% vacancy in 2004
- 7.8% vacancy in 2003

Notably, during 2004 and 2005, the supply of self storage space in the Tri Cities area nearly doubled with the addition of 300,000 sq. ft. in four new facilities.

Both parties agreed that during the years 2004 and 2005, the supply of self storage space increased by 300,000 sq. ft., or nearly 100%. The taxpayer argued that the supply of new facilities in the Tri Cities would continue, and the present 30% vacancy rate was the long term stabilized rate. The Assessor argued that the doubling supply in two years had caused a temporary spike in vacancy rates to the 30% level, but over time the long term vacancy rate would stabilize in the 15% range.

The Board found that it took the facility about two years to lease up to 90% occupancy, which it considered the norm for the industry. The Board considered that the 100% increase in supply over the 2004-2005 period was an abnormality in supply and would take approximately two years to be absorbed. The Board did not accept the taxpayer's 30% vacancy rate, which the Board determined was an anomaly caused by a 100% increase in supply over the prior 2 years. The Board accepted that the GVRD self-storage long-term stabilized vacancy rate was about 10%, and settled on 15% as the appropriate rate for the subject.

One is left to wonder if it is appropriate to use a long term stabilized vacancy rate when the Act specifically calls for valuation at July 1 of the year prior to assessment. Given the nature of the self-storage market, the question of whether the Assessor must use a stabilized rate or actual rates is likely to arise again.

(b) Operating Expense Allowance

In Apex, the taxpayer observed that expense allowances for self-storage facilities are typically assessed at 40% to 45%. The taxpayer wondered at the rationale behind this, observing that an unheated facility with limited common areas had the highest rate applied of 45% while other un-heated buildings show 40%. The taxpayer put forward a 40% allowance for consistency.

The Assessor said that self-storage projects typically show expense ratios between 35% and 40%. However given that he could not confirm this due to secrecy of these numbers in the market, he accepted 40%.

The Board observed that the subject offered heated units in comparison to some other facilities and had greater common areas that need to be heated, cleaned, and maintained, which ought to increase the operating costs.

The Board did not accept the Assessor's suggestion that the higher potential revenue to which the expense allowance would be applied would cover the higher expenses.

The Board noted that the first year's expenses for the subject reflected a 44% expense ratio, but also that the parties did not normalize these figures to reflect full occupancy. As a result, the Board found an expense allowance at the low end of the range used by the Assessor, and applied a rate of 40%.

5. Appropriate Market Capitalization Rate

The next issue is the appropriate market cap rate to apply to NOI after expenses and vacancy allowance.

The parties agreed that the Board must use capitalization rates of self-storage facilities rather than capitalization rates from other property types. The problem of course is finding sufficient comparable sales to derive a cogent rate.

The Assessor used a range of capitalization rates in the 2005 assessment roll for other self-storage facilities ranges between 8.49% and 9.0% in Coquitlam. The Board noted a 9.25% rate in use for a facility in Port Coquitlam.

The Board was unable to determine if there was a decline in cap rates given the dearth of sales. The Assessor said that newer facilities pose lower risk and thus should have lower capitalization rates. The Board however noted that this speculation was not supported either by the capitalization rates used to date in assessment valuations or the long time to achieve market lease-up. In the result, the Board settled on a capitalization rate of 8.75% as a reasonable reflection of the risk based on the limited sales evidence at hand.

6. Allowance for Initial Lease-Up

The Board was asked to consider a lease-up allowance to reflect that the subject was in its start-up phase and would not reach a stabilized operating scenario for at least a year from the effective date. By October 31, 2005 (a year past the state and condition date for the 2005 roll) the building was only at 60% occupancy, not a stabilized figure of 90%. The taxpayer said that to capitalize the stabilized income into perpetuity in the initial year did not provide an estimate of value to a purchaser as of the effective date, July 1, 2004.

The Assessor said that no lease-up allowance was appropriate because the subject formed part of a larger market and given the fee simple, the value assumed that the facility was operating at market levels. The Assessor said that the stabilized vacancy allowance applied to all properties in the jurisdiction adequately captured the subject's initial lease-up and thus higher vacancy in the early years.

The Board found that, absent separate evidence speaking to an additional allowance for lease-up, and given that it had made some allowance for this in the higher than normal vacancy allowance, it was not prepared to make a separate deduction for initial lease-up.

This leaves open the opportunity for a taxpayer to advance the argument that there should, on cogent evidence, be an allowance both for long-term stabilized vacancy, and to reflect short-term lease up revenue losses.

7. Deduction for FF&E

The taxpayer sought a deduction for fixtures, furnishings, and equipment (FF&E), arguing that since the subject operated as a business, similar to a hotel or motel, a component of FF&E is not assessable as it is required for the operation of the venture. This was estimated at $44,222.

The Assessor opposed this, saying there was no precedent for such a deduction, and in any event, the Assessor did not account for them in the capitalization rate or expense rate for the equity comparables, and that the parties did not consider them in the capitalization rate study. The Board could not tell if they were considered or not.

Since the Board did not know whether deductions were made to the sales comparables (due to lack of information as to how the stabilized NOI was arrived at), the Board found it could not look to the market for guidance. The Board was persuaded by the Assessor's position that no deductions were made to the other self-storage facilities, which would make it inequitable to make a deduction in the subject on this component alone, without considering the other inputs.

This appears to leave open, provided there is cogent evidence, the question of whether FF&E is appropriate deducted for self-storage facilities.

8. Equity

Equity is often raised by taxpayers because, if made out, it entitles the taxpayer to the lesser of a correct valuation or the valuation enjoyed by its neighbours / competitors.

It succeeds, however, only if the taxpayer can establish a pool of comparables (the "equity set") in the same municipality.

In Apex, the taxpayer said there was an equity set comprising the four other self-storage facilities in Coquitlam. Since none had sold, it was not possible to compare the assessment to sale ratios (ASR) as an equity test. Instead, the taxpayer compared the valuation parameters applied to the subject with those used to value these comparables.

The Board agreed that the four other self-storage units formed an equity set, despite differences in age and quality.

As to whether there was inequity, the Board noted serious inconsistencies including a range in net rental rates ($12.35 to $14.47 per sq.ft.), vacancy allowances (10% to 15%), expense allowances (40% to 45%), and capitalization rates (8.5% to 9.25%) which the Assessor could not explain.

Choosing Maple Leaf Storage as the most comparable in the equity set, the Board determined what it considered to be "equitable" rent, vacancy rate, operating expense ration, and cap rate. Using these, the Board determined an equitable value which it then compared to the values for the equity comparables. Taking into consideration additional revenue sources, the Board called this the equitable value for the subject.

