Tips & Traps of Valuing Residential and Commercial Property
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What is Value?

Spencers Case
Spencer v Commonwealth [1907] HCA 82; (1907) 5 CLR 418 (29 October 1907)

Griffith CJ was Premier of Queensland

Sir Samuel Griffiths was twice Premier of Queensland, the first time from 10th November 1883 to 13th June 1888, and the second time 2 months later. He made a significant contribution to Federation and in particular the status of the Senate as a House of Review. He became Chief Justice of the High Court (after federation) and established a precedent that applies to today and his principle must be the most quoted principle in legal decisions on valuation matters in Australia

> The test of value of land is to be determined, not by inquiring what price a man desiring to sell could actually have obtained for it on a given day, i.e. whether there was in fact on that day a willing buyer, but by inquiring "What would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?"

What is Value? Cont'd

Definitions

Market Value

The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

Market Rental

The estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

Use to which the Valuation is to be put – does one value fit all?

There is a perception in the market that a single value applies to every circumstance and that every valuation should look the same no matter the use to which the report is to be put. That is far from the truth. Valuation reports must be customised for both the value reported and the report content. The role of the valuer is to convey the information to the user of the report that will most assist that user for the specified purpose.

Too often I have the argument that the purpose, to which the user is to put the report, is not relevant to me as the valuer. This is just exposing myself to a claim for Professional Negligence. Significant investment decisions are made on the advice of the valuer. The person making that decision needs to be fully informed on relevant matters. On the other hand you do not want the document to be cluttered with information that will not assist the reader, although that same information may be helpful to another reader for a different use. That is not to say every valuation does not need to contain specific information. This includes proper identification of the land and the date of valuation just as a start.

Most valuers place limits on those that can rely on the document. In one instance a developer approached me to complete a valuation on certain assumptions and advised why he needed that document. I included the normal qualifications in the document as to who could rely on the document and the purpose for which it could be used together with detailing the assumptions. He was very upset when I refused to remove the qualifications, limitations and exclusions. The intent was to use the document to pull the wool over the eyes of a person they were dealing with.

The uses to which a valuation can be put include:

- Mortgage
- Books of Account (In Use)
- Litigation
- Managed Funds (Prospectus)
- Acquisition / Disposal
- Compulsory Acquisition
- Negotiations
- Rental
- Rating / Taxation

Mortgage

Report Content

The mortgage document is addressed to the bank and most valuers do not give consent for a copy of the valuation to be given to the owner / purchaser.

The banker needs to gain a good understanding on the quality of the property. The banker will not normally have seen the property. Therefore there is a need to give a detailed description of the property including the improvements.

There is a perception that values placed on mortgage valuations are generally conservative. If that is done the valuation does not conform to the definition of value.

The valuation will normally contain a risk profile. This includes such things as current state of the market, likelihood of the value fluctuating, the covenant provided by the tenant, the quality of the asset (depreciation / obsolescence over capitalisation), the cash flow profile and asset management if the mortgagee enters into possession of the property. That risk profile assists the lender to understand the risk of advancing the funds and hence, whether or not to provide the loan and the terms and conditions of the loan.

The Australian Property Institute have established Guidance Notes for the valuations for mortgage purposes. Guidance note 8.2.1 sets out in detail the requirements for mortgage valuations.

http://www.api.org.au/assets/media_library/000/002/165/original.pdf?1400716914

"As if Complete" Valuations and Progress Payments

Other forms of Mortgage Valuation include "As if Complete Valuations" and "Progress Payments".

We had completed an "as if complete" and "4 progress payments" to completion for about 20 houses for particular developer. I was quite surprised when I received an abusive phone call from the financier reporting that in about half the cases the houses had not been built. The developer had come to learn our procedure even down to statements that things were not yet completed and the progress payment should not yet be made. His versions were very noticeable in that his forgeries used Times New Roman. At the time we used Arial. The lender had accepted photocopies of the report. Now we and most valuers qualify that the original signed copy of the report is the only thing that should be relied on.

Mortgage (Cont'd)

Two Tiered Market

Valuation is based on evidence. The valuer's job is to reflect the hypothetical market. There is significant debate at the moment between developers and the profession. The whole world now likes the idea of getting something for nothing. We even see bookies offering your money back if you lose in particular circumstances. Naturally the odds are adjusted to reflect that but it seems to work. The same thing occurs with developers. They offer the purchaser a discount or cash back for settling on time, they offer free investment advice, they offer a furniture package and quite often just think it is appropriate that if they provide you with a garage they should put a car into it.

Naturally the valuer only has regard to the real estate. The problem is getting transparency in the market transactions. Developers have historically tried to hide these deals from the valuer. They initially expected the valuer to adopt the price at which the asset sold. The valuer however only valued part of that asset. The industries are working more closely now but the problems still exist.

The investment seminars also lead to a two tier market. People are led to believe property values only rise. Over time this is true with market value but there are fluctuations in the market. We are in a boom crash cycle and do not learn our lessons from the past. If the purchaser however pays 25% over market value for the property it will take quite some time to catch up.

