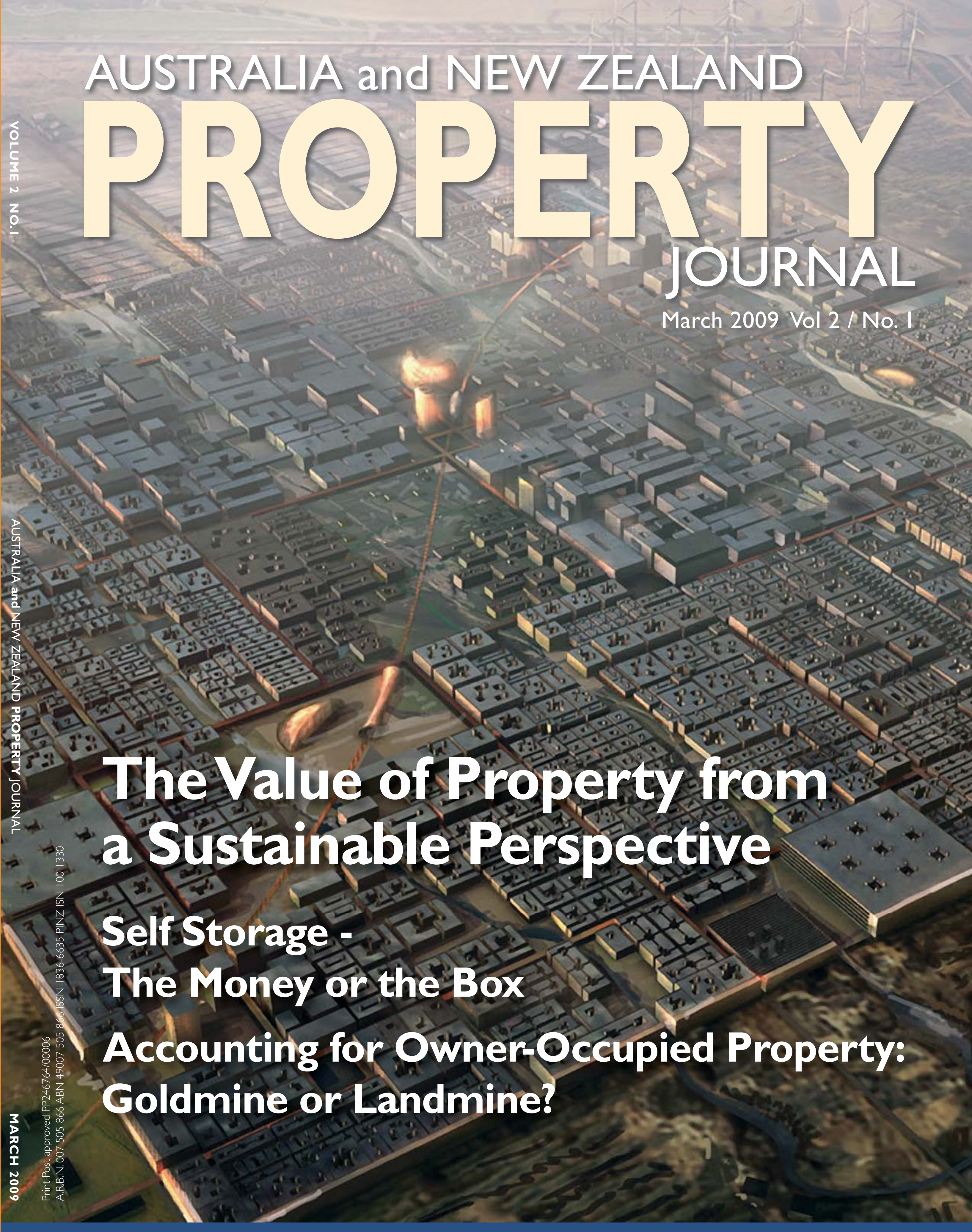

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The Value of Property from a Sustainable Perspective

Self Storage - The Money or the Box

Accounting for Owner-Occupied Property: Goldmine or Landmine?

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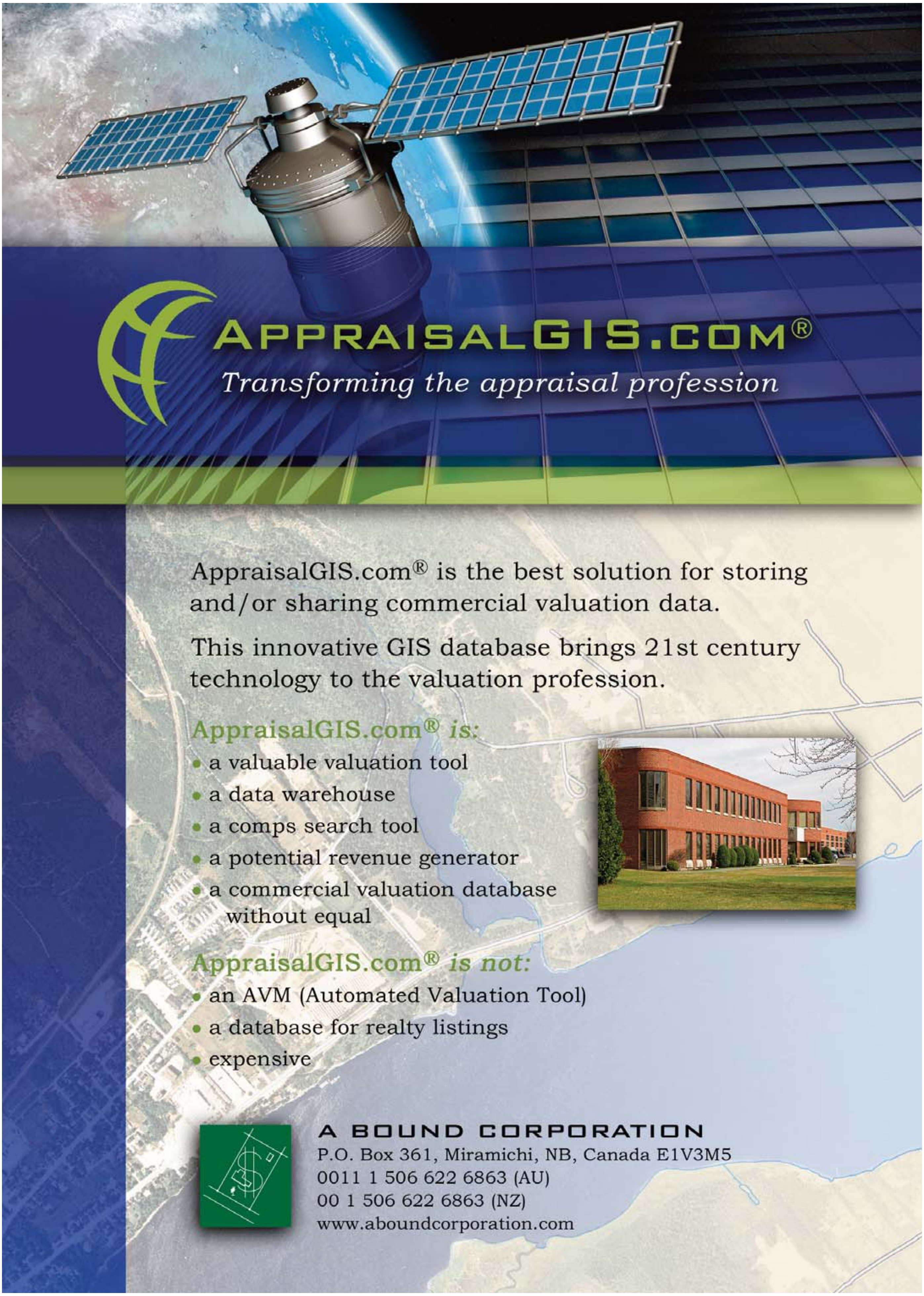
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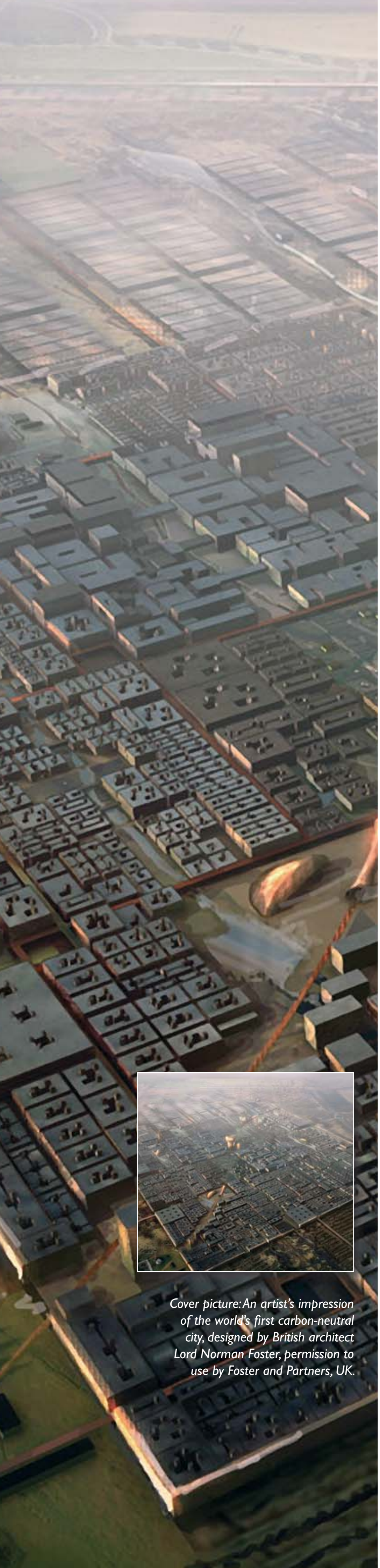

Cover picture: An artist's impression of the world's first carbon-neutral city, designed by British architect Lord Norman Foster, permission to use by Foster and Partners, UK.

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API NATIONAL PRESIDENT'S REPORT

James Pledge

API National President

Australia currently seems besieged with natural disasters. The devastating fires in Victoria and the floods in northern New South Wales and Queensland, the personal loss and tragedy is unfathomable.

The scale of the destruction and loss of life in Victoria has brought the Institute together in providing assistance to those affected. In this regard the Institute has contributed $30,000 to the Red Cross Bushfire appeal through National and Divisional donations. In addition, the Victorian Division is participating in the Built Environment Bushfire Support Roundtable, which aims to provide assistance through members volunteering their professional time to those directly affected by the bush fires. In these times of economic crisis I thank all members who provide assistance to those affected during this time of need.

Members will start to see the Certified Practising Valuer (CPV) marketing campaign in April. The approach will inform the wider industry of the benefits when engaging a Certified Practising Valuer and offer a facility that supports Certified Practicing Valuers with a member website, locator and newsletter. There will also be a marketing kit available for CPVs supported with merchandise and point of sale material.

As the Institute enters a critical phase in the organisation's growth, I am pleased to announce that API will be conducting a National Research Study in the next few months. The research will be state specific and will provide insights to the benefits members can obtain from a wider access to Institute services. It's about meeting the expectations of members and setting a benchmark for API to monitor performance as the Institute builds a national structure on new cutting edge systems that will drive efficiencies on a national scale never before seen. In addition, the research will assist the Institute and the API Divisions to ensure it remains the premier property professional organisation into the future. All members will have the opportunity to contribute. We want to know what your expectations are and how best we can deliver the services you need.

The research is timely as the Institute is in the process of engaging an Integrated Business Management System that incorporates contact management, content management, front-end solutions (website portal), interactive content, increased member services, additional support to service delivery and material to assist members in their professional work. The fully functional and interactive system will provide a national platform that will reduce administrative costs and enable the Institute to provide a greater range of services to all members – including those in rural and remote locations.

To help members with the costs of Professional Indemnity, the Institute has commenced work on the establishment of a Capped Liability Scheme for members undertaking valuations. The scheme will be piloted in NSW in late 2009 and then rolled out across other States and Territories. The Professional Indemnity Sub-Committee is working with the Professional Standards Council to establish the scheme.

The Future Property Professionals (FPP) program will be implemented in January 2010. Extensive development is being carried out this year and a number of modules will be piloted in Adelaide later in 2009. The FPP program is designed to assist recent graduates and applicants for membership, attain the requisite professional training to make them more effective property professionals. Completion of the FPP will be compulsory for all members and applicants seeking Provisional Membership (with RPV) and Associate Membership (with or without CPV). "Face-to face" modules are being designed and, to assist transition to the Institute's new website portal, modules will also be available on-line as part of the Institute's new Integrated Business Management System.

The third edition of the Institute's Risk Management Module (RMM) will be launched in May 2009 with new and updated information on issues that have impacted the profession over the last 3 years. In association with Phillips Fox, the module presentations will include issues arising from Client Selection, Internal Communications, Site Meetings, Investigations, Analysis and Reporting, Management and Insurance.

The Risk Management Module is compulsory for those members undertaking valuations and new members who undertakes valuations must complete the RMM within their first 12 months.

The Institute is reviewing the PropertyPro software making the application compliant with the Lending Industry XML Initiative (LIXI) which has established an e-Commerce standard to remove barriers to electronic data exchange within the Australian lending industry. The review of Property Pro incorporates new features to assist valuers. The new system focuses on broader applications, reductions in member business costs and will be compatible with all software and hardware configurations.

My term as National President will expire in May 2009, so this is my last report to members. Since my appointment last year, my fellow Councillors, the state Divisions and the multitude of members have worked tirelessly to progress "change" for the Institute. The National Office, under the leadership of the National Director, Grant Warner, needs special recognition. Grant has brought together a small team of highly skilled professionals and practitioners who are behind many new and innovative concepts for the Institute and it has been a privilege to have worked alongside the National Office to bring many of these concepts to fruition.

James Pledge
President
Australian Property Institute

PINZ PRESIDENT'S REPORT

Chris Stanley

PINZ President

The start of 2009 has seen a continuation of the volatility in New Zealand and worldwide financial markets. The central banks of the major economies have moved to increase liquidity and governments have announced major initiatives to stimulate the internal economy. Many of these impact on the property sector.