Of late, the Board has resisted similar arguments that it must examine each of the components of a particular valuation method to determine equitable components, and then drive out of this an equitable value. The Board is increasingly of the view that it must not examine each valuation input for equity, but must instead compare final values for equity comparables to determine if the subject has been treated fairly. In the recent decision in *Wal-Mart Canada Inc. v. Assessor of Area 26 – Prince George* (2005), SC 492, 2005 BCSC 1625, the B.C. Supreme Court held that use of different valuation parameters in the development of a comparable assessment will not determine equity if the resulting valuation reflects a similar relationship to market value.

Closing Comments

As earlier noted, the focus for self-storage facility owners and taxation agents is typically on valuation principles. I expect that we will be hearing more from innovative owners, tax agents and experts on the refinement of these principles as property taxes take on an increasingly important role in determining the bottom line for investment in and operation of these facilities in British Columbia.

Thank you again for the opportunity to speak to you. I will look forward to meeting you in our roundtable discussions.

APPENDIX - BOARD DECISIONS

Decision and Order

IN THE MATTER OF AN APPEAL PURSUANT TO S. 50 OF THE *ASSESSMENT ACT*

CONCERNING:

Apex Self Storage Ltd

APPELLANT

AND
Assessor Of Area #10 - North Fraser Region

RESPONDENT

Appeal No.:	**2005-10-00225**
Refer to as:	**Apex Self Storage Ltd v. Area 10 (2006 PAABBC 20060348)**
Date of Decision:	**July 27, 2006**
Property:	**10-43-305-08450-000**
	195 Schoolhouse Street, City of Coquitlam
Heard:	**April 18, 19 & 20, 2006 at Richmond**
Panel:	**Rob Fraser, Panel Chair**
	Audrey Suttorp, Panel Member
Appearances:	**John Parkes, for the Appellant** **Guy Holeksa (Counsel for the Assessor) and Derek Holloway, for the Respondent**

INTRODUCTION

[1] The appeal is from the decision of the 2005 Property Assessment Review Panel.

[2] Mr. Parkes, for the Appellant, contests the 2005 roll value on the basis that the Assessor has valued the subject inconsistently with the other storage facility properties in Coquitlam. He believes that the use of net leasable area rather than gross leasable area, as well as the inconsistent application of valuation components has resulted in an unfairly high assessment of the subject in comparison to other similar properties ("equity comparables"). He contends that the Board should lower the assessment from $5,922,000 to $4,590,000.

[3] The Assessor agrees that the current assessment is inconsistent with the equity comparables and contends the actual value is $8,100,000 and the equitable value is $7,300,000.

ISSUES

[4] The issues in this appeal are:

1. the actual value of the warehouse component of the subject as at July 1, 2004, and;
2. whether the warehouse component of the property has been equitably valued in comparison to the other self-storage facilities in Coquitlam. The parties are only disputing the assessment of the warehouse (self-storage), thus, all references relate to that component unless otherwise noted.

[5] The specific issues for the actual value calculation are:

1. Is it appropriate to use the net leasable area rather than the gross leasable area as reflected in the valuation of self-storage facilities in the area?
2. What is the market rental rate for the warehouse component? Should an average rental rate be applied or unit specific rental rates?
3. What vacancy and expense allowances should we apply?
4. What is the appropriate capitalization rate?
5. Should we make an allowance or adjustment for the high level of vacancy at the property as at October 31, 2004 (state and condition date for 2005 roll)?
6. Is it appropriate to make a separate deduction for fixtures, furnishings and equipment (FF&E)?

[6] The specific issues for the equity value calculations are:

- Is there a pool of "similar" properties to test the equity value?
- Is the subject valued fairly and consistently in relation to the equity comparables?

FACTS

[7] The subject is a self-storage facility, which opened in January 2004. The facility is on a rectangular site of 2.51 acres on the southeast corner of Schoolhouse Street and Lucille Starr Drive in Coquitlam. The site is fully serviced. Booth Creek bisects the site and reduces the usable area due to required setbacks.

[8] The improvements consist of two separate buildings, one on either side of Booth Creek. A two-level, 77,411 sq.ft. concrete tilt-up warehouse storage facility is located on the eastern portion of the

site. A small commercial building is on the front (western) portion of the site and houses the facility's office and a rented space. The buildings were constructed in 2003. The storage building has main floor units that are accessible from the exterior parking lot, as well as second floor units (primarily smaller units) that are accessible via interior corridors and two elevators. The net leasable area of the storage facility is 61,675 sq.ft. The storage building is climate controlled, provides 24-hour access, has a security system in place, and has sprinklers. The subject offers a mix of unit types, as is typical for the self-storage industry, ranging from 5' x 5' units to 10' x 30' units; 636 units are available.

[9] The storage facility was 33% occupied as at the state and condition date, October 31, 2004. By October 31, 2005, the storage building was 60% occupied.

[10] The portion of the property improved with the self-storage building is zoned M1. The portion west of the creek (two-storey commercial building) is zoned M9. The parties' submissions indicate that the property complies with the zoning and that it is built to its highest and best use.

SUBMISSIONS

[11] Submissions included oral presentations from both parties, as well as:

- Exhibit No. 1: Assessor's Brief authored by Derek Holloway, dated March 23, 2006
- Exhibit No. 2: Assessor's Equity Review authored by Derek Holloway (no date noted)
- Exhibit No. 3: Assessor's Rebuttal authored by Derek Holloway, dated March 24, 2006
- Exhibit No. 4: Appellant's Rebuttal authored by John Parkes, dated April 12, 2006
- Exhibit No. 5: Appellant's Brief authored by John Parkes, dated March 24, 2006
- Exhibit No. 6: Letter from Guy Holeksa to John Parkes, dated February 20, 2006
- Exhibit No. 7: Appraisal report by Candace Watson prior to construction, effective date Aug. 1, 2002
- Exhibit No. 8: Appraisal report by John Parkes prior to construction, effective date September 6, 2002
- Exhibit No. 9: Appraisal report by John Parkes, effective date June 15, 2005
- Assessor's Summation Document authored by Guy Holeksa, submitted April 20, 2006
- Assessor's Authorities - compiled by Guy Holeksa, submitted April 20, 2006
- Appellant's Summation Document authored by John Parkes, submitted April 20, 2006

ACTUAL VALUE

Approaches to Value

[12] There are three generally accepted approaches to value, namely the income approach, the direct comparison approach, and the cost approach. Mr. Holloway calculated the actual value of the subject using all three. Mr. Parkes focused primarily on the income approach. He provided some commentary on the direct comparison approach only as it relates to equity.