If the valuer sees all the sales coming from a particular location not being the local market, a high degree of caution will be taken. That location is not limited to Australia. Cars do not sell at the same price everywhere and if you find a location where the car you put in the garage sells for more than in the local market then the investment seminars can be worked in that country as the real estate component seems cheaper.

Books of Account (In Use)

Different Values for the same Property

We have just completed a portfolio of about 30 properties. The valuations were to be used for Mortgage Purposes and for Books of Account.

The Mortgage Valuation assumes the property is sold with Vacant Possession. The inherent assumption is that if an owner occupier defaults on the loan or goes into receivership the occupier will also be in receivership.

The value also needed to be assessed as to what value the property was to the entity. How much would they be willing to pay for the property to occupy the same. Alternately how much would the value of the business reduce if the entity was deprived of the asset.

The third concept is the entity may wish to raise capital by selling the asset with a lease back. This lease back gives the purchaser the covenant and adds significant value to the property. The value of the tenant is typically 10% to 20% of the value.

Books of Account (In Use) (Cont'd)

Firstly, there is the allowance for the time to find a new tenant, incentives that you would need to offer and the costs of leasing the space. The major part of the benefit is however the covenant of the particular tenant. How much more would a prudent investor pay for a supermarket with a 20 year lease to Woolworths than to a Mum & Dad Tenant.

We now have three values for the one property in the same report.

In Use Concept

The in use concept flows through to the land. The value of a parcel of land that has improvements on it greater than now permissible under the Town Plan may have a value greater than the value of that same land if it was vacant.

On the other hand if there is a degree of obsolescence the value of the land as part of the value of the asset may be less than the value as if vacant. Heritage property is a prime example of this situation. The land value can usually only assume that building is the highest and best use. The inherent land value in some cases particularly in CBD's may only be 20% of the land value as is vacant.

Litigation

Litigation or forensic valuation is a specialised area. The valuer's duty of course is to the court and not to the instructing party. Clients often want to lead you in a particular direction. I have often seen it in Court where they have been successful in leading their expert but of course unsuccessful in convincing the Court. My arguments are normally more aggressive with the client than the opposing counsel / valuer. Although my client is not happy on the way through they are happy with the end result.

Valuations need to be prepared recognising that the document, and that from the opposing side, is the sole document to inform the Judge about the property. It is essential that the logic translating the evidence through to conclusion is very clear.

The document needs to be prepared with the knowledge that if I have left a hole in my logic that hole will be exposed in the course of cross examination. A forensic report can often take four or five times longer to prepare than say a mortgage valuation for the same property.

Joint Expert Reports also now form part of the litigation process. Again skill is required to demonstrate your approach should be preferred whilst still demonstrating total respect for the other expert.

Managed Funds - Prospectus

Valuations for a prospectus or for ongoing valuing of the fund need to pay particular attention to Corporations Law. The document is to be read by people interested in investing in the fund. Significant reliance is placed on the valuation and any projections it may make.

Acquisition and Disposal

If the sale is of a simple asset such as a house I normally suggest to the vendor a valuation is not necessary. Valuations are not inexpensive. I prefer the potential client to talk to the three agents with highest profile in the local market. Those agents normally have that high profile due to their professionalism. The market decides the value of the property and prudent purchasers put no weight on the opinion of a valuation obtained by the vendor.

Purchasers normally seek finance and therefore they are aware if something is wrong with the price they have offered when the finance is rejected based on the valuation.

Contracts in Queensland have a big warning on the front that the purchaser should seek both legal and valuation advice. Prudent purchasers of second hand product will understand local value due to the significant effort put into the purchase. The valuer has the skills to identify risks that may not be apparent to the purchaser. Purchasers of new product should always seek valuation advice.

Where it is appropriate to complete a valuation for a vendor, the report should again be customised. The vendor does not need a detailed description of the building in which they have lived for the last 20 years, they know it fairly well. What they do need to know however is information about the market and about the evidence on which the valuation opinion is based. They valuer should customise the report in such a way to ensure the vendor has confidence in the opinions.

Compulsory Acquisition

In my opinion, which is not shared by many, the last thing an affected owner needs is a valuation to prepare a claim for compensation. On the other hand the Resuming Authority should be seeking that report. I am yet to experience a situation where the Resuming Authority does not negotiate down from the initial claim, no matter how valid the claim. They simply will not accept the initial position.

Therefore I normally provide a report setting out my beliefs as to where compensation should lie but also setting out arguments that would lead to a higher figure. Valuation is a subjective approach and whilst I may have an opinion as to how something may be treated the other valuer have an approach that leads to something higher or lower for that aspect.

