ABSTRACT

Through a review of literature, the current method of capitalisation rate selection, for use in the capitalisation of income method of valuation, is identified as comprising a process of the adjustment of capitalisation rate evidence deduced from the analysis of comparable property sales. Such adjustment process if found to be subjective, informal and heuristic, lacking a framework which accords with property, finance, commerce and economic theory and being dependent upon practitioner opinion, intuition and experience, which is found to contribute to an unacceptably high level of variability in capitalisation rate adjustment between properties at a point in time.

Consistent with this general problem area, the principle issue, a range of subsidiary issues and a rationale for addressing such issues are identified and a Thesis Problem defined. It is contended that an objective and measured approach to capitalisation rate determination, consistent with property, finance, commerce and economic theory, would diminish the role of the practitioner and contribute to a reduction in the level of variability in adjustment identified. It is proposed that this may be achieved through the use of an econometric model (the Thesis Proposition) which will result in a lower standard deviation for a sample of determined capitalisation rates than arises from the application of the current method by practitioners (the Thesis Hypothesis).

The Thesis Aim is to model those issues which contribute to capitalisation rate determination and the Thesis Objectives are to investigate existing econometric models, identify those issues which determine the capitalisation rate and develop and apply a model of such issues. The Thesis concentrates solely on the adjustment of capitalisation rates between prime, CBD office investment properties in Sydney at a point in time.

A three step general approach to the solution of the Thesis Problem is proposed. The first step comprises a review of literature, through which an existing econometric model is not found and the determinants of the capitalisation rate are identified, taxonomised and modelled algebraically. The second step includes the collection and analysis of data (using a Practitioner Survey with 39 respondents and a sample of 46 office properties) to quantify the variables in the algebraic model with the development and proposition of an econometric model of the determination of the capitalisation rate. The third and final step comprises the application and independent testing of the econometric model proposed, which finds the Thesis Hypothesis proven and the Thesis Proposition to be valid.

It is, therefore, concluded that the use of the econometric model proposed, which is based on and accords with property, finance, commerce and economic theory, diminishes the role of the practitioner and contributes to a reduction in the level of variability in capitalisation rate adjustment, between properties at a point in time, compared to that arising from the application of the current method by practitioners.

The study forms a distinct contribution to knowledge and to the analysis of property investment through original and independent research, which offers a practical application of relevance to industry. The Thesis also highlights a range of policy recommendations including the need for change in the perception of property as an asset class, a greater focus on research, increased market efficiency, the adoption of new approaches, a change in emphasis in valuer education and in the attitude of valuers together with a change in focus for the role of relevant professional bodies, which are contended would be of benefit to each participant in the property investment industry including its ultimate beneficiaries, the community at large.