[13] The direct comparison approach is based on the principle of substitution, where the subject is compared to similar properties that have recently sold. Given the lack of sales evidence, it is not feasible to consider the direct comparison approach in our actual value estimate.

[14] The cost approach comprises a separate land value plus the contributory value of the improvements. The subject is not brand new and thus some level of depreciation ought to be deducted, a figure which we are unable to estimate from evidence provided. More importantly, it is axiomatic that purchasers of income-producing properties such as the subject that are competing in the market with established businesses, typically base their investment decisions on the income-producing potential, not on the cost to build. Therefore, we do not consider the cost approach an accurate measure of market value for the subject and it is not applied.

[15] The income method is based on the premise that income-producing property is generally purchased and sold based on the present worth of anticipated future income benefits. For assessment valuation purposes the method used is the direct capitalization approach, which involves the capitalization of a stabilized income stream by a market-derived capitalization rate. Both parties provided evidence for the use of the direct capitalization approach.

Use of Net vs. Gross Leasable Area in Valuation

[16] The Assessor has valued the subject and the other self-storage facilities in Coquitlam based on their gross leasable area. Mr. Parkes argued that this is flawed, as the other facilities are primarily single-level buildings with exterior access and thus have minimal common area that does not generate revenue. The subject is two-levels in design and thus has greater common areas. Mr. Holloway noted that gross leasable area was used due to the lack of reliable information available on net leasable areas prior to this appeal. Both parties agreed that it is more correct to apply rents to net leasable area as that is the area that generates actual revenue. We concur and accept a net leasable area (NLA) of 61,675 sq.ft. for the subject. Mr. Holloway accepted the net leasable areas of the other self-storage facilities in Coquitlam as provided by Mr. Parkes and we have used these figures in our analysis.

[17] Unless otherwise noted, all references to rents per sq.ft. in our decision relate to net leasable area.

Market Rental Rate

[18] Mr. Holloway presented data from three appraisal reports prepared by Ms. Watson (2002) and Mr. Parkes (2002 and 2005). The reports show a range of annual market rents in 2002 between $12.36 and $15.72 per sq.ft. of NLA for competing facilities. Mr. Parkes' 2005 appraisal report focused on unit specific rental rates and did not provide a rate per sq.ft. He then considered the annual rents shown by the occupied units at the subject at October 31, 2004, which he averaged at $18.73 per sq.ft. Mr. Holloway concluded that $18.73 per sq.ft. was the estimated overall average market rent for the subject. He also noted that the subject rents achieved
October 2004 were in line with survey results and are at market. The other facilities in Coquitlam reflect rents applied in their 2005 assessment values between $12.35 and $14.47 per sq.ft. In his rebuttal to the Appellant's report, Mr. Holloway felt that BCA's market rents are reasonably appropriate from market and equity viewpoints with the exception of the subject. In further

testimony, Mr. Holloway argued that the subject's rents are artificially low due to discounts given during initial lease-up.

[19] Mr. Parkes' analysis focused on gross versus net rents as applied by BCA, as previously discussed. He focused specifically on one unit type and concluded an average market rental of $13.50 per sq.ft. for the subject.

[20] Due to the highly competitive nature of the self-storage market, neither Mr. Parkes nor Mr. Holloway was able to provide income statements or rent rolls for competing properties. Both parties relied on the rental research completed by Ms. Watson in August 2002. In addition, the parties presented some evidence from appraisal reports and surveys regarding asking rates for vacant units at the other storage facilities. We are not satisfied that the rental information provided is relevant in terms of timing (none of the surveys captured the rents achieved in 2004, the year in question), or in terms of being an accurate indication of the actual rents being achieved. Mr. Holloway did not provide evidence to support his reliance on asking rents. Mr. Holloway said that new facilities such as the subject should achieve higher rents than older facilities. He did not produce substantive evidence to support this theory and thus we are left without a clear indication as to whether a premium would be paid and thus should be incorporated. Furthermore, by his own admission, Mr. Holloway found that the other facilities are valued at market (between $12.35 and $14.47 per sq.ft.).

[21] Both parties agreed that the rents achieved by the subject in October 2004 represent market. While Mr. Holloway presented oral argument to the contrary, we have little evidence other than the subject rents to provide good indication of market rents. Thus, we accept the actual rents as market. However, we find the rent of $18.73 per sq.ft. (concluded by Mr. Holloway as the average actual rate per sq.ft.) is incorrectly calculated since it does not address the unit mix. He arrived at this rent by taking a straight average of the rental rates achieved for 10 unit types, which in our opinion ignores the mix of different sized units. We believe the correct way to apply the actual rents to achieve 100% occupancy is to apply each actual rent specifically to each unit type. This addresses the true unit mix and reflects lower rents applied to larger units and higher rents to smaller units. This produces a weighted average of $16.54/sq.ft. per annum at October 31, 2004, which we conclude to be the market rent for the subject.

Vacancy Allowance

[22] Mr. Parkes stated that there was an over-supply of self-storage space in the market in 2004 due to the introduction of two new facilities (the subject and the Maple Leaf Self Storage in Port Coquitlam). In mid 2004, the four established facilities in Coquitlam had vacancy rates between 2% and 10%. In October 2004, the subject had a vacancy level of 67%. Mr. Parkes noted the range of vacancy levels used by the Assessor on other self-storage valuations for assessment purposes is between 10% and 15%. He concluded that a vacancy allowance of 15% is appropriate as the subject is taking a long time to lease-up, and is competing with other new facilities. Mr. Holloway pointed out the need for a long-term stabilized vacancy. He provided market vacancy studies as at mid 2002 and mid 2005, showing 2.6% and 28.6%, respectively, although not based on his own research. The 2005 figure is from the 2005 Parkes appraisal report. It is based on estimated vacancy rates for the market (including several new facilities). It reflects 11 self-storage facilities in Coquitlam, Port Coquitlam, and New Westminster. Mr. Parkes did not include the subject in this study. Mr. Holloway considered that 10% vacancy is representative of a long-term stabilized market. He argued

that this figure includes the years of initial lease-up when new properties can experience higher vacancy levels. He felt that the subject's new nature and superior features place it at the low end of the range of vacancy rates. He concluded a vacancy allowance of 10%.