In New Zealand the government has made a number of moves to insure liquidity in the finance sector and announced that a number of infrastructural projects which will be fast tracked.

Notwithstanding all these measures both locally and internationally, finance markets are still very unstable with significant changes on a daily basis in exchange rates and equity markets. We have seen major fluctuations in our export commodity prices on the world market. New Zealand is in a recession with the likelihood of limited real growth in the short term. Unemployment is rising, receiverships and liquidations have increased dramatically as have the number of mortgagee sales.

The property market is not immune to the changes in the New Zealand and world economies. We have seen falling residential property values throughout the country, an increase in the yields required for investment property and a reduction in sales volumes in the rural sector.

This is a rather depressing situation for the New Zealand economy, however a number of positive changes have occurred as a result of the government initiatives.

Home owners coming off fixed rate mortgages will happily accept the flow on from the reduction in the OCR resulting in a substantial reduction in mortgage interest rates with fixed rates available below 6.0%.

Home affordability has improved. The first round of tax cuts took effect late in 2008 and the second round will soon follow. The reduction in mortgage servicing costs and the two tax cuts should flow through to the business community and hopefully reduce redundancies.

Commercial debt funding costs are far lower than twelve months ago giving owners of investment property the opportunity to be in a positive cashflow situation. At prudent debt/equity levels investors can achieve excellent returns on their equity.

Our listed property companies and trusts are showing very good dividend yields and a number of market commentators are recommending investment in these vehicles as deposit rates fall.

As with finance markets the Property Institute has undergone a major structural change. At the Special General Meeting in Wellington in December 2008, members voted overwhelmingly to move to Professional Communities. The new Rules to implement and facilitate Professional Communities were passed and new structure came into effect from 1 January 2009.

This is a very positive outcome for the Institute giving us the opportunity to expand the base of professionals within the Institute. It also gives us greater flexibility to provide targeted services and education to meet the ongoing needs of our diverse membership.

Over the next three months the Institute will be focusing on the bylaws as well as the operational issues that will be faced by each professional community. The composition of the national committees will be reviewed to ensure full representation by the professional communities and better delivery of services.

For many of our members it will be "business as usual" however this restructure gives members the opportunity to play an increased role in the Property Institute to ensure we remain relevant in a changing business environment.

We have a very busy education programme developed for 2009 with a major focus on the AGM and conference in Auckland in June. We will also be continuing our popular audio conferences as well as further development of targeted education modules for our online education programme.

One of the highlights for the Institute was the naming of Graeme Horsley as a Member of the New Zealand Order of Merit in the New Years Honours list.

Graeme has made a major contribution to the property profession over many years. He is highly regarded, not only within the property industry but also in the wider business community. His skills are recognised internationally.

This is a great honour for Graeme and we all congratulate him on this award.

During 2009 your PINZ Board will continue to increase the level of services we provide to you, to assist you in these demanding economic times. It is our aim to provide you with a wide range of "tools" to assist you in your professional life.

I believe our greatest challenge is be, and to remain to be, relevant to our clients. We need to be proactive rather than reactive. We must aim to provide property solutions for our clients and be seen to be adding value rather being a compliance cost. The Institute, with your input, can assist you and your clients to achieve this goal.

I wish you well for 2009 and look forward to both strengthening and increasing the services that Property Institute can offer you.

Chris Stanley
President
Property Institute of New Zealand

Thinking about the Value of Property from a Sustainable Perspective

Dr Lynne Armitage

Dip Surv, PG Dip Urban Studies, M Environmental Planning, PhD, FAPI (CPV) FRICS Reg Valuer NSW and Queensland CEnv

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Valuers have long been sensitive to changes within the markets they are working within and from time to time fundamental shifts occur which affect the entire market to some degree. Most recently the global financial crisis comes to mind but possibly of greater long-term impact is the awareness of climate change resulting from rapidly increasing levels of carbon dioxide in the atmosphere. This paper identifies, by reference to a range of published sources, the context and some of the terms associated with sustainability issues in the property sphere and considers some approaches which valuers may wish to reflect upon in order to better equip themselves to working within a carbon-sensitive market. More specifically it considers what is meant by sustainability, what is being done by others and what valuers can do in response.

Introduction

In February 2009, the Commonwealth Bank of Australia headlined some of the characteristics of the current global financial crisis which is recognised as being the worst since the Great Depression of the 1930s:

- No signs yet that the world economy has begun to thaw;
- Central banks continue to apply stimulus, with the BoE & RBA cutting rates;
- Data out next week will only highlight the necessity of both monetary and fiscal stimulus.

(Commonwealth Bank 2009)

From a valuation perspective, the particular set of skills of valuers to deal with the relatively unfamiliar environment of managing negative economic growth – which for some have lain dormant since previous financial downturns and for others are only now being developed – will be challenged as the market seeks to adjust to an inexorable decline in activity and consequential contractions in value. Whilst this crisis will affect the economic health of the vast majority of the Australian population, another, less visible but equally challenging, set of long-term indicators cannot be sidelined: those relating to global environmental health. It is perhaps sobering to recall the words of the economist Herman Daly (1991) that "*the economy is wholly-owned subsidiary of the environment*".

In 1997, a survey (Armitage 2001) of 1800 valuer members of the Australian Property Institute – then AIVLE – asked respondents to rank the relative importance of some 80 nominated characteristic factors of the property market which they considered "very important" when valuing investment grade property. Unsurprisingly, the top five factors were:

1. Comparable transactions	75%
2. Lease terms and conditions	71%
3. Location	69%
4. Tenure	59%
5. Contamination	54%

Only when the added response of "important" was added did any reference to environmental consideration receive mention: then it appeared at number 35 – ranked equally with "point in the business cycle" by more than 55% of respondents. The purpose of this observation is not to suggest valuers did not give sufficient consideration to environmental aspects but to highlight the way we as a community have more recently shifted our view of our relationship with the environment. Since it falls to valuers to take responsibility for interpreting such sentiments by converting them to dollar values, it may require valuers to adapt and extend existing skill sets to reflect such new environmental considerations as they affect property value.

In every sense, sustainability is an idea whose time has come. What we are now witnessing globally is the adoption and internalisation process which Senge (1994) characterises as being the phase where we move from a shared vision which is powered by common caring to a sense of ownership which in turn calls forth an active response and commitment or, more simply, perhaps by a recognition of self interest and a diminishing range of alternative options.

Whilst an undercurrent of concern for our treatment of the environment has been compounding for a generation, though often politically marginalised, most recently our quantitative appetite has been fed by the release of the *Garnaut Review in Australia* (2007) and by the *Stern Review* (2006) in the UK on the economics of climate change. Stern unequivocally states:

- the scientific evidence is now overwhelming: climate change presents very serious global risks, and demands an urgent global response; and
- there is still time to avoid the worst impacts of climate change if strong collective action starts now.

Stern 2006

The fundamental concept we, as a profession, are addressing is one we know to be at the core of our professional motivation: that of managing our relationship with our environment, more specifically in the context of economic use and exchange, tempered by concepts of corporate social responsibility and triple bottom line. But there is a long way to go before we can operationalise this aspiration beyond the limits of our familiar comfort zone.

For the valuation profession to reconceptualise its view of property to incorporate considerations of sustainable practices within the property market, it is necessary to investigate the way we currently view such activity and consciously recognise the impacts of such initiatives on property value. To develop our understanding of the relationship, this paper considers the context of sustainable practice and theory in the area of the built environment in Australia, and discusses a number of mainly recent and predominantly international studies from governments, professional property organisations, academia and professional firms which have been investigated and reviewed.

These findings are structured under three principal sections:

1. What is sustainability?
2. Where are we now? What is being done by others?
3. What do we need to do now?

1. What is sustainability?

In 1987, the Brundtland report (*Our Common Future* – UNEP World Commission on Environment and Development 1987) was released by the United Nations. It is considered a seminal work highlighting the environmental problems facing the planet and stressing a growing awareness of the need for global environmental action formulated through realistic proposals of environmentally sustainable development (ESD). Tangible outcomes, consequential upon the report, include such subsequent international agreements as the Montreal and Kyoto Protocols and Agenda 21 – which further enshrined ESD as an operational framework for policy and practice in the business and broader community.

It recognised the synergies between economic, social and environmental issues and argued that, for the benefit of human well-being, there was a need for the integration of these elements into policies which promoted sustainable development. The Commission defined sustainable development as: "*development that meets the needs of the present generation without compromising the ability of future generations to meet their own needs.*" (Brundtland 1987)

It identified the requirements for sustainable development under seven themes:

- A political system that secures effective citizen participation in decision making.
- An economic system that is able to generate surpluses and technical knowledge on a self-reliant and sustained basis.
- A social system that provides for solutions for the tensions arising from disharmonious development.
- A productive system that preserves the ecological base for development.
- A technological system that can search continuously for new solutions.
- An international system that fosters sustainable patterns of trade and finance.
- An administrative system that is flexible and has the capacity for self-correction.

(Brundtland 1987)

As discussed in a draft review of the Brundtland report, progress in the area of economic development (UNEP 2007), over the past 20 years has been variable. There have been many international agreements signed since the Rio Convention on Biological Diversity in 1992 and the Kyoto Protocol on Climate Change in 1997 and the September 2007 Sydney APEC "Affirmation" was the Australian precursor to the current Rudd Government's more proactive approach. Many now represent a much broader range of stakeholders involved in international decision-making and, as a consequence, positive social change is occurring in many parts of the world such as, for example, enrolments in education having risen internationally. Yet resource consumption continues to increase, *climate change presents very serious global risks, and demands an urgent global response*

inequality continues unabated and the sustainable development agenda still lacks clear objectives or effective champions.

Economic perspective

Focusing on the first three themes identified above by Brundtland – political, economic and social – and concentrating on the realms of property and the built environment, there is a growing recognition and acceptance that the capitalist economic focus on the resource factors of capital, labour and land as represented by studies of traditional economics, and also of labour and welfare economics, needs to be more equally complemented by that of environmental economics as Pearce and Turner (1970) discussed. Considering the environment as an economic good, protecting it from unpaid use is problematic as, in large part, the environment is a shared resource and this "non-excludability" makes its use and regulation difficult to identify, monitor and regulate. Concurrently owners/guardians of such shared resources have little benefit from seeking to provide the stewardship to counteract the depletion and degradation of the resource. In contrast to corporate production, the scale and indivisibility of environmental resources generates resource use and management issues with which we are now being confronted where the closure of the unprofitable activity – on a global scale, as opposed to at the level of the firm – is an option we as a species are keen to avoid.

... the sustainable development agenda still lacks clear objectives or effective champions.

The public management of environmental resources has the virtue of a longer term perspective which values the need for the stock of resources to be conserved in quantities sufficient for future generations and a range of pricing techniques exist (See Appendix 1) by which the value of natural resources can be assessed, with taxation being one of these means of shifting the burden of the negative environmental effects (Pigovian taxes) and which may also achieve a shift in resource allocation, thereby reducing demand.

Political and social perspectives

From the political and social perspective, there is an emerging recognition that markets will not function well without clear and protected property rights. Such property rights need to be secure, indefinite, enforceable and legally transferable (Panayotou 1992) and acknowledge the status of the present and future generations. The usual contemporary approach is the intra-generational view, as recognised for example in the provisions of the Kyoto protocol, which distributes property rights enshrining the principle of occupation. In the context of emissions this favours rich nations as eco-taxes accrue eventually to the owners of emission rights (the polluting nations) themselves. A different approach, which would more likely favour the poor, would be to allocate an equal share of permits to everyone regardless of their level of emissions. (Keyzer and van Veen 1997)
In the case of climate where no state or individual has yet seized sovereign rights over the regulation of ecosystem services this might be possible. The relatively low spending on energy intensive goods by

the poorer countries would strengthen the link between environmental policy and poverty alleviation.

However, as Pezzey (1992) recognises, the needs and rights of future generations deserve to be treated equally with those of the living generation – a feature which many traditional societies can be considered to value more highly than many more economically dynamic societies. A system which recognises only the rights of the current generation is unlikely to consider the impact of the persistence of its own environmental degradation. Gerlagh and Keyzer (2001) assert that to alleviate this problem a trust fund could be established entitling all members of present and future generations to an equal monetary claim over the use of natural resources. Such a trust fund would act as a transfer mechanism to redistribute income across the generations, arguably as did feudalism in some societies, but with questionable community benefit.

This redistribution is an example of the principle that it is the polluter who should pay for the negative impact by internalising its cost as part of its production cost. Thus a generation which uses more resources than it is entitled to will compensate future generations for the degraded environment. Such a trust fund approach can only succeed if the current generation recognises and accepts responsibility for its activities and the compromises this entails. It must be recognised that it is political will which has the power to operationalise such a response rather than technical feasibility and the introduction of carbon trading and the associated management of carbon emissions are steps to internalise such resource misallocation.

2. Where are we now? What is being done by others?

From the property perspective, there is a strong recognition and acceptance of a shift towards intervention to promote the culture of sustainability from property investors, occupiers, developers and the professions but it is the practical aspects of these issues which will need to be understood before they are able to effect real change.

Whilst the terms sustainability, sustainable development (SD) and corporate social responsibility (CSR) are widely used there is, not surprisingly, some confusion for the majority of people who are not experts in these areas and the Brundtland review's widely recognised definition of sustainability has been presented already. Property professionals are well used to accepting the genuine boundaries of their professional roles and responsibilities and professional indemnity ensures this focus is not blurred. In Australia, there has been increasing public awareness of broad environmental issues after a very slow start, compared for example to the lead from the European Community and the United States. In September 2007, the APEC summit provided a pre-election focus, in the media if not in the broader community, as an international driver for government and industry to address issues associated with climate change but this emphasis needs to be expanded to the triple bottom line perspective of balancing environmental and social issues with economic ones. The election in November 2007 of a new federal government is providing the framework for more sensitive environmental policies to be developed across the country with legislation for the management of carbon emissions management and an associated trading scheme scheduled to be introduced in federal Parliament in mid- to late-2009.

