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**LONDON LIFE INSURANCE CO.**

**v.**

**ASSESSOR OF AREA 9 - VANCOUVER**

Supreme Court of British Columbia (A872713) Vancouver Registry

Before MR. JUSTICE COHEN (in chambers)

Vancouver, April 15, 1988

J. R. Lakes for the appellant

J. E. D. Savage for the respondent

**Reasons for Judgment**

June 29, 1988

This is a case stated by the Assessment Appeal Board ("the Board") pursuant to s. 74 (2) of the Assessment Act, R.S.B.C. 1979, c. 21, at the requirement of the Assessment Commissioner seeking the opinion of the Supreme Court in the following questions:

1. Did the Assessment Appeal Board err in law when it held that the words "state and condition" in Section 26 (1) of the *Assessment Act* required that the vacancy of office buildings on September 30, 1985, rather than the vacancy of office buildings on July 1, 1984, be used in determining the value of the subject building by the income approach?
2. Was there any evidence on which the Assessment Appeal Board could find as it did, that the vacancy rate to be used to determine the value of the subject office building should be 19%?
3. Did the Assessment Appeal Board err in law when it held that in using the income approach to value property and in particular the subject property, that the valuator must rely "upon the (actual) vacancy rate prevailing in Class 'B' office buildings in Vancouver as of September 30, 1985"?
4. Did the Assessment Appeal Board err in law when, in utilizing the income approach to value the subject property, it utilized a capitalization rate derived from a sales analysis using a vacancy rate totally different than the vacancy rate utilized by the Board to value the subject property?
5. Was there any evidence before the Assessment Appeal Board to allow it to use a vacancy rate to value the subject property, totally different than the vacancy rate used for the purpose of the sales analysis used to determine the capitalization rate which the Board used to value the subject property?

6. Did the Assessment Appeal Board err in law when it used the average vacancy rate for office buildings as of September 30, 1985, rather than the "expected long term vacancy rate" for such buildings?

7. Was there any evidence before the Assessment Appeal Board permitting it to use the vacancy rate of office buildings in Vancouver as of September 30, 1985, rather than the "expected long term vacancy rate" for such buildings?

8. Was there any evidence before the Assessment Appeal Board which permitted the Board to ignore the "market comparison approach" used by the assessor to value the subject building, when such approach and the value derived thereby was unchallenged?

The facts upon which the questions must be considered are set out in paragraphs 1-11 of the stated case as follows:

1. The subject building is a nine-storey office building located in Vancouver. It has a basement used for parking. The main floor is used for retail sales and the upper floors are offices. The building was built in 1975/76 and was purchased by London Life in February 1983 for \$16,400,000. The building was assessed at an actual value of \$13,774,150 for the year 1986, which is the assessment under appeal.

2. The valuation date for this land and its improvements for the 1986 Assessment Roll was July 1, 1984, with its state and condition being considered as September 30, 1985.

3. While the assessor valued the property using the market sales approach and the income approach, both the appraiser for the respondent assessor and the appraiser for the appellant relied upon the "income" method of valuing real estate, in arriving at the final valuation of this property for assessment purposes.

4. There was no major dispute between the appraiser for the respondent assessor (9.5%) and the appraiser for the appellant (8.9%) concerning the capitalization rate (cap rate) to be employed in the use of the income approach in valuing this building.

5. The Board relied upon a cap rate of 9% in its calculations after giving consideration to the fact that the appraiser for the respondent assessor had determined that the cap rate should be around 9%, as a matter of appraisal judgment (to give himself a little bit of room) used 9.5%, and the fact that the appraiser for the appellant had used a cap rate of 8.9%.

6. There was no major dispute between the parties regarding the amount of expenses required to operate such a building in relying upon the income approach. The Board relied upon the expenses allowed by the appraiser for the respondent assessor.

7. There were two areas of dispute between the appraisers for the respective parties:

(a) the vacancy rate to be employed in relying upon the income approach; and

(b) whether an allowance should have been made by the appraiser for the assessor regarding an item referred to as "tenant's inducements" in his appraisal.

8. The appraiser for the respondent assessor calculated a "floating 11-year" average vacancy rate of 8.47% - but arbitrarily relied upon a vacancy rate of 7.5%, in using the income approach to value this land and building as of July 1, 1984.

9. The appraiser for the appellant relied upon the average vacancy rate prevailing among Class "B" office buildings in Vancouver as of the date of valuation, July 1, 1984 (13.8%).

10. The appraiser for the respondent assessor agreed that the vacancy rate of Class "B" buildings in Vancouver was 19% as at September 30, 1985.

11. The Board used a vacancy rate of 19%, being the vacancy rate of Class "B" buildings in Vancouver, at September 30, 1985, since this was considered by it to be the economic vacancy rate prevailing for like office structures at the date when the Board should consider the state and condition of the subject building, pursuant to the legislation then in effect.

The issue before me is the vacancy rate to be employed in the valuation of the subject property. The appraiser for the appellant used a rate of 13.8%. The appraiser for the respondent used a rate of 7.5%. In arriving at its decision the Board used a rate of 19%, being the vacancy rate of Class "B" buildings in Vancouver, as at September 30, 1985. Neither the appraiser for the appellant nor the appraiser for the respondent advanced a vacancy rate of 19% as being appropriate.

Counsel for the respondent explained the principles and the appraisal theory applicable to the income approach to value. In the income approach to value an appraiser estimates the income a property will receive over its life, the expenses it will incur and discounts or capitalizes the net income over the remaining life of the property. In the discounted cash flow approach this is done by estimating for each year a net income and discounting the income stream to a present value. In the income capitalization approach a normalized income and normalized expenses are estimated and the resulting net income capitalized at a rate derived from the market. If a property is relatively short-lived a factor is applied to the capitalization rate to take into account the estimated duration of the income stream. Where the property is relatively long-lived no factor is applied to the capitalization rate and the income is capitalized in perpetuity. The subject property is relatively new and neither the appraisers nor the Board applied any factor to the capitalization rate in respect of any anticipated shortened life of the subject property.