[23] In considering the vacancy allowance to apply, we are persuaded with the argument made by Mr. Parkes. Although the subject is part of a larger market and thus a stabilized long-term vacancy rate is appropriate, the subject has no proven history and is taking longer to lease than originally anticipated. This indicates either a problem with the subject facility or an industry wide shift. Both Mr. Parkes and Mr. Holloway agree that the market in 2004 and 2005 had excess capacity given the additional new facilities already opened and proposed. In our opinion, a stabilized vacancy of 15% is the more appropriate estimate of the long term vacancy based on the market evidence available at the time, as well as the yet unproven nature of the subject.

Operating Expense Allowance

[24] Mr. Parkes note that, for assessment purposes, expense allowances are 40% to 45%. He commented on the fact that there seems to be little rationale how these are applied, noting that an unheated facility with limited common areas had the highest rate applied of 45% and other un-heated buildings show 40%. Mr. Parkes concluded a rate of 40% for consistency purposes.

[25] Mr. Holloway stated that self-storage projects typically show expense ratios between 35% and 40%; the appraisals entered into evidence support this observation. He noted that he was unable to research this himself due to the secrecy under which facilities operate in this highly competitive market. He concluded a rate of 40%.

[26] The subject offers heated units in comparison to some other facilities and has greater common areas that need to be heated, cleaned, and maintained. Both parties feel that these items will increase the operating costs although they did not present evidence to this effect. Likewise, Mr. Holloway did not provide evidence to support his premise that the higher potential revenue to which the expense allowance will be applied will cover the higher expenses. There is no historical data for the subject as it is in its initial year of operation; any information provided does not reflect a long-term stabilized scenario. The first year's expenses for the subject reflect 44%, but the parties did not normalize these figures to reflect full occupancy.

[27] We find that the market evidence supports an expense allowance at the low end of the range used for assessment purposes and we apply a rate of 40%.

Additional Revenue

[28] There is additional revenue from retail income, outside storage, and office rental. The figures for the outside storage and rental income are not in dispute and have been applied as detailed below. The retail income is a function of the gross potential storage income; the percentage is not in dispute although the total will vary depending on the rent applied to the self-storage units.

Rental Income (% of potential gross storage income)							
			$1,020,105	@	2.50%		$25,503
Outside Storage Income							
			$24,000	@	50%		$12,000
Office rent							
		1,500	sq.ft. (net)	@	$8.60	$12,900	
Less			vacancy	@	5%	$ (645)	
Effective Gross Office Income						$12,255	
Less		expenses		@	8%	$ (980)	
							$11,275
Net Additional Revenue							$48,777

Market Capitalization Rate

[30] We were disappointed with the lack of well-researched capitalization comparables. Mr. Parkes did not provide any capitalization rate evidence. Mr. Holloway presented four comparables. Of these, we discounted one sale for locational differences and one sale for excess land and site rental differences. Of the remaining two, one was an unaccepted 2002 offer and thus not indicative of anything other than what a purchaser was willing to pay for multiple facilities throughout the region. The fourth comparable was a portfolio sale but it took place past the valuation date. Of critical importance is the fact that Ms. Watson researched the sales, with no information provided as to how she stabilized the income. The veracity of this evidence is questionable and we cannot accept research completed by others without clear explanation and application; we did not have the opportunity to hear from Ms. Watson on the sales evidence, as she was not called as a witness. Thus, we are unsure how to reconcile the capitalization rates provided.

[31] Both Mr. Holloway and Mr. Parkes agreed that we must use capitalization rates of self-storage facilities rather than capitalization rates from other property types.

[32] The range of capitalization rates applied in the 2005 assessment roll for other self-storage facilities ranges from 8.49% to 9.0% in Coquitlam. There is evidence of a facility in Port Coquitlam assessed using a capitalization rate of 9.25%. Mr. Holloway proposed a rate of 8.5% due to the superior new nature of the subject. He referenced several articles which suggest that capitalization rates were declining in 2004, however, provided no evidence that related directly to the subject or the market in which the subject functions. Mr. Parkes made a case for 9.0% based in part on the fact

that the subject presents higher risk due to its yet un-established two-level design (un-proven in the area), and lack of future expansion potential (due to high density already on the site and the creek which reduces the usable area of the site). Mr. Parkes agreed that capitalization rates are declining in the region generally for most investment properties, however, disagreed with the timing of the decline. He was of the opinion that the decline started in early 2005. Whether the rates are declining or when the decline started has little relevance, as the parties did not provide us with evidence of sales that have been properly researched and thus we have no starting point from which to compute a decline.

[33] Mr. Holloway argued that newer facilities pose lower risk and thus should have lower capitalization rates. He felt that since the subject is new and the equity comparables are probably in the last half of their economic life, the subject has a much lower risk to *return of* the investment – a longer period from which to recapture the investment. However, he provided no evidence on the economic life of self-storage facilities. He continued by stating that the subject also has superior *return on* investment, as it is new with more features than existing facilities. However, the capitalization rates used to date in assessment valuations do not reflect this and given the long time to achieve market lease-up, the market does not support his speculation.

[34] In light of this, we are left with the rates applied in the assessment valuation of other self-storage facilities, which range between 8.49% and 9.00% in Coquitlam with one in Port Coquitlam at 9.25%. We agree with Mr. Holloway in finding that there is no evidence that shows that over time the market will not readily accept two-level facilities. However, we do not feel that the new nature and design features of the subject make it far superior. The comparable properties enjoy high occupancy levels and the subject is only 33% leased after 10 months of operation. Furthermore, such features would already be accounted for in the rental rate and we cannot double count. We also note that the subject does not offer exposure to a main thoroughfare as is the situation for most of the other facilities. Thus, we are convinced that a rate above 8.5% is appropriate but lower than the 9.0% proposed by Mr. Parkes. We believe that the newer nature and new design features of the subject offer it long term competitive benefits over the other facilities; they support a rate below 9.0%. However, the oversupply of self-storage units in the area is manifesting itself in a longer lease-up time as well as more competitive rates than anticipated. These factors suggest a rate above 8.5%. In the final analysis, and for lack of specific comparables to indicate the market rate, we select a capitalization rate of 8.75% as a reasonable reflection of the risk based on the very limited evidence presented.

<u>Allowance for Initial Lease-up</u>

[35] Mr. Parkes pointed out that the subject is in its start-up phase and will not reach a stabilized operating scenario for at least a year from the effective date. In fact, the benefit of hindsight indicates that by October 31, 2005 (a year past the state and condition date for the 2005 roll) the building was only at 60% occupancy, not a stabilized figure of 90%. He argues that to capitalize the stabilized income into perpetuity in the initial year does not provide an estimate of value to a purchaser as of the effective date, July 1, 2004. His calculation shows a rental loss of $331,602, which reflects the difference in the Year 1 actual net income and his stabilized net operating income.