Sustainable development and the cycle of property

Sustainable development can be thought of as:

> *"a process for growth that understands, invests in and maintains not just financial resources, but human, social and environmental resources, all at the same time."*
>
> *(Heywood et al 2007)*

To achieve this, the damaging consequences of merely trading one aspect off against the other must be avoided and the need for compromise must be recognised – which only a cultural shift in people's perceptions of what is acceptable can resolve. At the level of the individual as well as that of the community or nation, it is necessary to deliberately seek to balance economic, environmental and social benefits and costs when faced with options.

Triple bottom line is often represented using either of two commonly accepted models (O'Riordon et al 2001): the three pillars model or the Russian doll model as illustrated in Figure 1. The three pillars model views sustainability as the merging of social wellbeing, economic enterprise and environmental integrity whereas the Russian doll model places economic capital at the core as the basis of wealth creation which drives the engine of development and both are constrained by environmental and social considerations. In each case, these three dimensions are often expanded to include a fourth – government and other institutional frameworks – which are required to make sustainability work.

In March 2005, a sustainable development strategy paper (United Kingdom 2005) was presented to Parliament as a framework for a long-term agenda. It enshrined four priorities:

- A "one planet economy": sustainable consumption and production.
- Confront the greatest threat: climate change and energy.
- A future without regrets: protecting our natural resources and enhancing the environment.
- Span from local to global: creating sustainable communities and a fairer world.

It specified a number of guiding principles with TBL credentials – including living within environmental limits, achieving a sustainable economy, promoting good governance) and, in respect of the government approach to corporate social responsibility, envisaging:

> *"businesses taking account of their economic, social and environmental impacts, and acting to address the key sustainable development challenges based on their core competencies wherever they operate – locally, regionally and internationally."*
>
> *UK Government 2005:56*

Applying these principles to property through adopting the lens of the property lifecycle, some impacts of sustainability were identified (Heywood 2007) for each stage as shown in Appendix 2: Impacts of sustainability on the property lifecycle. Here, a range of property professions were discussed in relation to the way in which their workday practices translate these principles in to their operational reality at the various stages of the property lifecycle with which they have involvement and which is just what many of the present ranking tools also do. For example, under the "property" grouping – which includes inter alia valuation, facilities management, asset management, commercial management – the three main areas of influence were considered to be concept/asset initiation, planning and procurement, and occupation and use including refurbishment.

Turning specifically to the valuation field, valuers are duty bound to comply with *International Valuation Standards* as adopted in Australia by the Australian Property Institute (API) and hence to reflect the market's interpretation of the impact of sustainability on price or value. When a professional opinion is given, it is devoid of any personal prejudice regarding the significance of sustainability, as is the case with any other aspects of the market. However, in order to perceive the emerging reality of the market's awareness of the impact of sustainability on worth, price and value, valuers must upskill and gain understanding of the principles of sustainability.

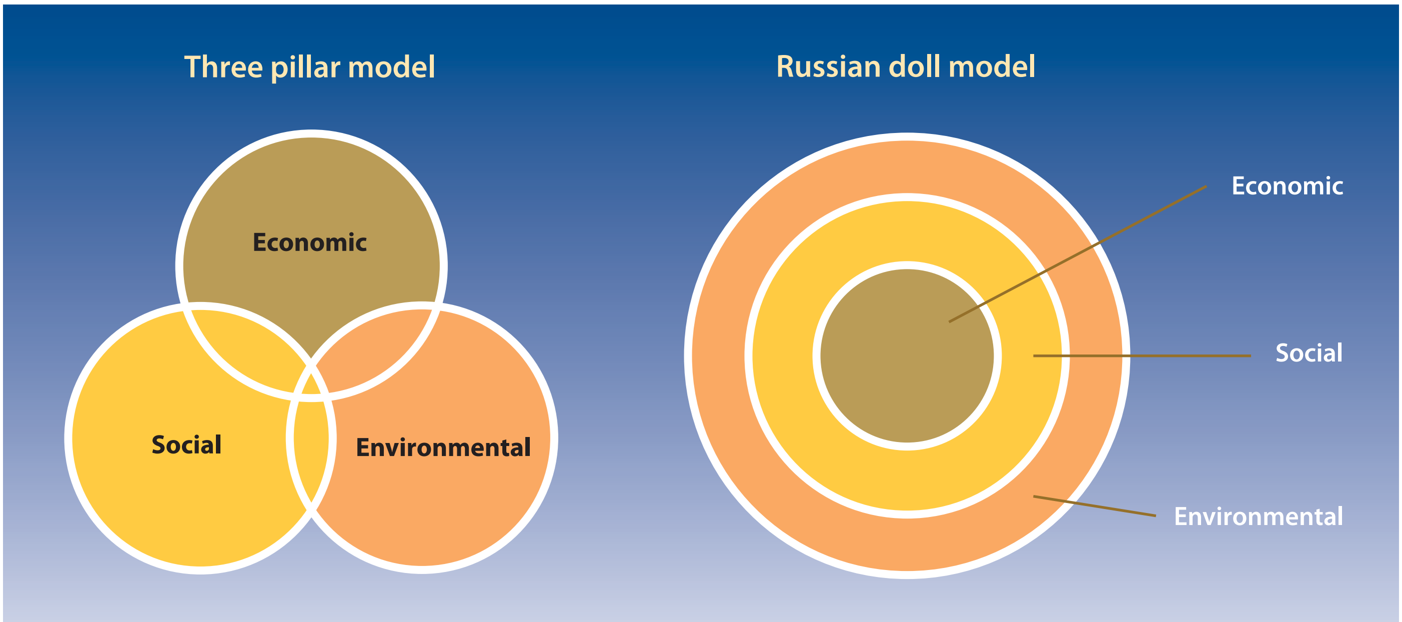

Figure 1 : Representations of triple bottom Line

Source: Heywood et al 2007

Valuers will be required to broaden the range and depth of their existing expertise into some currently unfamiliar and, possibly, uncomfortable territory to interpret the valuation implications of an increasing range of triple bottom line issues and to recognise the synergies and interrelated nature of aspects previously viewed in isolation. For example, this might include the emerging influence of low-carbon buildings which offer reduced operating costs (financial aspect), improved working conditions (social) and valuable carbon credits (environmental) whose traded worth is still in flux. In the context of development and investment strategies, advice which members of the "property group" are likely to be called upon to supply will extend to many of the issues identified in Appendix 3: Widening valuers' TBL horizons.

By 2006, practitioners' perceptions of sustainability had shown some improvement compared with the 1997 survey (Armitage 2001) discussed above. An international online survey of 47,000 property practitioners (Dixon *et al* 2007) addressed many of these concerns in the context of the professions related to property and the built environment and 10% of the sample chose to respond. The survey sought to assess the extent of respondents' use of information relating to sustainable development, to identify and prioritise action to access relevant information regarding this development, and to provide such as an online resource.

Property firms and industry associations are also researching the impact of sustainability on property with "green" being seen as "good for business". (Corps 2005) This Canadian study showed a clear link "between the market value of real estate and its environmental friendliness". It found that greener buildings can:

- Earn higher rents and prices;
- Attract tenants and buyers more quickly;
- Cut tenant turnover;
- Cost less to operate and maintain;
- Benefit occupiers; and
- Improve productivity.

From a European perspective, King Sturge (2007) takes a strong, almost coercive, approach to the need for all participants in the property market to prepare for the coming changes likely to ensue from climate change. It identifies four targets for property investors, developers, financiers, occupiers and policy makers:

- Prepare for climate change and increased weather uncertainty and extremes.
- Expect increased property insurance, litigation, maintenance and energy costs.
- Recognise that legislative change will lead changes in the property market at an increasing pace.
- Accept corporate social responsibility as a reality and conformity is no longer optional e.g. requiring carbon footprinting for buildings as a benchmark.

The King Sturge report provides a comprehensive coverage of relevant European Union directives in areas of energy performance of buildings for both existing and new buildings; waste, electrical and electronic equipment directives; and environmental liability directives and discusses sustainability policies and initiatives for 24 countries across the EU, country by country, and details a comprehensive range of sustainability assessment tools for building sustainability including checklists for the public and private sector, for asset managers, designers and developers: overall a very comprehensive resource, though not unique.

Jones Lang LaSalle (2007), for example, asserts that sustainability is "becoming a mainstream requirement for most property owners and tenants in Australia's CBDs" and discusses current legislative requirements and where this is likely to lead. It considers sustainability as "not yet being a significant factor" in valuation models (Jones Lang LaSalle 2007:2) from the perspective of most owners, investors or valuers but anticipates "it will be reflected in purchase yields, net returns to owners and in property valuation … in the near future." It recognises the leading role of all tiers of government in Australia which specify industry leading accommodation standards, controlled emission standards and other performance requirements often framed within a legislative or preferred supplier context.

It is understood (Armitage, personal communication 2008) that there is currently research being undertaken by the South Australian Government to review the activities of state governments across the country which is likely to confirm the widely held view of the exemplary role government exhibits across a range of sustainability metrics.

Whilst there may be extensive incorporation of triple bottom line assessment in many government and corporate policies, this approach is not yet embedded in the property investment market overall as revealed in a number of surveys of investor attitudes to green buildings over the past decade. (Sayce, Ellison and Parnell 2007:641) The option of measures to promote the adoption of more sustainable practices is mooted through the introduction of fiscal incentives. Currently the business case for investment in sustainable property rests on reducing risk as opposed to enhancing return. The opportunity to reward sustainable practices in property investment and management is an option worthy of further investigation.

Whilst much of the available literature deals with commercial investment property, a major study of industrial property (Jayne, Mackmin and Syms 2007:374) reported recently a survey which highlighted imperfections in the nature of the property market preventing valuers from being able to identify how factors, such as compliance with controls over environmental contamination, affect or do not affect market value. Value theory (Turvey 1957, cited in Jayne et al) suggests "rental value can be ascertained residually" and that whilst legislative compliance has the potential to increase costs of occupying industrial property, the ability to pass on or absorb this impact will tend to vary with the strength of the individual property or the state of the market. One of the paper's conclusions was to confirm the widely held view that "improved management practices would suggest that better environmental management may result in better rents and values" (Joyce et al 2007:376), an opinion reasserted at the API's Queensland Property Conference in November 2008 (Goddard 2008) who stated property managers' oversight of energy use in a building would both reduce energy use/outgoings and ensure compliance with green credentials to promote value enhancement.

Similar sentiments were expressed by Borger (2007), Director of Leighton Properties Australia, speaking at an API professional development seminar event discussing the impact of developing A-grade office towers with a green-star rating of five in respect of the liability for outgoings. He commented that there appears to be a growing practice of leases to be structured gross of outgoings to ensure the benefit of the efficiencies in outgoings reverts to the building owner/investor and as such contributes to the reduction in outgoings overall. Possibly this is reflected by the market in a strengthening of the capitalisation rate.

... better environmental management may result in better rents and values.

3. What do we need to do now?

It is simple and self evident – in theory: All we need to do is shift our mental models and move to a shared vision. This is easier said than done but recognition is one of the first steps along this path. Senge (1994) recognises the need for a cultural shift: "shared vision is – must be – **compelling**, or it's not likely to be either **shared** or possess any of the other characteristics needed."

Senge propounds that shared visions:

- Change people's relationship with the enterprise – it's no longer "theirs", but ours. This allows those people who previously had mistrust to begin to work together.
- Create a commonplace image, identity, purpose and set of operating values.
- Compel courage – and new ways of thinking and acting. Establish overarching goals. Foster risk-taking and experimentation.
- Foster long-term commitment.

Senge 1994

These factors may speak to the great power of an idea whose time has come. But Maslow once observed that shared purpose and vision were the most striking common characteristics of high performing teams. In the absence of a great dream, pettiness prevails and a shared vision is not just "an idea", but "a force in people's hearts". (Senge 1994)

Looking forward in the international property arena, an "agreement to address the interrelationship of sustainability and value" was launched and its intent captured in a memorandum entitled the *Vancouver Valuation Accord* (2007). This Canadian initiative brought together valuation, appraisal and related industry leaders in property as signatories to a formal expression and commitment to advance understanding, knowledge, education and practices about valuation and sustainability. Recognising the increasing need and demand for the business case for sustainability to be established where valuation plays a crucial role and embracing the initiative that valuers no longer wish to ignore sustainability, the accord is a commitment to:

- Reviewing how sustainability relates to the practice and standards of valuation.
- Working with stakeholders to promote awareness of and competency in the appropriate methods of addressing sustainability in valuations and worth appraisals.
- Working with those within and outside the valuation professions worldwide, to educate and inform about sustainability and its relationship to value and worth.
- Regular reporting of the collaborative progress via an agreed secretariat set up for that purpose, and targeting a full report on progress at the GLOBE 2010 Conference in Vancouver, Canada.

Source: Vancouver Valuation Accord 2007

In Australia, we are not quite so advanced along the sustainability highway, perhaps waiting to review the impact of international initiatives before committing to action. We are not short of experts, nor are we short of ideas, but we do need leadership. Government at the federal and state levels and educational institutions are all well placed to seize this opportunity to take the thought leadership to promote such positive outcomes. The Australian Federal Government released its major policy initiative – the *Garnaut Report* – in September 2008 and substantial economic impacts are likely as a consequence of carbon market trading which is expected to follow over the next few years. Whilst the impact of these innovations cannot yet be foreseen in detail, they are certain to require new models of thinking to be successful in effecting change and will be recognised in the market by price adjustment. Appendix 3 "Widening valuers' triple bottom line horizons" provides some areas which may represent the broader view needed to develop a greater awareness of the incidence of sustainable practices.

