

ANZ - Valuation Guidance Note

Assessing Rental Value

Members are advised that this Guidance Note has been endorsed for release to members and their clients.



1.0 Introduction

1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary and advice to Members assessing rental value.

1.2 Status of Guidance Note

Guidance Notes are intended to embody recognised 'good practice' and therefore may (although this should not be assumed) provide some professional support if properly applied. While they are not mandatory, it is likely that they will serve as a comparative measure of the level of performance of a Member. They are an integral part of 'Professional Practice'.

1.3 Scope of this Guidance Note

This Guidance Note applies to Members assessing the market rent of premises held under an actual or hypothetical lease and preparing a report thereon. Rental Value is a generic term including the term "rent".

1.4 International Valuation Standards

This Guidance Note is intended to be consistent with the publication "International Valuation Standards 2007"

as issued by the International Valuation Standards Committee. However, there may be departures from "International Valuation Standards 2007" to reflect Australian and New Zealand law and practice.

This Guidance Note should be read in association with the Practice Standards, Guidance Notes and related documents in Professional Practice, in particular IVGN 2 'Valuation of Lease Interests'.

2.0 Instructions

2.1 Prior Written Instructions

In accordance with the relevant Rules of Conduct (API or PINZ), a Member should confirm acceptance of instructions in writing prior to the valuation being undertaken.

2.2 Content of Instructions

Members should have regard to relevant provisions within Professional Practice concerning the content of instructions.

2.3 Supporting Documentation

In assessing rental value, the following documentation should be considered:

- original lease documentation (including collateral agreements and executed

documents) to be sighted where possible, otherwise the copy relied on should be executed;

- confirmation of current rent and other matters as may be appropriate;
- documents relating to financial implications such as outgoings;
- details of the floor areas, preferably surveyed in accordance with an industry accepted method such as ANZRP4 Methods of Measurement, PCNZ/PINZ Guide for the Measurement of Rentable Areas or the Property Council of Australia's 'Method of Measurement for Lettable Area';
- if applicable, a statement from the lessor and lessee as to the extent that information obtained from the parties may be detailed in the report;
- details of the fit-out or other incentives provided by the lessor, if applicable; and
- details of the lessor's and/or lessee's improvements.

2.4 Relevant Skills and Expertise

In accordance with the relevant Rules of Conduct (API or PINZ), a Member should not accept an instruction beyond their competence.

If a Member does not have the relevant skills and expertise to assess rental value, the Member should decline the instruction or retain an appropriate specialist to provide advice.

2.5 Full Disclosure

Full disclosure of all relevant information by the parties is critical to the assessment of rental value. Where a Member suspects that information provided by a party, or the parties to a dispute is false, incomplete or misleading, the Member

should advise the parties and, if not resolved, the Member may decide to decline the instructions.

2.6 Further Advice

It may be necessary for a Member to address legal or other issues where these are in dispute. The Member should obtain legal or other appropriate interpretation to ensure the correct course of action is taken. Where a Member is uncertain on the issues, the Member may:

- advise the parties to the dispute of the necessity to obtain such advice;
- provide to the parties a quote relating to obtaining such advice;
- obtain confirmation in writing from the appropriate party/parties accepting liability for the cost of that advice; and
- obtain confirmation from the parties that any time limitation that is imposed on the Member for completing the determination is appropriately extended.

3.0 Definitions

3.1 Primacy of Lease Definitions

In assessing or independently determining the rental value of premises held under the terms of an actual lease, the definition of terms contained within that lease have primacy, unless contrary to any legislation.

3.2 Common Terms

The following terms are in common use and are defined in the joint API, PCA & REIA publication, Glossary of Property Terms (2007):

- rent (including gross, net, face, effective, passing/contract and market);
- rent review;

- lease;
- leasing incentives;
- tenant;
- landlord;
- lessor;
- lessee;
- profit rent;
- rental shortfall; and
- permitted use.

The definitions adopted in the Glossary of Property Terms (2007) are provided in 8.0 Terms.