[36] Mr. Holeksa, for the Assessor, argued that no lease-up allowance is applicable as the subject forms part of a larger market and given the fee simple, the value assumes that the facility is operating

at market levels. He opined that the stabilized vacancy allowance applied to all properties in the jurisdiction adequately captures the subject's initial lease-up and thus higher vacancy in the early years.

[37] We are not convinced by Mr. Parkes' argument, as he provided no supporting market evidence. In our deliberations, we are limited to considering only that evidence presented to us either orally or in written form. The appraisal reports entered into evidence and heavily relied upon by Mr. Holloway are based on the assumption that the facility is fully leased at market rentals with stabilized occupancy. Thus, they do not provide any evidence or guidance on this issue. As we have made some allowance in the higher vacancy allowance applied, and as no evidence is available regarding this matter, we are not making a deduction for lease-up.

<u>Allowance for FF&E</u>

[38] Mr. Parkes argued that a deduction is appropriate for fixtures, furnishings, and equipment (FF&E). He made the case that as the subject operates as a business, similar to a hotel or motel, a component of FF&E is not assessable as it is required for the operation of the venture. He calculated this figure at $44,222.

[39] Mr. Holloway did not made a deduction for this figure and stated in rebuttal that there is no precedent for such a deduction. He continued by stating that the overriding reason to not include these deductions is that the Assessor did not account for them in the capitalization rate or expense rate for the equity comparables and that the parties did not consider them in the capitalization rate study. As noted earlier, the parties did not provide us with a breakdown of how the capitalization rates were calculated for the sales comparables. Thus, we do not know if they were included or not.

[40] We do not know whether deductions were made to the sales comparables (due to lack of information as to how the stabilized NOI was arrived at), and therefore, we cannot look to the market for guidance. However, we are persuaded by Mr. Holloway's position that no deductions are made to the other self-storage facilities. Thus, it would be incorrect to make a deduction in the subject on this component alone without considering the other inputs. We have not made a deduction for FF&E in our valuation.

<u>Actual Value Estimate Conclusion</u>

[41] Based on the discussion and conclusions above, the market (actual) value of the subject at July 1, 2004 is:

Total Net Operating Income (NOI)			$ 569,031
Divided by Capitalization Rate			8.75%
Estimated Income as per Income Approach to Value			$6,503,206
less Lease up Allowance			$ -

less FF & E Deduction			$ -
Estimated Actual Value			$6,503,206
Rounded to			$6,500,000

<u>Equity Consideration</u>

[42] We will consider two questions under equity. First, is there a pool of "similar" properties to test the equity value? If yes, then is the subject valued equitably/ consistently in comparison to these similar properties?

[43] Mr. Parkes contended that there is a pool of similar properties, namely the four other self-storage facilities in Coquitlam. As none of these facilities has sold, neither party was able to conduct an assessment to sale ratio (ASR) analysis. Mr. Parkes, instead compared the valuation parameters applied to the subject with those used to value these comparables. He concluded a lower equity value than actual value and states that the property owner is entitled to the lower of these values, following *Bramalea Limited v. Assessor of Area 9 - Vancouver* (1989), Stated Case 277 (B.C.C.A.). Mr. Parkes concluded an equitable value of $4,590,000. In his submissions, Mr. Parkes recognized some minor differences between the comparables and the subject.

[44] Mr. Holloway took issue with the four comparables noting that they are all older facilities with inferior qualities. However, he noted that they are the only point of reference. He stated that he believed that the Assessor has assessed the comparables fairly, but not the subject, in relation to them. He said that the subject is dissimilar in age, rents, and capitalization rates and that we must reflect these factors in the valuation. Mr. Holeksa (for the Assessor), relying on *Ross and Grubb v. Assessor of Area #10 – New Westminster* (2002) Stated Case 419 (BCCA) *and Hilton v. Area 14* (2001 PAABBC 20014823 noted the need to take into account any differences between the properties. Mr. Holloway concluded an equity value of $7,300,000 that is below his actual value estimate of $8,100,000.

[45] We find that the four comparables presented do form a pool of similar properties for equity consideration purposes. Although the equity comparables are older and some are inferior in terms of offerings, they are part of the competitive set. Despite any differences, they all offer self-storage units of various sizes to the public. They are highly competitive in terms of price. As stated in *Beverly and David Ross and Alan J. Grubb v. Assessor of Area 10 – Burnaby/New Westminster (1999)*, Stated Case 419 (BCSC) – Continued 2656-3 (C.A.) similarity is not an absolute and differences between similar properties require that the assessments vary. Thus, while we accept them as equity comparables, we recognize the fact that we must account for any differences. Our starting point is the assessment calculations of the four equity comparables. We have difficulty in accepting that the comparables are fairly assessed as claimed by Mr. Holloway as the Assessor valued all of them based on gross area, which the parties conceded was inaccurate. Very limited market data or information on the equity comparables was available to the Assessor when they valued them. However, given the lack of market evidence, we have no option but to use the assessments of the four comparables as the basis for the equity review.

	No. of Units	Gross sq.ft.	Net Leasable sq.ft.	2004 Assmnt / gross sq.ft.	2004 Assmnt / net sq.ft.	2004 Vacancy Rate	2004 Expense Allowance	2004 Cap. Rate	2004 Assmtn WH	WH Assmnt / net sq.ft.	Assmnt / unit
Budget (concrete block, 1-storey, heated)	692	74,600	69,438	$11.50	$12.35	10.0%	40.0%	8.5%	$5,450,188	$78	$7,876
Maple Leaf (concrete block, 1 & 2-storey, heated)	449	49,756	39,545	$11.50	$14.47	10.0%	40.0%	9.0%	$3,433,164	$87	$7,646
Public Storage (concrete block, 1-storey, un-heated)*	651	81,686	65,265	$11.50	$14.39	15.0%	45.0%	9.25%	$4,747,723	$73	$7,293
Barnet (tilt-up, 1-storey, un-heated)	410	40,675	35,487	$12.50	$14.33	10.0%	43.0%	8.5%	$3,072,184	$87	$7,493
*After reduction - verbal figures											

[46] We agree with Mr. Parkes that the application of gross rental rates as detailed in the chart above has resulted in a net rental rate (at $15.67/sq.ft.) for the subject that falls outside the range as applied to the equity comparables. Neither party provided clear evidence as to where in the range of $12.35 to $14.47/sq.ft. the subject rents should fall, or if the rent should be outside the range. Three of the comparables show a tight range of $14.33 to $14.47 per sq.ft. Mr. Holloway did not present any evidence for a subject rent outside this range, excepting his opinion that the subject was superior. Although the parties presented asking rents for the properties, they are all higher than the rates applied in the assessment valuations and thus do not assist us in our equity consideration. For the equity analysis, however, we must consider the equity comparables as they are currently presented on the roll.