Professional bodies can support increased professional awareness and targeted professional development; governments are in the process (however long it may take) of legislating for changing practices via performance standard upgrades etc.; universities are replete with degrees offering a full range of "green" credentials through virtually every faculty; industry associations can promote a green agenda through lobbying and each individual can become more knowledgeable of sustainability issues and commit to acting in their own and in the community's best triple bottom line interest and do it, sooner – not later.

Conclusion

For valuers, the response to upskilling for effective practice in the greener environment will draw upon the full range of highly developed existing skills, attitudes and knowledge and, with a measured response, incorporate the incidence of change as they have previously when the then novel considerations of contamination, heritage or even – albeit a very long time ago – of planning control added to the range of essential characteristics of the market to be collected, synthesised and reviewed as a part of normal property market analysis which is distilled into the single dollar figure reported and defended as their opinion of value. Unlike some critics – e.g. Goddard 2008a who states in a generally supportive article that 'one part of the industry which has been slow to adopt the change they need to make are valuers'– I have every confidence that the profession is no laggard and that the prospect and incidence of climate change, increasing extreme weather events and rising sea levels and the like will be met with the same gravitas as are changes to other, possibly more familiar, market variables. Such is the hallmark of the profession where every valuation reflects upon the factors affecting value of that particular legal interest at the particular time the value is being assessed. Since I would assert that the valuation process is sound, the incorporation of new content based on a market which values sustainable practices more highly is but a matter of continuing professional development.

References – *A full list of references is available from the Editor on request.*

Appendix 1:

Approaches to the valuation of natural resources

1. Use value:

In circumstances where the end use of the natural resource is clear, as in the case of drinking water, timber or tourism generated by a forest, and each has a functioning market, the valuation of the resource can be imputed from the prevailing market prices of these uses. This includes both the production function approach and the defensive expenditure approach as detailed below.

- The **production function method** identifies the marginal contribution of the natural resource to the production of the commodity being marketed. For example: the benefit of water to crop production (Freeman 2003, Archaya and Barbier 2002).
- The **defensive expenditure method** assigns a price to a natural resource which is equivalent to the cost of maintaining its productivity by fixing the damage from the emission of pollutants and resource degradation (Tiezzi 2002).

2. Surrogate markets:

Where there is no functioning market for the end-use, a surrogate market may be generated.

- **Hedonic pricing** is the **method** which values the presence of natural resources by, for example, comparing the prices of houses with otherwise similar characteristics under different environmental conditions (Taylor and Smith 2000) to assess the impact of that change in circumstance.
- The **travel cost method** measures the value of a recreational site by surveying travellers on the economic costs they incur when visiting the site from some distance away (Pendleton and Mendelsohn 2000) though issues of cost versus value may impinge.

3. Stated preferences:

Another approach is to identify stakeholder preferences to elicit additional information with these techniques including the contingent valuation and conjoint stated preference methods.

- The **contingent valuation method** seeks information on willingness to pay from survey questionnaires and interviews (Kolstad 2000, Mitchell and Carson 1989).
- The **conjoint stated preference methods** use experiments which involve contingent, dependent ranking, or contingent choice, among alternatives that provide different levels of non-market goods (Roe and others 1996)

Source: derived from UNEP 2007 GEO-4 Chapter 1 'Environment for Development' Draft 1, September 2007

Appendix 2: Impacts of sustainability on property across its lifecycle

Property stage	Social	Environmental	Economic
Concept/asset initiation	A safe, secure integrated development, rural regeneration, public access	Maintain and enhance natural amenity and biodiversity.	Improved land and asset values, simulate local investment, intrinsic value and non-tangible assets of open space amenity
Planning and procurement	Provision of local labour, development of local skills through training initiatives; quality urban design and public realm; planning sustainable communities; community involvement at the design stage	Minimise energy demand through renewable energy supply; minimise environmental impact; increase use of recycled materials; use ethically sourced products and services; provide for enhanced public transport and "walkability"	Local economic regeneration; responsible and profitable growth; attracting investment and building local capital
Construction	Better design; respect for people; minimisation of disruption, noise, dust, light; considerate contractors scheme	Carbon amelioration; waste minimisation; maximise recycling; develop Construction Environmental Management plans	Use of local suppliers and labour; quality of design and materials as an agency tool or selling feature
Occupation and use (including refurbishment)	A better quality of life; built to last'; clean, working and friendly	Energy efficient operation; effective maintenance; occupier recycling schemes; use of greywater etc.	Use of local suppliers and contractors; increase in occupier productivity through sustainable facilities management/ workplace management
Demolition and remediation	Minimisation of disruption: noise, dust, light; considerate contractors' scheme; improved amenity	Maximise recycling; minimise waste to landfill. Onsite remediation; creative use of demolition waste	Improved spatial use; improved land value and economic uplift from urban uplift; presumption in favour of development on brownfield sites promoting shorter planning period

Derived from: Heywood 2007:8

Appendix 3: Widening valuers' TBL horizons

Derived from Heywood 2007:19

Development or investment issue	Potential focus of advice
• Protection and enhancement of the natural environment	Recognition of local, regional and global benefits of effective environmental management strategies and their potential to impact on the economic performance of a property or portfolio
• Sustainable use of resources	A more broad-ranging understanding of techniques and materials available to improve resource efficiency for constructing, operating and regenerating buildings
• Reduction of waste generation and the responsible disposal of waste	Understanding on-site waste management systems and alternatives as an operational outgoing
• Reduced energy consumption	Assessing the triple bottom line impacts of low energy consumption of building materials, services and fuels; impact of same on total occupancy cost, tenant attraction and retention
• Sustainable land use and transportation planning and management	Reflect the benefits and costs of location and accessibility regarding its proximity to cycle paths, walking tracks and public transport for occupiers, visitors and service providers
• Sustainable design practices and whole life costing	Recognise and measure the long term benefits of sustainable design on building operation and occupier satisfaction
• Community development and social inclusion	The "contextual fit" of a property in its local and broader community will need to be recognised as an emerging market factor

Appendix 4: Garnaut Review Terms of Reference 2007

To report to the Governments of the eight States and Territories of Australia, and if invited to do so, to the Prime Minister of Australia, on:

1. The likely effect of human induced climate change on Australia's economy, environment, and water resources in the absence of effective national and international efforts to substantially cut greenhouse gas emissions;

2. The possible ameliorating effects of international policy reform on climate change, and the costs and benefits of various international and Australian policy interventions on Australian economic activity;

3. The role that Australia can play in the development and implementation of effective international policies on climate change; and

4. In the light of 1 to 3, recommend medium to long-term policy options for Australia, and the time path for their implementation which, taking the costs and benefits of domestic and international policies on climate change into account, will produce the best possible outcomes for Australia.

In making these recommendations, the Review will consider policies that: mitigate climate change, reduce the costs of adjustment to climate change (including through the acceleration of technological change in supply and use of energy), and reduce any adverse effects of climate change and mitigating policy responses on Australian incomes.

This Review should take into account the following core factors:

- The regional, sectoral and distributional implications of climate change and policies to mitigate climate change;

- The economic and strategic opportunities for Australia from playing a leading role in our region's shift to a more carbon-efficient economy, including the potential for Australia to become a regional hub for the technologies and industries associated with global movement to low carbon emissions; and

- The costs and benefits of Australia taking significant action to mitigate climate change ahead of competitor nations; and

- The weight of scientific opinion that developed countries need to reduce their greenhouse gas emissions by 60 per cent by 2050 against 2000 emission levels, if global greenhouse gas concentrations in the atmosphere are to be stabilised to between 450 and 550 ppm by mid century.

Consult with key stakeholders to understand views and inform analysis. A draft Report is to be distributed for comment by June 30 2008. The final Report is to be completed and published by September 30 2008. Interim draft reports on particular issues may be released before that time for public discussion. The Report will embody the independent judgments of its author. ■

Valuing Small to Medium Enterprises (SMEs) in Australia

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Valuing Small to Medium Enterprises (SMEs) in Australia

Given the current economic climate, reliance on sound advice is even more critical for business owners and operators. This is a student paper which examines the role of the valuer in undertaking business valuations including a review of the methodologies adopted, inspection and research procedures and reporting requirements. The author prepared the paper as part of the final stage of a master's degree being undertaken at Bond University. It puts forward an interesting perspective on determining appropriate capitalisation rates. Please note that as a student paper the views remain that of the author only.

Brett McAuliffe

Adjunct Professor of Urban Development, Bond University, Gold Coast

Many business valuations are undertaken by accountants acting for a business and also by business brokers. Arguably, the best person for this job however, is a specialist business valuer, as professionally trained valuers possess a skill-set ideally suited to the task.

Business valuers commonly employ three approaches to determining value, and if possible, reconcile the indications derived from two or more of these approaches and associated methods. The three main methods are a Market Approach, Asset-based Approach *and* Income Approach.

So long as a few basic rules are followed, the research, valuation and reporting of a business is well within the skills of real property valuers, and the onus is on valuers to put up their hand and take on this work.

Introduction

It remains that many business valuations are undertaken by accountants acting for a business and also by business brokers. Arguably, the best person for this job however, is a specialist business valuer, as professionally trained valuers possess a skill-set ideally suited to the task.

In the case of accountants, many practices are becoming more specialised in what they wish to, or can, offer their clients, as an increasing demand for business regulatory and taxation compliance work means that accountants often do not have the capacity, the expertise, or the desire to conduct business valuations.

Valuations provided by business brokers are better described as appraisals, and the vast majority of business brokers base their appraisals on historical financial performance as opposed to the generally accepted valuation principles using Future Maintainable Earnings. Further, if the business brokerage has, or is likely to, list the business for sale, at the point of listing the business broker becomes an agent for the seller and any valuation cannot be therefore deemed to be independent.

Professional advisers such as accountants and solicitors appreciate the distinction between an appraisal and a valuation, and are therefore increasingly suggesting to their clients that the services of a specialist business valuer should be sought to undertake business valuations.

The situations that precipitate the need for a business valuation include:

- Proposed sale of all or part of a business;
- Potential purchase of all or part of a business;
- Partnership disputes;
- Marital break-up and division of assets;
- As part of a due diligence process undertaken by a buyer or buyer's accountant;
- Capital raising;
- Stamp duty assessment;
- GST assessment.

Historically, lenders rarely rely upon a business valuation of a business for mortgage security purposes as they instead assume a charge over the assets held by the business, as well as

the bulk of Australian businesses are unlisted, privately owned, micro or small-to-medium enterprises usually obtaining a personal guarantee from the borrower. However, some financiers will lend money against a going concern and its associated cash flow. Notwithstanding the current turmoil in the financial markets, finance brokers are also increasingly being used by business owners to seek out a better money deal. It remains to be seen if this trend continues, and if it does, whether or not financiers will seek a business valuation to assess the risk profile of the business and borrower. If they do, it could lead to considerably more work for specialist business valuers.

Can valuers of real property also value businesses? The answer is "yes", so long as the real property valuer understands the nuances and methodology in valuing businesses, and is comfortable analysing profit and loss statements and balance sheets. This paper will discuss the constituent parts of a business valuation process.

Valuing Businesses versus Valuing Real Property

When a buyer purchases land or buildings there is both a guarantee of tenure and a physical asset, however when purchasing a business a buyer often may receive no physical assets and the tenure will only be as strong as the current lease, if in fact a lease is being made available.

Even if the purchase does include physical assets (such as plant, machinery, fixtures, fittings and stock) and/or intangible assets (such as patents, logos, brands, contracts, websites and special telephone numbers) the rationale for buying a business is rarely to access assets, but to access its future income.

A business entity is merely a vehicle that can produce future income, and the value of a business entity is directly related to the risk of being able to produce that income on a maintainable basis.

Therefore, in order to establish the value of a business, it is fundamental that a business valuer understands how to accurately quantify future income, or more correctly, Future Maintainable Earnings (FME), and then to quantify the risk to maintaining the FME.

> ***So long as a few basic rules are followed, the research, valuation and reporting of a business is well within the skills of real property valuers...***

This concept is fundamentally different from the valuation of real property where a direct comparison to recent sales or a comparison to income yields are valuation tools that are often used. In fact, the very nature of the competitive (even secretive) business environment means that it is only rarely possible to compare a business to like businesses in a comparable locality, and so business valuers must use other accurate, objective and consistent methodologies.

Valuation Methods

As we all know, market value is defined as the amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction, after proper marketing, wherein they had acted knowledgeably, prudently and without compulsion.

Market value, when valuing businesses, is accepted as being equivalent to "fair value" as ascribed in the Australian Accounting Standards Board Accounting Standard AASB 116.

Underlying the definition "market value" is the presumption that the entity is a going concern without any intention or need to liquidate, to curtail materially the scale of its operations or to undertake a transaction on adverse terms. It is further assumed that the asset is exchanged after an adequate period of marketing to obtain its most advantageous price.

Business valuers commonly employ three approaches to determining value, and if possible, reconcile the indications derived from two or more of these approaches and associated methods.

1. A *Market Approach* to value compares the subject business to similar businesses, business ownership interests, or securities that have been sold in the open market. The comparable businesses are in the same industry as the subject business. Examples include the valuation of service stations, retirement homes, hotels, and clubs, and businesses where shares are traded on an open market.
2. An *Asset-based Approach* to value examines a balance sheet for a business that reports all assets, tangible and intangible, and all liabilities at market value. The asset approach to value is based on the theory that the current value of all assets (tangible and intangible) less the current value of the liabilities should equal the current value of the entity.
3. An *Income Approach* to value calculates the anticipated value of present income or benefits in view of their expected growth and to which a risk rate is applied. Income is therefore converted into an indication of value

either by means of direct capitalisation of a representative income level, or using a discounted cash flow analysis method.

Choosing a Valuation Method

Some businesses have specific valuation methodologies; for example, under the *International Valuation Standards* (IVS) there are Guidance Notes for the valuation of Extractive Industries. This uses the Income Approach method and analyses discounted future cash flows as its basis of valuation.