The actual vacancy rate of a property is its actual vacancy as of the date of valuation. The economic vacancy rate is a projected vacancy rate based on long-term trends. The respondent submits that by applying a 19% vacancy rate the Board has said that the subject property will sustain a 19% vacancy rate for its remaining life and contends that there was no evidence before the Board to support such a finding. At pp. 16 and 18 of its decision, the Board found as follows:

When contemplating the use of the Income Approach, all of the factors employed must be contemporary. The capitalization rate is obtained from the recent sales of comparable buildings in the general area. The economic income is obtained from similar buildings operating in the same area at the same time. The vacancy rate is to be calculated from a comparison of like situations at the time of comparison (see Westcoast decision *supra*). The Assessor has followed this procedure until he came to the application of the vacancy rate. In this instance, instead of employing the current prevailing vacancy rate, which has a direct effect on the total value of the subject building, he has conjured up a vacancy rate using past statistics. Mr. Geddes, on the other hand, was basically on the right track, but failed to fully comprehend the impact of the Trizec decision (*supra*) and relied upon the vacancy rate prevailing as of the valuation date, July 1, 1984, when he had the opportunity to consider the "state and condition" of the building as of September 30, 1985 (when he had appealed the revised roll).

The Board is of the opinion that, while the valuation date for this building is July 1, 1984, for the purposes of this appeal, the Assessor must view its "state and condition" as of September 30, 1985 (see Section 26, subsection 1 of the *Assessment Act*).

The Board is of the opinion that the average vacancy rate prevalent in the downtown area of 13.8%, mid 1984, should not be employed, as suggested by Mr. Geddes.

The Board is of the opinion that Mr. Geddes should have relied upon the vacancy rate prevailing in Class B office buildings in Vancouver as of September 30, 1985.

Under cross-examination, the Appraiser for the Assessor agreed that the vacancy rate prevalent for office buildings in Vancouver for 1985, would be about 19%.

One must use the vacancy rate prevailing at the date of valuation (subject to the state and condition in the case of the revised assessment roll) in valuing a building using the Income Approach.

For the above reasons the Board finds that the vacancy rate to be applied in valuing this building, using the Income Approach, is 19%.

The respondent says that the Board erred in law by concluding that ". . . the vacancy rate to be applied in valuing this building, using the Income Approach, is 19%." in that it acted without evidence or on a view of the evidence which could not reasonably be entertained. (*Crown Forest Industries Limited v. Assessor of Area 6 - Courtenay* (1985), B.C. Stated Cases, Case 210, p. 1191).

In my opinion, the Board erred in law in its interpretation of s. 28 (1) of the *Assessment Act* which provides that "actual value" means the actual value that land and improvements would have had on July 1 had they and all other land and improvements been on July 1 in the state and condition that they are in on September 30 and had their use and permitted use been on July 1 the same as they are on September 30. The valuation date for this land and its improvements for the 1986 assessment roll was July 1, 1984 with its state and condition being considered as of September 30, 1985. There is nothing in this section which requires that in the determination of actual value using an income approach the prevailing vacancy rate at September 30 must be employed. Further, the authorities cited in the Board's decision do not support such a conclusion. (*Westcoast Transmission Company Limited v. Assessor Area No. 9*, B.C. Stated Case 235; *Trizec Equities Ltd. v. Assessor of Area 09*, B.C. Stated Case 196). In the determination of actual value at July 1, 1984, the factor of a changed vacancy rate as of September 30, 1985, must be considered, but once considered it need not be used by the assessor if using it would be contrary to the application of established appraisal principles for assessment purposes.

The Board has a duty to act judicially and to decide, upon all the evidence before it, how much weight should be attached to the opinions of the experts. The Board did not rely on its own appraisal expertise in selecting the appropriate vacancy rate. While the Board has a wide discretion to accept or reject evidence, it acted in a perverse manner when it rejected all of the expert evidence and took the position that it must use the prevailing vacancy rate at the date of valuation when there was no basis in law for such a conclusion. I agree with counsel for the respondent that, based on established appraisal theory, it is fundamental to the application of the income approach to value that the factors and rates applied in this approach be consistent. The Board's decision to apply the 19% vacancy rate because it felt bound to do so resulted in an inconsistent income approach to actual value. The Board adopted and applied a capitalization rate based on market trends, which included a consideration by the appraisers of vacancy rate cycles for this type of property, while at the same time it used a vacancy rate rejected by the appraisers as a short term phenomenon that should not be capitalized in perpetuity.

In the result, I find that by using the prevailing vacancy rate as of September 30, 1985, the Board erred in its interpretation of the Act and on its application of the facts to the income approach to value which entitles this Court to intervene.

My response to the questions set out in the case stated for the opinion of the Court is that the answers to questions 1, 3 and 6 is "Yes" and the answers to questions 2 and 7 is "No". Questions 4 and 5 are related questions and are redundant.

With respect to question 8, in my view, this is an inappropriate question for the Court to answer. While the assessor relied upon the market as well as the income approach to value, the thrust of the appellant's and the respondent's approach was based on the income approach. In my view, it was open for the Board to reject the market approach and it was in the Board's jurisdiction to rely upon the income approach although, as I have already found, the Board erred in its application. In the result, I find that the answer to question 8 is that it does not involve a question of law and is not properly before me by way of stated case.