[47] Mr. Parkes considered that Maple Leaf Storage, while older in nature, was the most successful of the four comparables in terms of rents achievable and the most comparable to the subject. This facility also offers some upper-level units (albeit significantly less than the subject) and some heated units. It is older, but offers superior exposure and boasts high occupancy. Giving this comparable most weight, we conclude that the equitable rent for the subject is the same rate, or $14.47 per sq.ft. of NLA.

[48] With respect to vacancy and expense allowances, we find that the Assessor has applied these allowances inconsistently. Mr. Holloway was not able to explain the variation in any of the components of the income valuation of the comparables. For vacancy, Mr. Holloway proposed 10%, and Mr. Parkes 15%. We have applied a vacancy allowance at the high end of the range presented due to the high level of vacancy at the subject; 15% is applied. With respect to expenses, we accept that the new nature of the subject would create efficiencies and have applied a rate of 40% that is at the low end and concurs with the opinions of both parties.

[49] We have struggled to determine the subject's correct capitalization rate. The comparables show a range of 8.5% to 9.25%. Mr. Holloway chose 8.5% while Mr. Parkes applied 9.25%. We are perplexed why the Assessor has applied a rate of 9.0% to Maple Leaf and 8.5% to Barnet, when both parties agree that the latter is inferior. However, it is not up to the Board to pass judgement on the assessments of the comparables. Rather, we have to determine whether the Assessor has fairly assessed the subject in relation to the comparable set. We disagree with Mr. Holloway's opinion that the subject only has to be equitable to some of the comparables, and not necessarily all of them. Rather, we accept Mr. Parkes' contention that we should afford the subject every benefit even if that would cause inequity with some of the comparables. This is not the Board's problem, but rather a valuation issue that the Assessor can address in the next roll value. The real question is where the subject falls in terms of risk. While it is new and offers features not available in some of the equity comparables, the market has not shown that it is preferred over existing, older facilities. If the

subject were superior, we would expect to see customers switching. However, after 22 months of operation, the subject was still only 60% occupied (October 31, 2005). We find that the subject has inferior exposure to most of the comparables, higher vacancy, and lower future redevelopment potential due to the intense use of the site in place already. Considering these items, we have selected a capitalization rate between the middle and high end of the range, at 9.0%.

[50] The above income valuation components combine to form an equity value of $5,057,144 for the self-storage component (calculated as $455,143 / 9%). The above value reflects $82 per sq.ft. of net leasable area. The range shown by the equity comparables is $73 to $87. The subject's value falls in the upper half of this range

[51] To the equity income value estimate, we have added the capitalized value of the revenue sources for a final equity value estimate as calculated as follows:

Self-Storage Warehouse								
Potential Gross Income		61,675	sq.ft.(net)	@	$14.47	$ 892,437		
Less			vacancy	@	15%	$ (133,866)		
Effective Gross Income						$ 758,572		
Less			expenses	@	40%	$ (303,429)		
Net Operating Income Self-Storage Warehouse						$ 455,143		$ 455,143
Net Additional Revenue:								
	Retail Income (% of potential gross storage income)							
			$892,437	@	2.50%		$ 22,311	
	Outside Storage Income							
			$24,000	@	50%		$ 12,000	
	Office rent							
		1500	sq.ft.(net)	@	$8.60	$ 12,900		
	less		vacancy	@	5%	$ (645)		
	Effective Gross Office Income					$ 12,255		
	less		expenses	@	8%	$ (980.40)		
						$ 11,275	$ 11,275	
	Net Additional Revenue						$ 45,586	$ 45,586
Total Net Operating Income (NOI)								$ 500,729
Capitalization Rate								9.00%
Equity Value based on Income Approach								$ 5,563,650
Rounded to								*$ 5,560,000*

ANALYSIS AND FINDINGS

Actual Value

[52] The Board accepts the net leasable areas (rather than the gross leasable areas) as the correct figures for analysis of the subject.

[53] There was a lot of ambiguity regarding the rental evidence. The market evidence was weak as it did not capture the time frame in question and it was unclear to us whether the rents shown for the competing facilities were actual or asking rents. Both parties agreed that the actual rents were accurate and the best evidence of market rents. However, we disagree with the calculation of the correct average. We conclude that the overall market rent for the subject is the weighted average of $16.54/sq.ft. per annum at October 31, 2004.

[54] With respect to vacancy, Mr. Parkes' argument compels us that a higher rate of 15% is more appropriate due to the over supply of self-storage facilities in the market, and the difficulties in achieving stabilized occupancy levels at the subject.

[55] Both parties agree on an operating expense level of 40%. The Board agrees that the market evidence supports an expense allowance at the low end of the range used for assessment purposes.

[56] The subject has additional revenue. The figures for the outside storage and rental income are not in dispute. Only the actual retail income differs in our findings as the agreed upon percentage is now applied to a different gross potential storage income.

We find that the net operating income is $569,031.

[57] The Board was very disappointed with the lack of sales evidence. The parties did not complete any original research and did not provide usable sales. Thus, the Board has only the capitalization rates applied in the assessment valuation of other facilities. We felt that both parties' arguments had some merit, and thus we select neither a rate of 8.5% as suggested by Mr. Holloway nor the 9.0% proposed by Mr. Parkes. In the final analysis, and for lack of specific comparables to indicate the market rate, we select a capitalization rate of 8.75% as reasonable. This rate shows some premium from the low end of the range to reflect the as yet unproven nature of the subject and the over supply of self storage units in the industry. However, it also reflects a rate below the high end of the range as the subject is new and benefits from the latest design features.

[58] We did not make an allowance for lease-up as Mr. Parkes did not provide sufficient evidence to support his claim for this deduction. Furthermore, there is danger of double counting as we have already allowed a vacancy rate at the high end of the range to reflect the low occupancy levels experienced by the subject.