Businesses that are listed on a stock exchange are valued by the marketplace and their current value is known in real time; that is all risks and opportunities affecting the business have been factored into its share price and therefore a total entity value can be determined by multiplying the share price by the total number of shares issued. This is a form of the *Market Approach* method.

Unlisted businesses such as service stations, retirement homes, hotels, clubs, management rights, restaurants, newsagencies, pharmacies, motels and professional practices are commonly bought and sold and the valuation methodology falls to understanding what the market is currently paying and how that value is derived. This again, is a *Market Approach* method, although in many cases the approach may incorporate income approach methodology as well.

If the business is not profitable, or in some cases is a start-up business, the methodology usually used is an *Asset-based Approach.*

The bulk of Australian businesses however, are unlisted, privately owned, micro or small-to-medium enterprises. If profitable, their value is most often determined by an *Income Approach*.

Valuation Methodologies Examined

Market Approach

A *Market Approach* to value compares the subject business to similar businesses, business ownership interests, or securities that have been sold in the open market. The comparable businesses are in the same industry as the subject business and responsive to the same economic variables. It is appropriate to use the market approach methods when:

- there are an adequate number of comparable companies or market transactions;
- reliable data is available for both the subject business and the comparable companies; and
- the business has an expected steady earnings stream.

Examples include the following indicative market ratios (extracted from my Queensland database of sales over the past three years) and which do change over time due to the forces of supply and demand.

Food &Beverage outlets (cafes, restaurants, etc)	Around 23 x weekly turnover (approx. 44% cap rate)
Newsagencies	Around 3.5 x annual net income (approx. 29% cap rate)
Convenience stores	Around 13 x weekly turnover (approx. 25% cap rate)
Management Rights	Around 8 x annual net income (approx. 12.5% cap rate)

Other businesses with market rates include accounting practices, real estate agencies, rent rolls, medical practices, pharmacies and sometimes couriers and transport businesses.

As can be seen from the above table, the more risky a business sector is considered to be, the higher the effective capitalisation rate. Sales data can be gathered from various sources to determine the capitalisation rate range that business sales might be trading in; however it is a trap to choose a capitalisation rate that is the mid-point of all businesses within the subject industry, even if that industry has a narrow opening range. For example, the "going rate" for newsagencies is in the range "3-4 times net", which equates to a capitalisation rate range of 25-33%. The mid-point in this range is 29%, and indeed the majority of newsagencies probably sell for around 28-29% of FME, but nonetheless there are some that will sell for 25% (or lower) and others that will sell for 33% (or higher), and it requires professional research and an appreciation of the risks that apply to individual businesses to determine the appropriate rate to apply to an individual business otherwise a valuer runs the risk of over-valuing or under-valuing a subject business.

In most businesses, in most industries, it comes down to establishing a capitalisation rate range, researching the risk and applying the knowledge gained from a thorough investigation of the characteristics of a specific business.

Asset-based Approach

An *Asset-based Approach* to value examines a balance sheet for a business that reports all assets, tangible and intangible, and all liabilities at market value or an appropriate carrying amount.

As per *International Accounting Standards* 16, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses, thus business valuers can adopt values for assets as shown on balance sheets (allowing for any deterioration in time or condition).

The asset approach to value is based on the theory that the current value of all assets (tangible and intangible) less the current value of the liabilities should equal the current value of the entity.

These methods are generally not appropriate where assets are employed productively and earning more than the cost of the capital represented by the assets, as the value of the business would be in excess of the calculation of the value of its net assets. Thus, the net asset method is used primarily for businesses that are making a low economic rate of return, or are at the start-up stage of business operation.

Accordingly, the orderly realisation of net assets is not an appropriate valuation basis in the circumstance where the business is a going concern. However, the net assets are often taken as a base figure and as a benchmark for comparison purposes.

The following are situations where it may be appropriate to value a business using this method:

- the company has few intangible assets;
- the company's products or services add little to the value of the company;
- a controlling interest is being valued;
- the company is a start-up business;
- future earnings are unpredictable.

Income Approach

An *Income Approach* to value calculates the anticipated value of present income or benefits in view of their expected growth, the associated risk, and the time value of money. Income is converted into an indication of value either by means of direct capitalisation of a representative income level, or a discounted cash flow analysis; with capitalisation being the most common approach in Australia.

Capitalisation of earnings

This valuation method involves dividing an estimate of the business's annual future maintainable earnings (FME) by a market capitalisation rate. This rate represents the return an investor would expect to earn from investing in the business which is commensurate with the individual risks associated with the business. Similarly, the capitalisation rate can also be viewed as the rate of return achievable from investing in an alternate asset of similar risk profile to the business in question.

The business value so derived is inclusive of all plant, equipment, fixtures and fittings, but exclusive of stock on hand (also known as "stock at valuation" or SAV), and work in progress (WIP).

(In the event of a sale to a third party, a business sale transaction normally provides for the vendor to collect its own debtors and pay off its own creditors. Inventory, or SAV, would normally be an added amount at the date of settlement; calculated on a pre-agreed basis and an offset allowed for any liabilities to be taken over by the purchaser, such as employee entitlements.)

For very small, or micro-businesses, where the proprietor is the principle beneficiary of the benefits (including Net Operating Profit), the FME is equivalent to "PEBITDA + anticipated growth" where PEBITDA = Proprietor's Earnings Before Interest, Tax, Depreciation and Amortisation. Those "earnings" include not only the Net Operating Profit, but other benefits the proprietor might have gained such as the business paying for private, discretionary spending.

In larger businesses, usually managed, FME is equivalent to "EBITDA + anticipated growth" where EBITDA = Earnings Before Interest, Tax, Depreciation and Amortisation.

Capitalisation of FME is valid where:

- there are no unusual transactions in historic earnings (or they have been eliminated);
- the earnings stream is considered to be consistent, that is, at a more or

less constant level of real earnings in perpetuity;

- there are no unusual transactions anticipated in future years;
- expected growth rates are predictable and moderate enough for relationships to hold;
- the business is well established and has undergone all the necessary major capital expenditure (apart from ongoing maintenance); and
- there are no large capital expenditure requirements so that ongoing capital expenditure requirements approximate annual depreciation and amortisation charges.

Financial analysis

Research into, and then adjustment of, historical financial statements to estimate the economic abilities of, and prospects for, a business is necessary to gain an understanding of the future maintainable earnings of a business. FME represents the expected level of profits for a business that is expected to be generated consistently for at least a further two to five years, and theoretically into perpetuity.

Financial analysis of a business requires a valuer to examine all relevant financial information available for the business, and to gain an insight into its current operational performance and its likely future financial performance. A business valuer must therefore be familiar with generally accepted accounting principles and the presentation of financial accounts. A typical financial analysis would involve researching each of the aspects listed below.

- Financial Information: Tax return/s (with Profit & Loss Statement and Balance Sheet), or Accounts for Purpose of Sale, Management accounts, Debtor's report/s, Creditor's report/s, Sales report/s, Payroll report/s.
- Revenue Trends: Up, down or static.
- Revenue Analysis: Income streams and diversity.
- Seasonality Analysis: Does it impact revenue and/or cash flow?
- Gross Profit Calculation: Don't accept the accountant's P&L – check it.
- Gross Profit Analysis: Is it within market parameters. Check against industry benchmarks.
- Stock/WIP Analysis: Age, condition, saleability, stock turn.
- Employee Analysis: Check against industry benchmarks.
- Operating Expenses: Check against industry benchmarks.
- Terms of Trade: Creditors, debtors, bad debts, predominant clients, contracts held.
- Assets Analysis: From P&E schedule, and/or depreciation schedule, balance sheet, general age and condition, what needs to be replaced?
- Marketing Analysis: Check against industry benchmarks. Most SMEs spend 2-5% of revenue in marketing efforts (the older the business then generally the lower the expense).
- Rental Cost Analysis: Security of tenure, lease terms and annual costs. Check against industry benchmarks.
- What is the impact of depreciation?
- Calculate working capital needs.

Whenever possible, a business valuer should conduct both "horizontal analysis" (year to year, across the page) and "vertical analysis" (dissect a year) to gain an understanding of revenue trends, where the revenue comes from and what impacts most upon Gross Profit.

After undertaking a financial analysis, and the inspection of the business, for those familiar with the processes, it is advisable the business valuer conducts both a SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis as well as a PESTLE (Political, Economic, Social, Technological, Legal and Environment) analysis of the subject business.

Once so analysed, a valuer will have as good an understanding of the business as he/she is practicably able to obtain.

Net Operating Profit and FME

There is a direct relationship between Net Operating Profit (NOP) and FME. The NOP shown on profit and loss statements includes expenses such as deprecation, discretionary and extraordinary expenses and therefore adjustments must be made to determine underlying FME.

In order to determine FME, firstly NOP must be adjusted to account for:

- the amount of depreciation charged against earnings (is it reasonable?);
- the amount of discretionary spending on expenses by the proprietor/s;
- the cost of funding capital requirements;
- the amount and extent of any extraordinary income and any extraordinary expenses;
- the amount of capital required to be invested in working capital to fund the growth of the business;
- the amount of capital required to be invested to maintain the level of real productive capacity; and
- growth.

In order to produce a FME projection that is representative of a business's ongoing maintainable earnings capacity, the period of review must be long enough to cover any cyclical fluctuations, however the exercise can be subjective in nature and its preparation requires considerable judgement. Analysis of at least three years of financial statements is good practice.

When determining FME, interest bearing liabilities are not generally included as part of the assets and liabilities being valued because under new ownership the nature of these assets and liabilities may change. It is also customary to add actual remuneration of working owner/s, and then deduct an amount commensurate with the salary of employees fit to assume the role of the owner/s to ensure real market conditions apply. Thus, most discretionary financial decisions made by a proprietor can be normalised out of a profit and loss statement and FME determined.

What to do with depreciation

The capital expenditure (CAPEX) requirements of the business must also be considered. A business valuer needs to understand the minimum level of annual capital expenditure required to maintain the trading performance of the business. In practicality, CAPEX is often considered to be commensurate with the annual depreciation expense. Therefore, when FME is considered, usually one will cancel the other (i.e. depreciation = capital expenditure), and therefore it is not adjusted out of the earnings.

Working capital needs

Business requires working capital to fund the difference between what is paid into the business by debtors and what needs to be paid out to creditors. Growing businesses require even more working capital to meet costs of new staff, new stock etc, so a business valuer must allow for future needs if required, by factoring in costs for extra capital required to underpin growth. Note that the balance sheet can provide some indication as to working capital needs.

Growth

Fundamental to the principle of business valuation is the recognition a business is an entity that can produce future income, and the value of a business entity is directly related to the risk of being able to produce that income on a maintainable basis.

An analysis of financial records will provide an insight in to how past income has been derived, but it is the SWOT and PESTLE analysis that are most useful in assisting a business valuer in assessing likely future income, or FME.

At the end of the day, a business buyer is seeking access to future income and will pay a fair market value to do so, and while historical financial statements are extremely useful in providing an insight to the financial performance of a business, they cannot be relied upon to provide the sole means of assessing growth prospects. There are seven recognised stages in the life-cycle of a business, being:

1. **Seed** – initial ideas, planning and forecasting;
2. **Start-up** – set-up, create market presence, attract customer base;
3. **Growth** – revenues, customers and profits increase annually. Competition becomes stiffer;
4. **Established** – growth slows and business becomes routine with a loyal set of stakeholders;
5. **Expansion** – new period of growth into new markets and new distribution channels;
6. **Decline** – Changes in the economy, society, or market conditions can decrease sales and profits;
7. **Exit** – the opportunity to cash out by selling, or it can mean shutting down the business.

In each of these stages, growth within a business differs. Sometimes growth is high, sometimes it is static and sometimes it can be negative. Careful analysis of a business can indicate to a valuer just where in the business lifecycle a subject business is, and the likely growth the business can expect. Coupled with the evidence of immediate past performance, and forecasts for the future, growth can therefore be quantified, albeit subjectively, and as it remains in most cases an imperfect science it is prudent to be conservative.

There are two major considerations when applying a growth rate to a business. Firstly, to what is the growth rate applied? Revenue? Gross Profit? NOP? Analysis of the financial statements and results of a SWOT and PESTLE analysis will indicate the part of the business to which the growth rate should be applied, and its ultimate effect on FME.

Secondly, is the business in a position to capitalise on growth potential? Analysis of the financial statements, along with a discussion with the proprietor/manager may indicate the business is unable to fund its growth, or an inspection might indicate that the premises from which the business operates cannot handle further growth, so allowances will need to be made to recognise these material constraints.

Business inspection

As with the valuation of real and specialist properties, a business valuer must physically inspect a business before a full valuation report can be issued. From a practicable point of view, the inspection often takes place **after** analysis of financial statements, as the valuer will be able to inspect, prepared with some underlying knowledge of the business. It is good practice to complete an inspection sheet when inspecting the business, to ensure all relevant aspects of the inspection are covered. Present at the inspection, should be the business owner or a knowledgeable manager.

A business inspection sheet would typically include the following headings:

- Name, address and contact details;
- Business description;
- Type of financial information to be/or supplied;
- Intellectual property held;
- When business established;
- Hours of operation;
- Description of location;
- Details of passing traffic (foot and motor vehicle);
- Access to motorways, CBD, suburbs etc;
- Proprietor/s role and hours;
- Proprietor/s wage/salary and other benefits;
- Staffing details/wages/awards;
- Client details (general);
- Supplier details (general);
- Terms of trade with clients (debtors) and suppliers (creditors);
- Licences held and/or required;
- Marketing efforts;
- Plant & equipment description and condition;
- Motor vehicles description and condition;
- Fixtures & fittings description and condition;
- Details of equipment leases held, if any equipment is encumbered;
- Premises – Rent/Value. Areas of showroom, warehouse etc;
- Photos/logos/brochures;
- Owner's opinion of value (and how it was derived);
- Reason for sale.

Inspections sometimes take place after staff have left or before they have arrived at work, and can take several hours. Photographs should also be taken.