I therefore recommend that whilst a claim needs to be fully justifiable arguments are to the high side. As an example on matter I settled earlier this year I felt compensation should result in $2.5 million plus or minus $100,000 and advised the client of these parameters but provided arguments at $3.0 million. It was then up to the client / lawyer, being fully informed, to lodge the claim which they did at the higher figure. The valuer for the resuming authority started at closer to $500,000 than $1.0 million. After significant discussion he came up to $2.0 million. Then when we were going through the detailed discussion he had theories with which I disagreed that increased his figures but he rejected some of my arguments that I know were correct. Finally, he formed the view that he must assess the property at less than the midpoint even though he had calculations which went higher. We finally settled at $2.45 million. It was within the parameters of my opinion of value.

Compulsory Acquisition (Cont'd)

There are however some lawyers who insist that I complete an actual valuation rather than provide the Resumption Report. They then base the claim on the valuation. I never compromise a valuation with any fat. As an expert I then will not compromise during the negotiations. It is up to the client if the client is happy to accept something less.

Negotiations

Before instructing a valuer to undertake a valuation where the user intends to use that opinion as a basis for negotiations, think as to whether it would be preferable to request a letter of advice setting out a negotiation strategy.

Whilst some valuers do not realise that they have the expertise to sell a product other than valuation, the more experienced do understand that we can wear many hats.

We provide reports that highlight valid arguments to achieve a particular result. Earlier this week I received a thank you from a tenant after providing this advice. Whilst still happy to settle above where I would have recommended I provided the tools for the negotiation in the form of verified evidence. The Lessee was a bit nervous to ask for any more and wanted to maintain strong relationships with his Landlord who initially was seeking a rental increase. The rental decreased by $250,000 which was about 25% of the passing rental.

In that instance the Landlord was aware of my involvement although I was not directly involved. I would have been if the Landlord did not see reason. A valuation would not have achieved the same outcome.

In another instance I was negotiating a rental for a Tenant where the asking rental was $700,000 and we settled for half of that amount. In this case I was directly involved. Of course the Lessor was not overly happy with that result. The twist of the story however is, with the knowledge of all parties I was consulting to the Landlord on the Statutory Valuation. As soon as the meeting finished on the rental, my client left and we continued the discussion with my now clients on the tactics for the Statutory Assessment.

Rental

Rental is the most specialised area of valuation but unfortunately this is not well recognised.

There are major differences between differing rental concepts:

- Market Rent sometimes referred to Current Market Rent
- Fair Rent some times referred to as Reasonable Rent
- Fair Market Rent
- Market Rental Value

Leases are worded differently and often use one term but then condition that term to specific assumptions that lead to another result. Unfortunately, the profession is not well versed on the concepts of rental.

Rental (Cont'd)

The simplest explanation of the difference between rental and rental value is set out in *McCafferty v Queensland Treasury Corporation* [1994] 2 Qd R 538 Ambrose J.

> In my view no competent experienced valuer would have any difficulty in distinguishing between a 'rental' and a 'rental value'.
> A 'rental' is simply the money paid as rent for the defined period under a lease. A 'rental value' on the other hand in my view is the sum arrived at after making proper allowance for all collateral advantages and disadvantages ascertained upon proper examination of all the arrangements made between the Lessor and Lessee including the various rights and obligations under the terms of the lease which reflects the net consideration passing to the Lessor from the Lessee under the lease and associated collateral arrangements.

The Retail Shop Leases Act 1994 in Queensland is a trap for many players. The market rent under the act is defined exactly with the same wording as used by Ambrose J. The rental is effective.

I was involved in a rental of a 5 year lease that had a review to market after 2 years. The Landlord had provided a 2 year rent free and never achieved the rental under the lease. The rental for the remaining 3 years was an effective rental and dropped about 40%. I am not sure if there was any intended deception in the drafting of the lease. I believe the parties did not understand the rent concept. I did act for the tenant at the review.

Valuation of Investment Properties is based on income stream and where positive or negative reversions are likely it is the reversion rental that is critical in the perpetual calculation. The passing rental is only relevant for a specified period up to reversion.

Rating & Taxation

Each State has its own rating and taxation legislation. In Queensland we have the Land Valuation Act 2010. About 50% of our business is in this area of expertise. It is a Specialist Area.

Intimate knowledge of the legislation is needed. It is also necessary to understand the method of valuation. The Valuer Generals need to initially complete assessments using bulk techniques, which there is no need to detail in this paper. Nevertheless, any bulk valuation process of necessity must result in errors. The technique is to identify those properties which fall outside the market, but only where it is assessed too high.

The valuers who specialise in this area need negotiation skills to resolve the matter without the need to attend formal court hearings. Once in court the costs mount and the exercise can result in a win in court but an overall loss.

Conclusion

Valuations are an informative document that assists the reader to gain a good understanding of a particular property in order to make a decision about the property. There is a wide range of uses to which the advice can be put and the report must be customised. Reports prepared for one purpose should not be used for any other purpose. To do so is to risk making a decision without specific facts that ought to be taken into consideration.

Valuers need knowledge of a wide range of legislation and precedent. As a result, valuers tend to specialise in different fields although most concentrate on mortgage.

Finally, when instructing a valuer to think about the use to which the consultancy is to be put. Do not necessarily ask for a valuation but discuss with the valuer the appropriate advice in the circumstances.

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