[59] We did not make a deduction for FF&E allowance. The parties did not provide us with a breakdown of how the capitalization rates were calculated for the sales comparables. Thus, we do not know if FF&E deductions were included or not. For lack of evidence, we have disallowed this deduction.

[60] Based on the discussion and conclusions above, we find the market (actual) value of the subject at July 1, 2004 is $6,500,000(rounded).

Equity Consideration

[61] The first issue under equity that the Board considered was whether there is a pool of "similar" properties to test the equity value. While the Assessor had some concerns with the equity comparables, he did find that they were the only properties that we could use to compare to the subject. The Board agrees that there is a pool of equity comparables and that any dissimilarities can be taken into consideration. We do have serious concerns, however, about the valuation of those comparables as there are inconsistencies between them. These inconsistencies include a range in net rental rates ($12.35 to $14.47 per sq.ft.), vacancy allowances (10% to 15%), expense allowances (40% to 45%), and capitalization rates (8.5% to 9.25%). The Assessor was not able to explain these differences.

[62] The Board finds that the Maple Leaf Storage is the most comparable due to its partial two-storey nature, high occupancy and thus ability to compete and resulting high rents. For equity purposes, we can accept a rent of $14.47 per sq.ft. as the economic rent for the subject.

[63] For the same reasons noted in the actual value calculation, we conclude a vacancy rate of 15% and an operating expense ratio of 40%.

[64] The capitalization rate again, gives us the most reason to ponder. The parties are polarized at either end of the range shown by the equity comparables. Without adequate explanation as to why the Assessor has applied the differing capitalization rates to the equity comparables, we are at a quandary to select the correct rate. Nonetheless, we have a range of capitalization rates and must decide where the subject falls in terms of risk. We find that the subject has inferior exposure to most of the comparables, higher vacancy, and lower future redevelopment potential due to the intense use of the site in place already. Considering these items, we selected a capitalization rate at 9.0%.

[65] The income valuation components combine to form an equity value of $5,057,144 for the self-storage component, or $82 per sq.ft. The Board considers this equitable to the comparables as it falls within the range shown by the comparables of $73 to $87. The parties did not present compelling evidence to support a value outside the range provided by the comparables. Furthermore, the parties did not give any compelling argument that would allow us to be more specific as to where the subject should fall within the range. The total equity value, including the additional revenue sources, is calculated at $5,560,000.

CONCLUSION

[66] In summary, the Board concludes the equity value of $5,560,000 for the 2005 roll value.

ORDER

[67] The Board orders the Assessor to amend the 2005 assessment roll as follows:

Roll No. 10-43-305-08450-000:

			FROM		TO
Land:	Class 6 - Business and Other	$	950,000	$	950,000
Improvements:	Class 6 - Business and Other	$	4,972,000	$	4,610,000
Total Assessed Value:		$	5,922,000	$	$5,560,000

Decision and Order

IN THE MATTER OF AN APPEAL PURSUANT TO S. 50 OF THE *ASSESSMENT ACT*

CONCERNING:

Imperial Self Storage

APPELLANT

AND
Assessor Of Area #10 - North Fraser Region

RESPONDENT

Appeal No.:	**2006-10-00038**
Refer to as:	**Imperial Self Storage v. Area 10 (2007 PAABBC 20070074)**
Date of Decision:	**April 3, 2007**
Property:	**10-43-224-994301-000**
	1180 Kingsway Avenue, City of Port Coquitlam
Heard:	**February 23, 2007 at Richmond**
Panel:	**Bruce Maitland, Panel Chair**
Appearances:	**Lonnie Neufeld and Alden Aumann, for the Appellant** **David-Nishi Beckingham and Derek Holloway, for the Respondent**

INTRODUCTION

[1] This is an appeal from the decision of the 2006 Property Assessment Review Panel respecting the assessment of a self storage facility in the City of Port Coquitlam (the "Property"). The Appellant contests the 2006 roll value on the basis that the vacancy rate of 15% applied in the assessment is too low and should be 30%.

ISSUES

[2] The only issue in this appeal is the determination of the long term stabilized vacancy rate to be used in calculating the Net Operating Income for capitalization, to determine actual value.

FACTS

[3] The Property, known as Imperial Self Storage, is located on the Mary Hill Bypass, an arterial highway in the City of Port Coquitlam. The facility was constructed in two phases: Phase I was constructed in 1999 and opened in January 2000 and offered 97,219 square feet of gross building area (GBA) in three buildings. Phase 2 was constructed in 2003 and opened in June 2003 and comprises a GBA of 26,863 square feet. The total GBA is 124,082 square feet. The facility offers a wide range of unit types including both inside units (reached via a common hallway) and outside units (with individual roll-up doors) as well as heated and unheated units and outside vehicle storage. Part of the site (1.5 acres) is encumbered by a BC Hydro right-of-way and therefore may only be developed with outside storage. The buildings are of concrete tilt-up construction and Building 4 (Phase 2) is two storeys; all of the rest of the buildings are single story with the exception of the building incorporating a partial second story to accommodate office space and the resident manager's unit.

[4] Both parties concluded that the existing use forms the highest and best use of the site.

[5] The parties have agreed that the income approach is the appropriate methodology for valuing 1180 Kingsway Avenue, Port Coquitlam (the Property).

[6] The parties have also agreed on the following facts:

- Total Projected Gross revenue $1,756,272
- Long Term Stabilized Operating Expenses 40%
- Capitalization Rate 9%

SUBMISSIONS

[7] Submissions included oral presentations from both parties as well as:

Exhibit No.	Description
1	Appellant's presentation to PAAB for 2004. Appeal No. 2004-12-00059
2	PAAB Decision and Order. Appeal No. 2004-12-00059
3	PAAB Decision and Order Apex Self Storage. Appeal No.2005-10-00225
4	Subject Occupancy Statistics

5	Candace Watson's Occupancy Study
6	Information RE: New Storage Facility Westwood Street, Port Coquitlam
7	Appraisal Institute Manual – Market Analysis and Valuation of Self Storage Facilities
8	Imperial Self Storage – Revenue, Expense and Vacancy Operating Statement
9	Statement of Agreed Facts between BC Assessment (BCA) and BCS Property Tax Co.
10	Appellant's Brief authored by Lonnie Neufeld
11	Appellant's Rebuttal authored by Lonnie Neufeld
12	Assessor's Brief authored by Derek Holloway
13	Assessor's Rebuttal authored by Derek Holloway

EVIDENCE

[8] The following evidence was agreed to by both parties:

- The actual vacancy statistics for the Property from its opening in February 2000 to December 2006.
- The Property started in February 2000 with a 93.9% vacancy, which dropped over the next two years to 11.3% in February 2002.