Choosing a Capitalisation Rate

The combination of undertaking a financial analysis, SWOT and PESTLE analysis, and a business inspection, provides a valuer with a good understanding of the operating and competitive environments in which the business operates, and thus an understanding of the risks associated with the business. This understanding is used to determine an appropriate Capitalisation Rate or Risk Rate to apply. As mentioned previously, this rate represents the return an investor would expect to earn from investing in the business which is commensurate with the individual risks associated with the business.

> ***... a competitor might be willing to offer more than the market rate if the purchase of the subject business resulted in a significantly strengthened market position...***

Business valuers adopt various methods to assess the risk profile of a business. The author of this report has created a methodology that requires 27 individual aspects of the business to be assessed, and a positive or negative risk rating applied. The ratings allow for '0' for neutral risk, and '1' or '2' for positive risk and '-1' and '-2' for negative risk. The values are totalled, and then applied to a risk rate range that has been derived from an analysis of industry sector sales and experience. A formula is then applied and a final capitalisation rate determined. The formula is:

$r = ((R2-A) + (R1+B))/2$

where

r = capitalisation rate

R1 = the low limit of the risk rate range

R2 = the high limit of the risk rate range

A = the total rating of 'positive' attributes to risk

B = the total rating of 'negative' attributes to risk.

An Excel spreadsheet can be created to allow the risk assessment rating to be quickly performed and a final capitalisation rate determined.

During the risk assessment, analysis of the competitive environment might also support the notion that a competitor might be willing to offer more than the market rate if the purchase of the subject business resulted in a significantly strengthened market position (strategic value), and so investigations must be wide ranging and thorough to allow for this possibility.

See Figure 1 (next page) – an example of the Excel risk assessment spreadsheet template.

Presentation of a Business Valuation

Compliance

As with any valuation report, standards adhered to, assumptions used, and any relevant disclaimers must be clearly stated. In addition to a statement summarising the business valuer's experience/expertise, a typical compliance schedule within the report would state the following:

- The valuation was performed in accordance with ethical code and performance standards of the Australian Property Institute (API).
- The statements of fact as presented in this report are correct to the best of the valuer's knowledge. Although the valuer believes the information used for this report was adequate, complete and appropriate for assessing the market value of the business, the

valuer has not audited or otherwise confirmed this information and makes no representations, expressed or implied, as to its accuracy or completeness of the conclusions to be drawn and shall not be responsible for the content, accuracy and truthfulness of such information.

- Any recipient of this valuation acknowledges that it is the responsibility of any purchaser to perform a due diligence review prior to any acquisition of the whole or any part of the business.
- The analysis and conclusions in the report are limited only by the reported assumptions and conditions.
- The valuer has no direct, indirect or financial interest or otherwise in the business as described in this report.
- The valuer's fee is not contingent upon any aspect of this report.
- The valuer has experience in the valuation of businesses similar to the business valued in this report.
- The valuer has made a personal inspection of the business valued in this report and has relied upon financial information, including Profit & Loss Statements and Balance Sheets, provided by the owner or accountants acting for this business.
- No other person, except any that may be specified in this report, has provided professional assistance in the preparation of this report.

Presentation

Generally speaking, business valuation reports should be fully speaking reports. Whereas a physical inspection of real property can provide a layperson with some idea of the strengths and weaknesses associated with a property and its improvements, a physical inspection of a business rarely

Lysnar's Conjecture

Step 1	**Complete Risk Analysis**	
	Rate	Rate
	Positive	Negative
Enter as	1 or 2	1 or 2
	(Neutral = 0)	
	Rate positive or negative	
Ability to finance		
Barriers to entry		
Benchmarking analysis		
Business longevity		
Client Dependence		
Competitive advantage/s		
Condition of assets		
Employee dependence		
Growth prospects		
Increase in competition		
Impact of substitution		
Impact of technology		
IP contribution		
Management dependence		
Obvious opportunities		
Operating hours		
Operator dependent		
Opportunity cost		
Popularity of product/service		
Reputation		
Security of tenure		
Special licences required		
Specialist skills required		
Stock investment		
Strategic value		
Terms of trade		
Working capital needs		
Other:		
Totals:	0	0
	(A)	*(B)*

Step 2	**Input Capitalisation Rate Range**	
	%	
Low =		*(R1)*
High =		*(R2)*

Automatic Capitalisation Calculation	
Where:	r=((R2-A) + (R1+B))/2
Therefore:	r=

Figure 1 - an example of the Excel risk assessment spreadsheet template.

uncovers the fundamental strengths and weaknesses of the entity.

Therefore a fully speaking report should address the following issues:

- Business introduction and background;
- Proprietor's roles;
- Employee details;
- Operating hours;
- Client summary;
- Supplier summary;
- Pricing strategy and terms of trade;
- Stock holding;
- Seasonality of trade;
- Documented procedures and quality control systems;
- Marketing effort;
- Premises and tenure;
- Assets employed;
- SWOT and PESTLE analysis;
- Financial analysis;
- Adjustments to earnings;
- Determining FME;

- Risk analysis;
- Valuation methodology;
- Determining a market rate, asset value, or capitalisation rate; and
- Valuation.

Below is an example of the presentation of a business value that has been determined using the income approach.

Example Business Pty Ltd:

Estimated Future Maintainable Earnings	**$360,000**
Capitalised at 51.0%	**$705,882**

For Practical Purposes, adopt a Market Value of $705,000

(Excluding GST, and Plus Stock At Valuation and Work In Progress, if any).

Annexures should contain a copy of the letter of instruction and extracts of financial information provided. It is up to individual valuers to decide whether or not they wish to include their financial and risk analysis worksheets.

Conclusion

It remains that many business valuations are undertaken by accountants acting for a business and also by business brokers. Arguably, the best person for this job however, is a specialist business valuer, as professionally trained valuers possess a skill-set ideally suited to the task.

When a buyer purchases land or buildings there is both a guarantee of tenure and a physical asset, however when purchasing a business a buyer often may receive no physical assets and the tenure will only be as strong as the current lease, however the rationale for buying a business is rarely to access assets, but to access its future income.

A business entity is merely a vehicle that can produce future income, and the value of a business entity is directly related to the risk of being able to produce that income on a maintainable basis.

Valuers of real property can also value businesses so long as they understand the nuances and methodology in valuing businesses, and are comfortable in analysing financial statements.

Business valuers commonly employ three approaches to determining value, and if possible, reconcile the indications derived from two or more of these approaches and associated methods. The three main methods are a *Market Approach, Asset-based Approach* and *Income Approach*.

The bulk of Australian businesses are unlisted, privately owned, micro or small-to-medium enterprises. If profitable, their value is most often determined by an *Income Approach*, which, for most businesses, in most industries, comes down to investigating the characteristics of a specific business, determining its Future Maintainable Earnings, and establishing a capitalisation rate to apply to those earnings.

Valuers are familiar with research and investigation of a real property, and in valuation reporting. It follows therefore that so long as a few basic rules are followed, the research, valuation and reporting of a business is well within the skills of real property valuers, so the onus is on valuers to put up their hand and take on this work or risk losing it to other professional groups. ■

References - *A full list of references is available from the Editor on request.*

Book Review

Property Valuation and Analysis

2ND EDITION 2006

Lawbook Co.
ISBN 0 455 22394.7.
598 pages.
Available at: **www.lawbooks.com.au/store**
Price: $114.36 (Jan 2009).

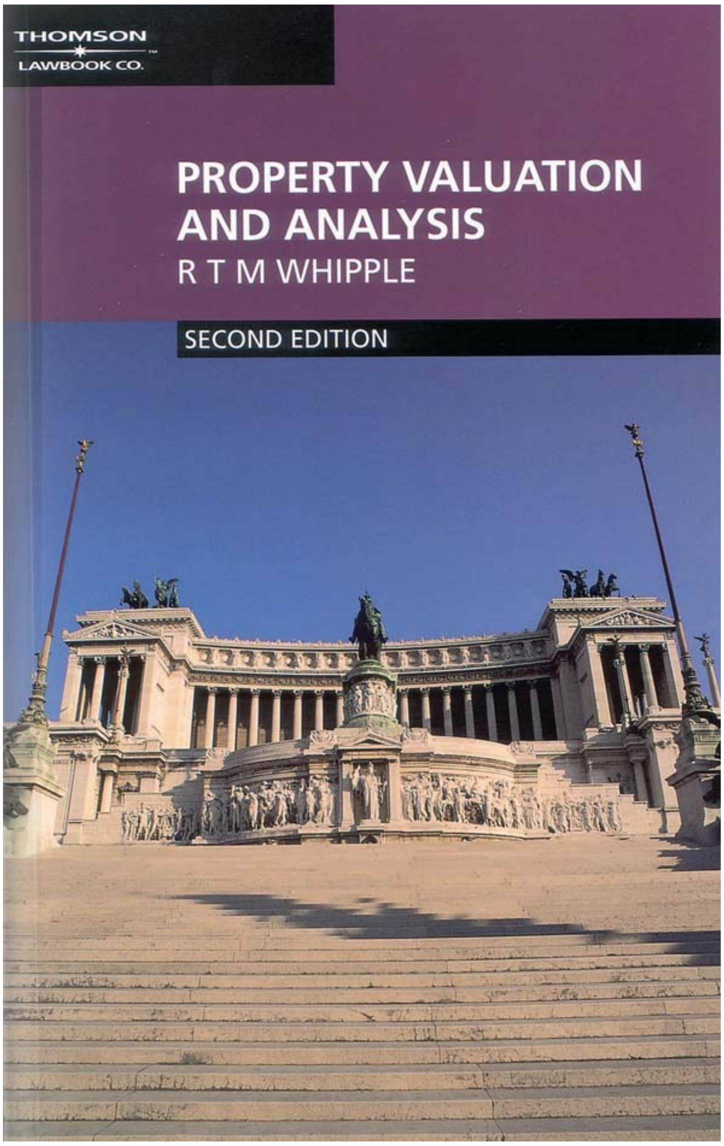
'Prelude to Valuations in the 21st Century'

The publication in 1995 of *Property Valuation and Analysis* by Professor Tom Whipple was a landmark event in the writing on land valuations. In producing a text dealing with the fundamentals of land valuation, Whipple moved away from producing another basic and comprehensive book that attempts to cover everything a valuer might need to know, including specialist areas, and thereby is able to move beyond the earlier works by Dr Murray (1949-1969), Rost & Collins and the multi-authored *Valuation Principles and Practice* text (1998+) and the recent adaption of the US Appraisal Institute's basic text by Professor Reed. Rather, this is a treatise that brings together for the first time the advances in valuation concepts and techniques of recent decades which enables objective valuation outcomes and, therefore, better client outcomes.

In providing for the future, there is no abandonment of what we know and value from the past. Rather this is a genuine and serious attempt to re-evaluate where we have come from and where we should now be heading. The book provides a re-statement of the fundamentals – the why – before moving to objective practices – the how. Whipple deals with the core of the valuation – its heart – price prediction.

The second edition comes after 10 years of reflection by the author. Whipple has taken this opportunity to move further forward in the development and adoption of logical and positive approaches both in theory and importantly in practical techniques. In doing so he makes a substantial contribution to moving the profession along the spectrum from valuations being an "art" by adopting and adaptation of relevant, objective, scientific methods.

Dr Murray, in 1949, was at pains to make quite clear that much of the material a valuer has to obtain is factual and can be determined with absolute precision. In that era he referred mainly to descriptive data. Whipple now takes advantage of



the giant strides taken over the past 60 years in intellectual and technological developments and their understanding and application by the valuer, and can make the same claim with the use of objective concepts, such as Most Probable Price, statistical and financial techniques such as correlation analysis, DCF opportunities in market analysis and price prediction methodology, all aided by the ubiquitous computer.

The second edition contains the same 13 chapters. The first two set the scene by dealing with the critical issues of property characteristics, the all-important physical, financial, location and linkage relationships, and then real estate markets. The remaining 11 chapters set out in detail the approaches and techniques the contemporary valuer needs to consider and how to use them, with generous examples.

Chapter 3 describes, in six basic steps, the valuation process. No unthinking assumptions are to be made. Rather a logical sequence prevails, and any assumptions are to be explicitly stated together with justification. The next six chapters describe in detail the issues, considerations, and the analytical requirements of the six steps.

Chapter 4 deals with Problem and Value definition. This chapter provides a detailed review of the "Spencer" case which deals with a "normative" definition of *fair* market value and similar, and then examines the case for the greater use of positive concepts of market value and their application in 10 different situations.

Chapter 5 deals with real estate productivity and characteristics which then allows **Chapter 6** to cover the identification of the most Probable Use and Buyer statements.

Chapters 7 and 8 take a side step and deal firstly with introductory and then advanced financial analysis concepts. In each case there is careful explanation, minimal but desirable algebraic equations plus understandable numeric examples.

Chapter 9 sets out objective techniques for use in the translation of sales data to the subject property. The chapter sets out simple and effective methods for objectively exploring relations within the sales and subject data set, the examination and selection of Units of Comparison, a detailed review of the Adjustment Grid Sales process, the Quality Points technique and Regression uses.

Chapter 10, over 125 pages, deals in great depth with Cash Flow Approaches to Price Estimation, having six parts, covering:

I. Direct Capitalisation;
II. Income Property Analysis;
III. The Modified Discounted Cash Flow Method;
IV. Discounted Cash Flow Analysis of Income Earning Buildings;
V. After-Tax Cash Flow Analysis;
VI. Development Projects.

Again, this is a chapter which provides comprehensive description with abundant examples, applications and comparisons within each part.

Chapter 11 discusses the uses of the Cost (sometimes called Summation) approach to price estimation, while **Chapter 12** sits back and considers valuation objects, applications, mortgage concerns, the valuation/accounting interface and the like. **Chapter 13** sets out a detailed structure of a valuation report, drawing heavily on the Professor James A. Graaskamp-produced, *The Appraisal of 25 North Pinckney*.

The book provides a re-statement of the fundamentals – the why – before moving to objective practices – the how.