4.0 Assessing Rental Value

4.1 Impartiality

In assessing rental value the Member should maintain an independent, unbiased and balanced state of mind.

4.2 Purpose of Assessing Rental Value

Assessing rental value may comprise:

- assessing the rental value of premises held under the terms of an actual lease; or
- assessing the rental value of vacant or owner occupied premises, assumed to be held under the terms of a hypothetical lease; or
- independently determining the rental value of premises held under the terms of an actual lease.

4.3 Market Rent Reviews

Market rent reviews in a lease enable the rental to be varied to reflect changes in the market between the date on which the lease commenced or the rent was last reviewed and the relevant review

date subject to the terms and conditions of that lease.

The fundamental starting point to any assessment of market rent, at rent review, is therefore the lease. A full understanding of the lease is required before the market rent can be assessed.

The agreed rental on review will reflect not only the market influences but also the terms and conditions in the actual lease document.

4.4 Issues for Consideration

When assessing rental value, a Member should have regard to:

- relevant legislation operating in Australia and New Zealand, including any retail and commercial tenancy legislation;
- directions to the valuer pursuant to the Lease; and
- Court decisions.

4.5 Lease Directions

When assessing the rental value of premises held under the terms of an actual lease or the independent determination thereof, members should follow the directions, if any, provided under the lease.

A Member should comply with any specific provisions contained in a lease unless:

- the parties have further agreed to vary that provision and have advised the member in writing of any agreed variations; or
- the provision is contrary to law.

4.6 Unspecified or Assumed Lease Terms

When undertaking an assessment of rental value under the terms of a lease

and also when notional lease terms are to be assumed, the Member should address (where appropriate) the following elements:

- the name of the lessor (where applicable);
- the name of the lessee (where applicable);
- description of the premises;
- permitted use under the lease;
- date of commencement;
- term of lease;
- date of assessment;
- option(s) for renewal;
- commencing rental;
- current passing rent (if applicable);
- method and frequency of rent reviews;
- period to which the rental being assessed is applicable which may be:
 - a period equivalent to the term of the lease; or
 - a period equivalent to the unexpired term of the lease; or
 - a period equivalent to the interval between rent review; or
 - another period;
- lessor's and lessee's liability for outgoings;
- assignment clause;
- sub-leasing rights;
- fitout and fitout costs;
- treatment of incentives; and
- make-good provisions.

4.7 Sources of Comparable Evidence

In assessing market rent the Member should consider the most appropriate evidence in the market place.

The best evidence is generally rentals which have been agreed in comparable

tenancies, at the relevant date with vacant possession (i.e. new lettings between arms-length parties), and in particular, where the use is the same or a substantially similar use as the permitted use under the lease.

In the absence of new lettings evidence, the member may have to consider the following:

- rentals agreed between arms-length parties at lease renewal or at the exercise of an option to renew an existing lease;
- rentals agreed at market rent reviews; and
- the outcome of mediations or determinations.

4.8 Application of Comparable Evidence

The terms and conditions of a subject lease may vary from the terms and conditions for leases of comparable premises. These variations should be taken into account in the assessment of the market rent under the subject lease.

When a Member is required to assess a rental under an existing lease which relates to market rent or similar terminology, a distinction may need to be made between an assessment of market rent under the usual terms and conditions of similar leases/tenancies and the terms and conditions of the actual lease, with adjustments for differences.

5.0 Independent Determination

5.1 Purpose

In the event of a dispute between a lessor and the lessee, a Member may be instructed or appointed to undertake an

independent determination of the rental value of the premises held under the terms of an actual lease.

5.2 Basis of Appointment

Depending on the requirements of the lease, a Member may be appointed to undertake an independent determination by acting as an Expert or as an Arbitrator.

The terms Expert and Arbitrator are defined in the Glossary of Property Terms (2007) and are provided in 8.0 Terms.

5.3 Conflict of Interest

When acting as an expert and the potential for a conflict of interest arises, Members are referred to ANZRPNGN 2 'Acting as an Expert Witness, Advocate or Arbitrator' and the Institute's Rule of Conduct 1.3.

6.0 GST

Members should explicitly state the treatment of GST in their report.