- The vacancy rate continued to decline to 3.3% in April 2003

[9] In May 2003, approximately 25,000 sq. ft. were added to the leasable area. Vacancy increased to 20.6% in May 2003. By June 2003, vacancy had dropped to 14.7% and remained in the 14-17% range until July 2004. From August 2004, the vacancy rate was 20.4%; it continued to rise to 36.2% in March 2006. Vacancy then declined to 29.8%. In September 2006, it remained at the 30% level until at least
December 2006.

[10] Candace Watson prepared a vacancy survey for the Tri Cities (Coquitlam, Port Coquitlam and Port Moody) which indicated:

- 2005 vacancy 28.9%

- 2004 vacancy 17.9%

- 2003 vacancy 7.8%

[11] During 2004 and 2005, the supply of self storage space in the Tri Cities area nearly doubled with the addition of 300,000 sq. ft. in four new facilities.

[12] Mr. Neufeld argued that the long term stabilized vacancy rate for the Property is 30%, while Mr. Holloway argued that it is 15%. Both agreed that the long term stabilized vacancy rate should reflect "the actual experience of the facility itself and the market as a whole". Mr. Neufeld emphasized the first part: the actual experience of the facility itself and the Property's current 30% vacancy rate. Mr. Holloway emphasized the second part: "the market as a whole" and noted that the Greater Vancouver Regional District self storage vacancy rate of 10%.

[13] Both parties agreed that during the years 2004 and 2005, the supply of self storage space increased by 300,000 sq. ft., or nearly 100%. Mr. Neufeld argued that the supply of new facilities in the Tri Cities will continue, and the present 30% vacancy rate is the long term stabilized rate. Mr. Holloway argued that the doubling supply in two years has caused a temporary spike in vacancy rates to the 30% level, but over time the long term vacancy rate will stabilize in the 15% range.

[14] The only evidence provided by either party on the future supply, was one facility in Coquitlam of 60,000 sq. ft. slated for opening mid to late 2007.

ANALYSIS AND DECISION

[15] The only issue we are dealing with is what is the appropriate long term stabilized vacancy rate to be applied to determine Net Operating Income for capitalization purposes.

[16] A review of the Property's actual vacancy statistics indicates that it took approximately two years (from February 2000 to March 2002) to get to a 10% vacancy or 90% occupancy level. After the Property increased in size in May 2003 by approximately 25% (25,000 sq. ft.), vacancy averaged around 15% until June 2004.

[17] After June 2004, vacancy increased to 30% by July 2005 (valuation date) and peaked in March 2006 at 36%; it then decreased to 30% by December 2006. The evidence indicates that for 2004 and 2005, supply of storage space nearly doubled in the Tri Cities area, including the opening of a large storage facility immediately across the street from the Property. This is reflected in the Property's rising vacancy rate during this period, to a high of 36%.

[18] The evidence indicated that no new facilities opened in 2006. It took the Property approximately two years to lease up to 90% occupancy and the evidence indicated this was within industry norms. As of December 2006, the market in the Tri Cities is still absorbing the new supply that came on in 2004 and 2005. We, therefore, do not have a stabilized market; we still have an "abnormality in supply". This increase in supply has not continued, as there was no new supply in 2006, and there is only one self storage facility of 60,000 sq. ft. slated to open in mid to late 2007. A 60,000 sq. ft facility is approximately a 10% increase in supply of self storage capacity in the Tri Cities area over two years, in contrast to the 100% increase in the previous two years.

[19] Mr. Neufeld, in his comments on regional and Tri Cities economics, noted continual population growth and increasing housing starts. As Mr. Holloway noted in his rebuttal, and I agree, these trends will lead to increased demand for self storage space.

[20] Mr. Neufeld argued the 30% vacancy rate is the long term stabilized rate as it has been hovering in the 30% range for approximately the last two years. Both parties accepted the Dictionary of Real Estate Appraisal (third edition) definition of stabilized occupancy as:

> Occupancy at that point in time when abnormalities in supply and demand or any other transitory conditions cease to exist and the existing conditions are those expected to continue over the economic life of the property; the optimum range of long-term occupancy which an income producing real estate project is expected to achieve under competent management in the open market for a reasonable period of time.

[21] Mr. Holloway also included an excerpt from the *Westcoast Transmission Company Ltd. V. Assessor of Area #09* (1987) B.C.Stated Case 235 which deals with vacancy rates used in calculating net income for capitalization purposes: "…when the appraiser capitalizes an existing or present income, he does so on the premise that the figure being capitalized is representative (in current dollars) of the long-term stabilized situation, not of some temporary or short term situation."

[22] The 100% increase in supply over the 2004-2005 period is an abnormality in supply and will take approximately two years to be absorbed. The latest vacancy statistics up to December 2006 are still within that two year absorption period. I do not accept Mr. Neufeld's position that the present 30% vacancy rate represents the long term stabilized vacancy rate. It is an anomaly caused by a 100% increase in supply over the previous two years.

[23] I have examined the occupancy history of the Property and note that from November 2001 to July 2004, in a more stable supply period when including the Property increased its own supply by 25%, the vacancy rate was over 15% in 10 months and under 15% in 23 months. The evidence indicated that the GVRD long term stabilized vacancy rate was estimated to be 10%. In looking at the actual vacancy of the Property in a stable supply period and the market as a whole, I agree with Mr. Holloway's long term stabilized vacancy rate of 15%.

<u>Actual Value Calculation</u>

Potential Gross Income	$1,756,272
Long Term Stabilized Vacancy Rate 15%	(263,440)
Effective Gross Income	$1,492,832
Expense Ratio 40%	(597,133)
Net Operating Income	895,698
$895,698 Capitalized @9%	$9,952,211

[24] The value of $9,952,211 is actually above the 2006 actual assessment as confirmed by the Property Assessment Review Panel of $9,107,600. The Assessor has not asked for a raise in the actual value from the 2006 PARP confirmation, and to maintain equity in the Tri Cities self storage

facility assessments the Board confirms the Property Assessment Review Panel decision of $9,107,600.

ORDER

[25] The Board confirms the decision of the 2006 Property Assessment Review Panel as follows:

Roll No. 10-43-224-994301-000:

Land:	Class 1 - Residential	$	19,700
	Class 6 - Business and Other	$	2,454,000
Improvements:	Class 1 - Residential	$	52,900
	Class 6 - Business and Other	$	6,581,000
Total Assessed Value:		$	9,107,600

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