Finally, the two-part appendix contains firstly Appendix A, an amalgam of three papers by Professor Richard U. Ratcliff, *A Rationalisation of Real Estate Valuation* which sets out his basic thesis leading to many of the concepts and techniques covered by this book. Appendix B is the full judgment of the Spencer case.

It is the reviewer's strong opinion that this is the pre-eminent book for serious practicing valuers operating in a "Western economy".

This is a required book for the senior valuation student to study and for the practising valuer to advance. ■

Maurice Squirrell
Associate Professor (Ret'd)
LFAPI

Asset Management - An International Discipline

Frank Bowyer
FB Consultants Pty Ltd,
Australia.

Iain Gillies
Network Property,
New Zealand Telecom.

Stephen Walton
State Government of New South Wales,
Australia.

Clive Warren
University of Queensland,
Australia.

This article contains a synopsis of public sector asset management practice in Australia, New Zealand and the USA. It describes the context, the main features of the government structures from which the processes have developed and highlights the benefits which have accrued.

Overview

Property asset management has been a focus for government and local authority attention outside the UK for nearly 20 years. In these guidelines we have focused on other English-speaking nations whose governmental systems are similar to the UK and where significant progress has been made in property asset management recently; namely Australia, New Zealand and the USA.

In Australia and New Zealand radical public sector reform resulted in significant changes in accounting conventions, reporting practice and ownership flexibility, with a loosening of the hitherto tight controls over the way the public sector managed assets and capital. The reforms changed the control parameters for the cost of capital, ownership of property and management standards, resulting in a "market" approach to the way public sector operations were managed.

Centralised departments charged with creating and managing all public sector property have largely disappeared in these countries and have been replaced by smaller, commercially focused procurement organisations managing capital, costs and organising the purchase or leasing of accommodation from private sectors providers.

The introduction of commercial-style performance measurement for public sector operations drove down a similar approach to asset management, focusing on:

- performance measurement and improvement;
- reduced public sector involvement and increased outsourcing of services based largely on cost reduction;
- separation of policy-making and service delivery;
- greater management flexibility; and
- greater financial accountability but with fewer checks and balances.

Other drivers of asset management reform include international accounting reforms and the entry of private sector real estate professionals into public sector management roles.

In the USA, years of under-investment and poor management led the administration to mandate departments to produce asset strategies, plans and regularly updated asset registers.

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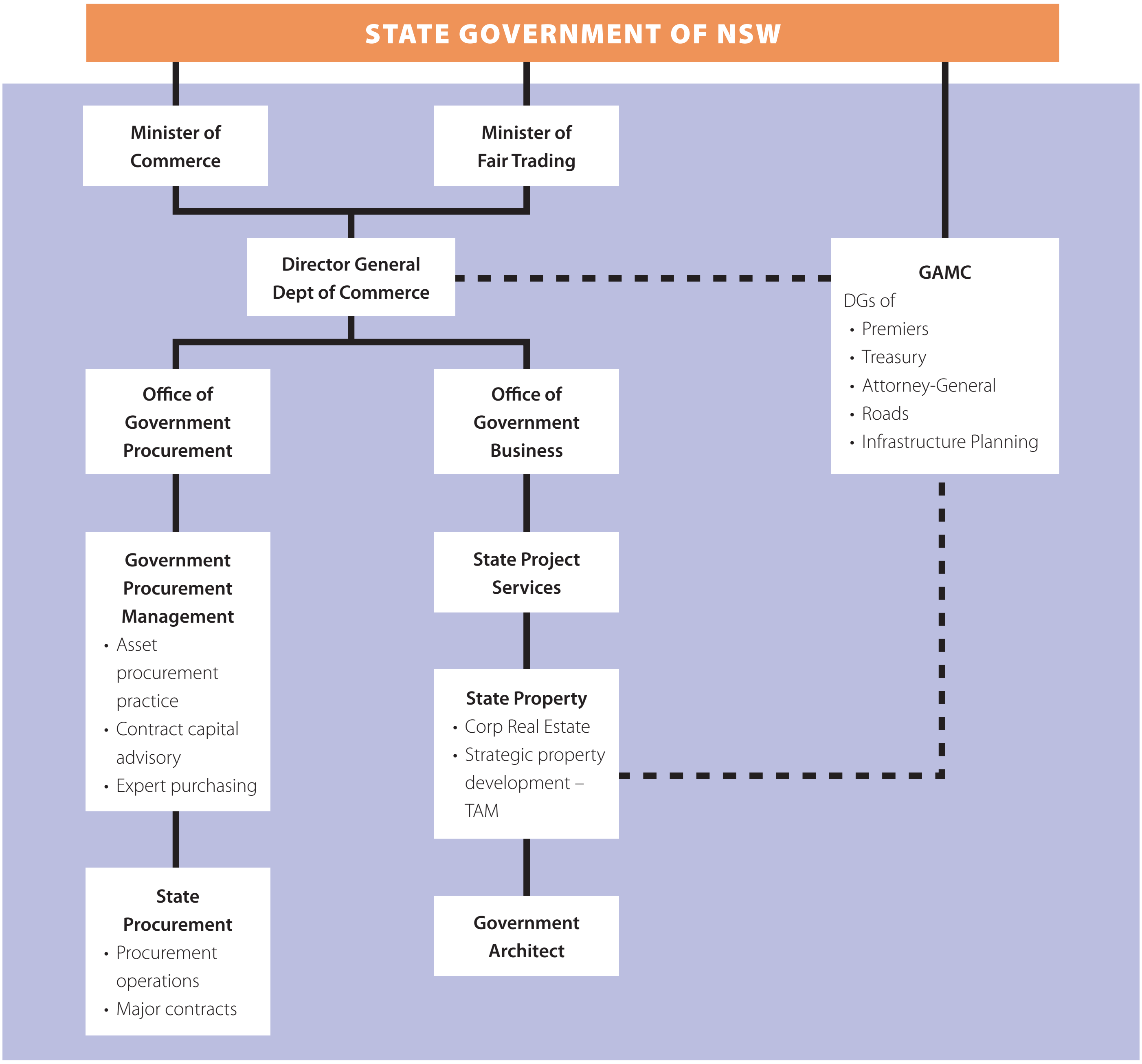

Figure 1: New South Wales Government Total Asset Management Framework

Asset management in Australia

The Australian approach to asset management has been driven more by the introduction of regulatory requirements and accounting standards, for example (IAM 2002):

- AAS 27 for local government;
- AAS 29 for government departments;
- AAS 31 for governments.

The Australian governmental system has close similarities with that of the UK. The Australian National Audit Office (ANAO) performs a similar function to the NAO in the UK. The consensus from a number of their reports confirms that there has been a much stronger drive towards improved asset management, including property asset management, at state level compared to central government, where property has been treated as a "free good" rather than as a valuable business enabler.

The ANAO first examined asset management in the general government sector in 1995 (ANAO 1995), excluding the Department of Defence. The ANAO found significant scope for improvement in most organisations. They reported a lack of a strategic approach to asset management, noting that this required decisions about current and future asset holdings to be made as an integral part of the corporate planning processes. Six recommendations were made and the ANAO also published an *Asset Management Handbook*, including strategic asset management principles and approaches.

By 1997-98 the ANAO was examining the extent to which its earlier recommendations had been implemented. The subsequent report noted that effective strategic asset management remained a challenge for many government organisations. It added that the gap had closed between what had been achieved and best practice during the intervening two years. Noting the linkages with corporate governance concerns, the ANAO report highlighted that many organisations had yet to:

- adopt a strategic approach to managing assets, involving integrating asset planning into corporate and resource planning frameworks;
- formalise and analyse systematically whole-life cost impacts of major asset acquisition, operational use or divestment decisions;
- establish baseline cost and performance standards for key assets, including monitoring outcomes against these standards;
- implement financial management and asset management systems to facilitate the routine capture and reporting of performance information for management purposes;
- integrate disposal decisions into an overall planning framework to monitor the outcome of disposal processes.

The audit also confirmed the limited nature of central policy advice and guidance compared with that in a number of state governments. The federal government in 1996 embarked on a major reform of the commercial property portfolio, outsourcing in three major contracts all asset management functions. All owned property was subject to a 15 per cent return on investment hurdle, rates which resulted in virtually all assets failing this ownership test and the government entering a major divestment campaign, with the space being leased back as required. These major changes in property ownership occurred during a period of high vacancy in the commercial sector and resulted in property sales which did not recoup the government's initial investment.

The ANAO has continued to audit central government departments and agencies in the asset management and property management areas. The Auditor-General, in an Occasional Paper setting out his views on Commonwealth assets and property management, noted that a further ANAO audit conducted in 2003 had still found difficulties experienced by a number of agencies in relation to:

- poor documentation concerning asset acquisition and disposal;
- assets not being recorded on the asset register;
- asset registers not being reconciled to financial systems.

The property divestment and outsourcing program of the mid- to late-1990s also passed the day-to-day management of commercial property assets back to the relevant departments away from a central coordinating asset management body. These changes have further reduced the government's control over the strategic direction of the property it occupies and reduced the transparency of acquisitions.

The state governments within Australia have adopted a range of asset management methodologies over the few years ranging from major outsourcing and divestment similar to the federal government approach in the case of Victoria, through to a largely in-house ownership model followed by Queensland. Three examples of the range of state government approaches to asset management and property asset management are presented in the following sections.

State government of New South Wales (NSW)

The NSW state government's reform program for the management of assets and office accommodation, initiated in 1996, established in 1998 a high-level body – the Government Asset Management Committee (GAMC) – with a whole-of-government focus to drive its programme of reforms. The structure is shown in Figure 1.

The GAMC was established to ensure the effective management of investment in assets and office accommodation. The Committee is chaired by the Director-General of the NSW Premier's Department and members include the chief executive officers of The NSW Treasury, Department of Commerce, Attorney-General's Department, Roads and Traffic Authority, Department of Infrastructure, Planning and Natural Resources and Forests NSW. The Committee meets quarterly with terms of reference to provide advice to the Budget Sub-Committee of Cabinet on:

- the alignment of asset and office accommodation resources with government's service delivery priorities;
- the appropriateness of agency asset management strategies;
- strategic asset and accommodation issues involving more than one agency;
- office accommodation strategies for metropolitan and regional areas;
- major investment strategies – acquisition, major refurbishments, lease pre-commitments, leasehold, and asset and property disposals;
- benchmarks and performance standards for asset and property portfolios.

Policy, budgetary frameworks and planning

As part of the policy reforms, a series of Total Asset Management (TAM) guideline papers were introduced to achieve better planning and management of NSW's existing and newly acquired physical assets. In this instance, these are defined

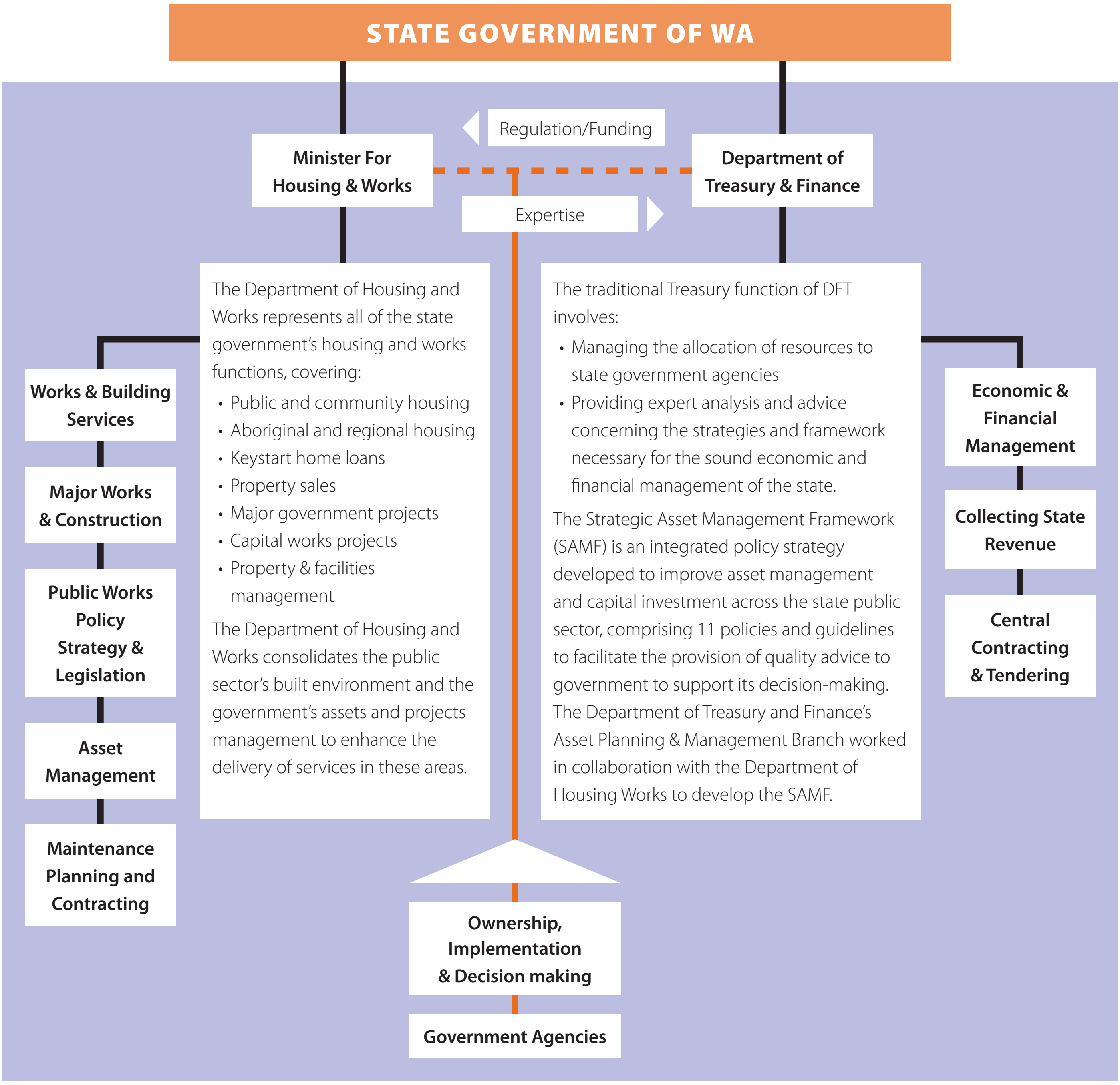

Figure 2: State Government of Western Australia Strategic Asset Management Framework

broadly as land, buildings, IT, infrastructure, collections, equipment or fleet owned or controlled by an agency resulting from past transactions or events, providing future economic benefits and having a definite business function or supporting the delivery of services. The TAM guidelines have recently been improved and aligned with the Results and Services Plan (RSP) and the budget process overall. Changes include:

- a restructured approach to the development of an asset strategy, with greater emphasis on risk management and asset performance measurement and better alignment with the RSP;
- a TAM template, to assist in the preparation and assessment of the asset strategy and supporting TAM strategic plans;
- a new capital investment strategic plan guideline, to reflect the requirements of the government's procurement policy reforms for major capital works projects;
- relocation of the TAM manual, which includes detailed guidelines together with supporting assessment and decision-making tools, to the NSW Treasury website (www.treasury.nsw.gov.au/tam/tam-guide.htm).