7.0 References

Relevant texts may include, but are not limited to:

Hyam, 2005, *A The Law Affecting Rent Review Determinations*, The Federation Press, November.

Duncan, 2005, *WD Commercial Leases in Australia*, The Lawbook Company.

8.0 Terms

Terms including, as defined in the Glossary of Property Terms (2007):

Arbitrator

An independent person who is called upon to conduct an arbitration. Is usually a person with experience and/or



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qualification in a particular field and may be nominated by the parties.

Advocate

A person who represents the cause or interest of another, even if that cause or interest does not necessarily coincide with one's own beliefs, opinions, conclusions, or recommendations.

Expert

A person who is recognised as having special knowledge or skills.

Rent

A payment made periodically by a lessee to a lessor for the use of premises.

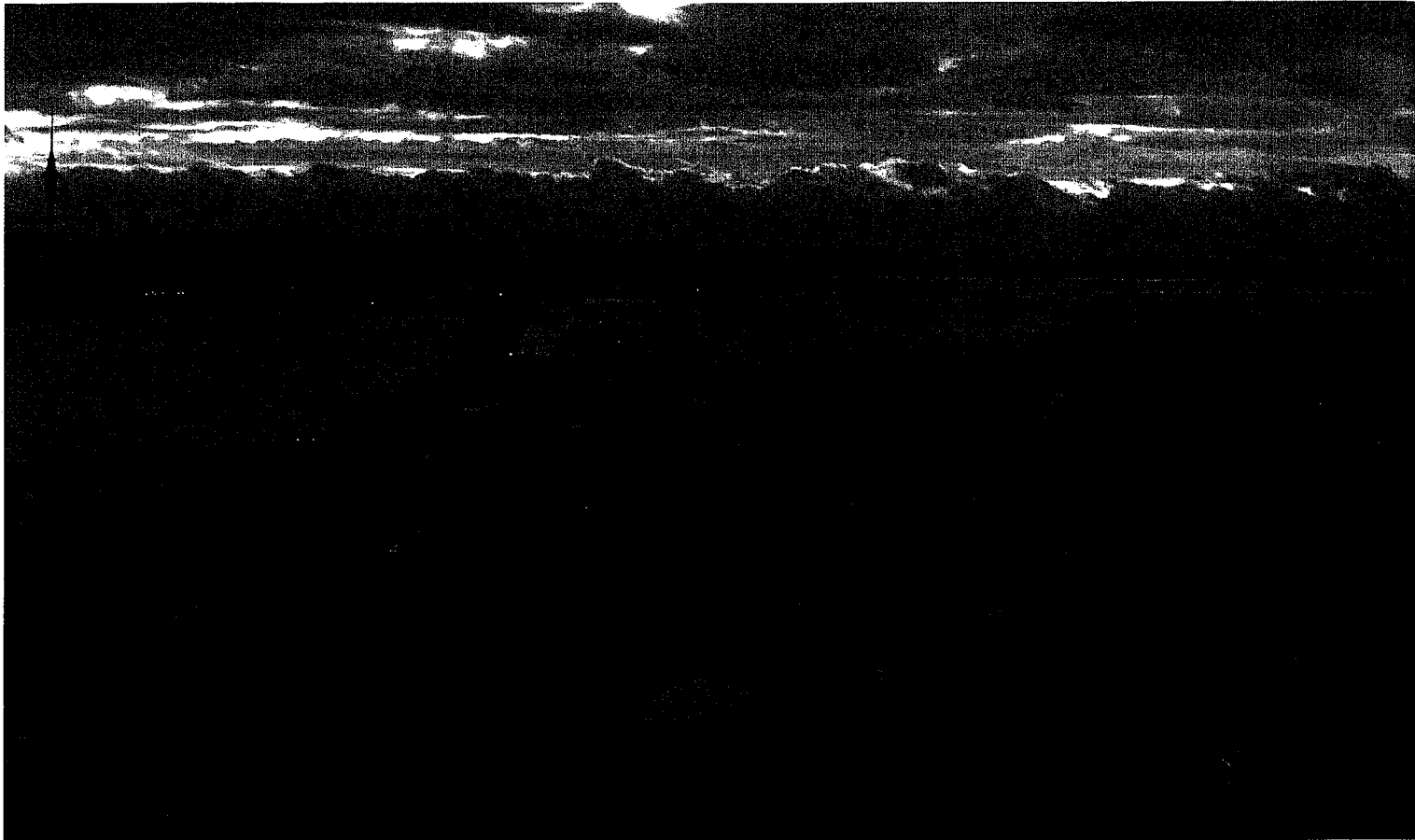
The term "Rent" is often associated with a variety of other terms outlined below:

Base: The minimum acceptable rental provided in a lease. In retail leases the base rent generally refers to the commencing rent which is supplemented with a 'percentage rent' based on the tenants turnover.

Break-Even: The point at which a tenant's base rent is equal to an agreed level of sales above which percentage rent takes effect.

Concessionary: A discounted rent, usually during the initial lease term.

Effective: The actual liability for rent



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and outgoings after adjustments for any incentives to the face rent are taken into account.

Equivalent: Equivalent refers to the rent being adjusted for the effects of any market rent reviews that will occur in the period of consideration.

Face: The rent shown on a lease document which may or may not include incentives and may or may not include outgoings.

Gross: In a gross lease, all operating costs of the property (excluding direct tenancy expenses) are included in the rental.

Market: The estimated amount for which a property, or space within a property, should lease on the date of valuation between a willing lessor and a willing lessee on appropriate terms in an arm's-length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Whenever Market Rent is provided, the "appropriate lease terms" which it reflects should also be stated.

Net: In a net lease the owner recovers outgoings from the tenant on a pro-rata basis (where applicable).

Passing (or contract): The rent specified by a given lease agreement; although a given contract rent may equate to the Market Rent, in practice they may differ substantially, particularly for older leases with fixed rental terms. The term, contract rent is North American usage; passing rent is Commonwealth usage. (IVSC)

Peppercorn: A term used where it is desired to reserve only a nominal rent for any period. A minimal rent which is below market value.

Turnover / Percentage / Participation Rent: Any form of lease rental arrangement in which the lessor receives a form of rental that is based upon the sales of the lessee.

Percentage rent is an example of a turnover rent. (IVSC).

Rent Review

A periodic review of rental under a lease using a predetermined method.

For example, increase in line with Consumer Price Index (CPI), or in accordance with a market valuation.

Lease

(a) A contract arrangement in which rights of use and possession are conveyed from a property's title owner (called the landlord, or lessor) in return for a promise by another (called a tenant or lessee) to pay rents as prescribed by the lease. In practice the rights and the duties of the parties can be complex, and are dependent upon the specified terms of their contract;

(b) An agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

Leasing Incentives

Inducements offered by landlords to attract tenants to lease space. Typically occurs when supply exceeds demand, but in order to maintain value by not lowering face rent or contract rent, tenants are given incentives such as rent free periods, cars and other gifts. Often such inducements are secret. The discount or contribution offered to a lessee at the commencement of a lease which may be applied at the start, during, or at the end of the lease term and is outside the lease terms.

Outgoings

The expenses incurred in generating income. In real estate, these expenses include but are not necessarily limited to property rates, insurance, repairs and maintenance and management fees.

Operating expenses when subtracted from gross income equal net operating income.

Profit Rent

The difference between the market rent and the current rent or ground rent resulting in a leasehold interest.

Rental Shortfall

The amount by which rent is less than the market rental.

Tenant

A person or entity paying rent in exchange for the occupancy of a building or dwelling. See also Lessee.

Landlord

The owner of leased property. The lessor.

Lessor

The owner of a property who transfers the right to occupy and use property to another by way of a lease agreement.

Lessee

A person / legal entity who receives the right to occupy and use a property under the terms of a lease.

Permitted Use

The allowable use within the premises specified in the lease contract (not to be confused with 'permissible use').

Vacant Possession

In real estate this refers to a right to possession of land or built-up property in respect of which there is no current occupant.

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