By 31 August each year, agencies are required to submit to NSW Treasury an integrated set of TAM plans which comprise an asset strategy driving four plans: a capital investment strategic plan, a maintenance strategic plan, an asset disposal strategic plan, and an office accommodation strategic plan. An agency's RSP is considered incomplete unless it is supported by the asset strategy and all supporting plans which effectively link executive performance with asset-related budgets.

State government of Western Australia

In June 1994 the Premier of Western Australia introduced a strategic asset management framework for the state government that recognised the need for a more rigorous approach to the management of Western Australia's portfolio of public assets. Subsequently, a Functional Review Taskforce was set up which recommended the further development and implementation of appropriate strategies to strengthen asset management policies and practices. This followed recommendations in a report published by PricewaterhouseCoopers in 2002 on the governance and management of Western Australian public sector assets. The principal Taskforce concerns and recommended actions were:

	Taskforce concerns		Action
✓	Increase rigour in the capital investment process	✓	Improve the quality of information provided by agencies for decision making
✓	Give greater attention to maintaining existing assets	✓	Deliver the benefits that were initially projected
✓	Institute greater coordination of asset management across the state public sector	✓	Planned disposal of significant assets

The state government structure incorporating the strategic asset management framework is shown in Figure 2.

As shown above, the Department of Treasury and Finance retains regulatory responsibility, approving funding and working in collaboration with the Department of Housing and Works which provides the technical expertise. The framework promotes linkages between the agencies' management of their asset portfolios with asset planning and corporate planning processes. It outlines the processes to manage assets through the lifecycle from planning to disposal, including an increased emphasis on maintaining existing assets. The results of this work are included in the new strategic asset management framework which comprises four key components: asset planning, capital investment, maintenance, and asset disposal.

The revised strategic asset management framework now includes several significant changes, notably:

- strategic asset plans are to be approved by the Minister and submitted to the Treasurer as part of the annual budget process;
- agencies will be requested to include information on maintenance expenditure within the strategic asset plan, consisting of a summary of the agency's proposed maintenance expenditure over the Budget, and forward estimates, identifying the sources of funding, such as the split between recurrent and capital funding, and the prevailing level of deferred maintenance, as well as any strategies to manage deferred maintenance.

The objectives and outcomes of the process are as follows:

	Planning objectives		Desired outcomes
✓	Strategic planning for management of assets	✓	Management of property asset portfolios as a corporate resource
✓	Ensure that facilities meet current and future requirements	✓	Accountability for strategic management of all real estate assets
✓	Benchmarking and performance management to competency and consistency standards Optimise each asset lifecycle	✓	Rationalisation supported by specific business case reviews
✓	Identify surplus assets	✓	Divestment of high-cost and under-utilised assets
✓	Matching space needs with staff requirements	✓	Achieving efficiencies through collocation of like functions
✓	Minimising 'all in' costs of owning, leasing, occupying and using space Maximising flexibility in space use and tenure Conforming real estate strategies Key reporting and tax requirements	✓	Improvement of the asset data and management information systems and transparency

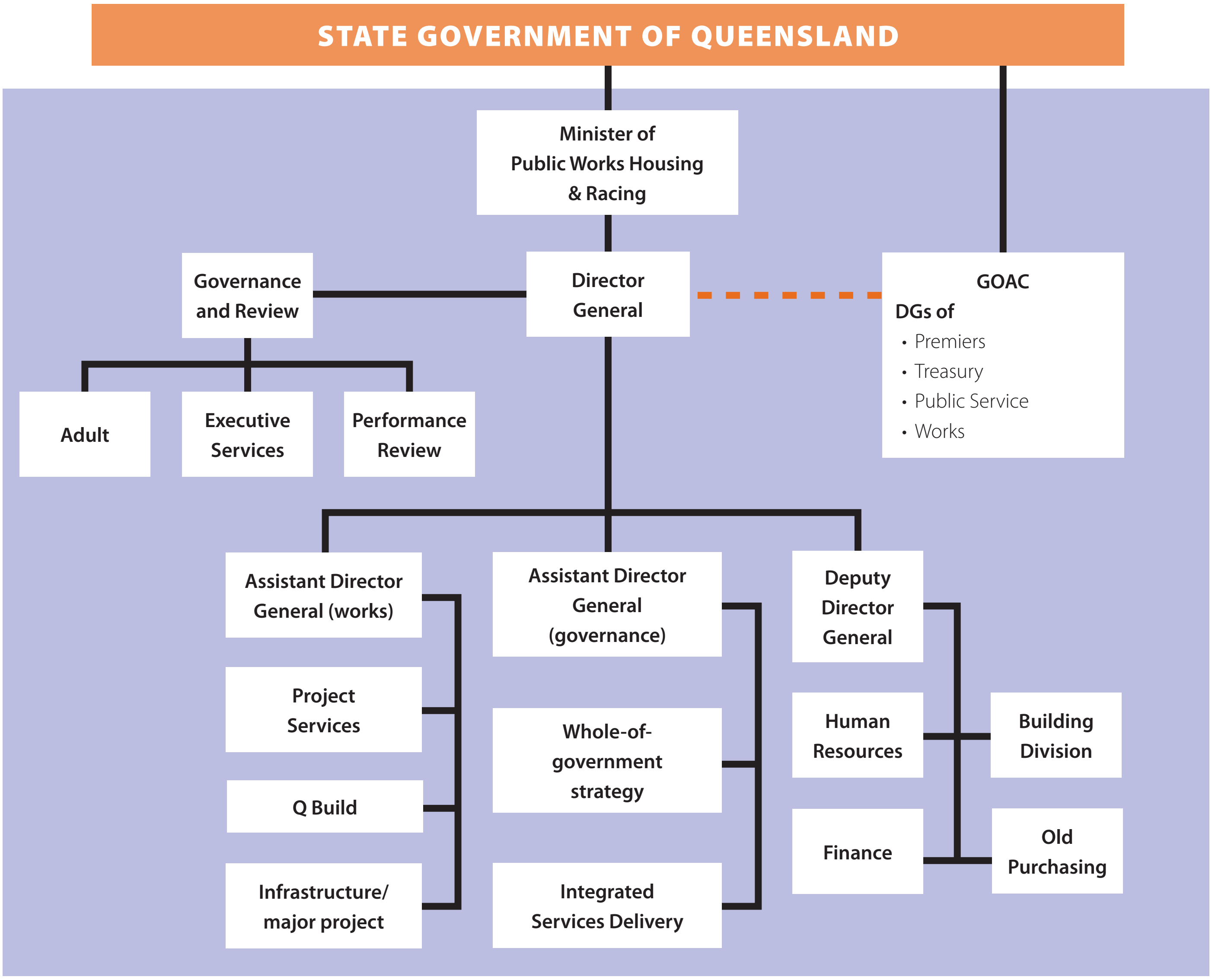

Figure 3: State Government of Queensland Strategic Asset Management Framework

The Government Office Accommodation Working Group (GOAWG) exists to ensure a whole-of-government perspective in managing the office accommodation portfolio. The GOAWG comprises senior representatives from the Department of Treasury and Finance, Department of the Premier and Cabinet plus Department of Housing and Works (DHW). The GOAWG evaluates office space proposals (new leases, refurbishments, etc.) exceeding $1 million, referred to it by DHW and GOAWG makes recommendations to the Minister for Works who signs off on commitments.

State government of Queensland

Asset management in Queensland is centralised under the Department of Public Works and Housing with divisions of Queensland Property Management (QPM), Qbuild and Project Services. Each of these divisions provides services to government departments on a fee-for-service basis. The structure provides for administrative separation of the construction and maintenance aspects of property provision from the strategic review processes and the ongoing maintenance and leasing management functions. This is illustrated in Figure 3.

Commercial office procurement is governed by a number of guidance documents and administrative procedures. The office accommodation management framework (OAMF) sets the basis on which property procurement is administered. It outlines the authority, scope, principles and working environment under which it operates and establishes clear roles and responsibilities for the department and other agencies utilising its services.

The OAMF is guided by the broader objectives of government and the strategic direction developed for the department. The wider governance issues include the Treasury's State Purchasing Policy. So, in implementing property procurement objectives, the policy provides clear guidance on the process to ensure state objectives are achieved. The Treasury also provides agencies with a framework for developing strategic asset plans within a "sustainable total resource management framework". The guidance seeks to encourage strategic management of outcomes through the alignment of assets, resources and agency services to meet government priorities.

NEW ZEALAND

Advising/policy/regulating	State Services Commissioner	LINZ	NZ Treasury	Minister of Finance	Office of the Auditor General
	• Public Sector Performance	• Crown land ownership • Provide Land Information • Manage ownership	• Advise on the NZ Economy • Assist with budgets, planning • Advise on standards	• Annual budgeting • Supervise Treasury • Set Financial Standards	• Annual audits • Controller function • Approvals of process
Governance	• Ministers of the Crown • Statutes relevant to each public sector				
Entitles	Ministries/Departments	State Owned Enterprises Crown Research Institutes	Other Crown Entitles • District Health Boards • Local Authorities • Tertiary Education Sector		
Asset owner	The Crown	The entity	The entity		
	Works and construction Contracting and tendering	Maintenance and planning etc.			

Figure 4: New Zealand Government: Where Asset Management Fits

Queensland differs significantly from other states in that it recognises the need for a balanced portfolio of owned and leased property and seeks to maintain an approximately equally balanced portfolio of the two. There is also recognition that government has the ability to manage in-house the processes of property management to achieve the best fit with a whole-of-government approach to the provision of supporting property infrastructure.

The strategic direction of property asset provision and management is set by the Government Office Accommodation Committee (GOAC) which has responsibility for setting the strategic direction and approach to ownership and management of government office accommodation. It also reviews all acquisitions, both freehold and leasehold, and disposals of buildings greater than 5,000m^2. The committee is the final arbiter in any property-related dispute between an agency and the Department of Public Works (DOPW).

At all levels of asset provision a regime of internal contracting and fee for service exists to promote performance evaluation and to prevent waste. All agencies pay a market-based rent to Building Services for the accommodation they occupy. In turn, the Building Division engages and pays QBuild to undertake maintenance on the owned estate through contracts at market-based rates for the services undertaken. Thus, a commercialised property system exists, with a high-level strategic management group taking government priorities and interpreting them, in terms of asset outcomes, via GOAC, which is documented and disseminated both within DOPW and to other agencies. At the same time, agencies will develop their own strategic planning outcomes, based on government priorities, and, through representation on GOAC, communicate their strategic direction and needs for supporting property resources.

Asset management in New Zealand

The New Zealand public sector is structured on the principle that each public entity is held individually responsible for delivery of services as required by government.

Each department has autonomy and there is no central body managing assets. The structure is illustrated in Figure 4.

Most public sector organisations report performance on an accrual accounting basis in a similar fashion to private corporations. A capital charge is applied to capital utilised in an agency's operations, effectively creating a proxy for borrowing capital from Treasury.

This has changed the asset mix over time as agencies have been encouraged to reduce capital assets.

The most comprehensive work in asset management has been undertaken by local authorities. Legislation – *Local Government Act* 2002 – introduced an expectation that all assets held by a local authority would be identified, managed well and would be considered in every part of the planning process for all activities of the authority. This required local authorities to generate clear asset management plans. These are generally developed from the bottom-up, starting with an asset register entry for each asset and working on from there.

The National Asset Management Steering Group (NAMS) Group, established by the Association of Local Government Engineering New Zealand, has developed a range of manuals that are now widely in use throughout the local authorities.

The NAMS manuals and guidelines are distributed worldwide and include the following:

- *The International Infrastructure Management Manual* (2006) is positioned as the Group's core document in asset management theory and practice. The manual is prescriptive in style, and sets out clear requirements to achieve a practical and effective asset management function. Although it covers a wide range of asset types, it focuses on infrastructure assets.
- *Optimised Decision Making Guidelines* provide economic analysis for decision making on the maintenance, renewal and replacement of infrastructure assets and includes over 30 actual case studies.
- *Depreciation and Valuation Guidelines* are a practical guide into the assessment of value, economic life and depreciation methods for infrastructure assets.
- *Developing levels of service and performance measures guidelines 2007* demonstrate how to establish levels of service and performance measurement for assets based on client requirements.

The US Government has 3.3 billion square feet (307 million square meters) of office space and 655 million acres (270 million hectares) of land.

Asset management in the USA

The US Government has 3.3 billion square feet (307 million square meters) of office space and 655 million acres (270 million hectares) of land. The General Services Agency (GSA) controls some 11.7 per cent of the real property space inventory. In January 2003 the Government Accountability Office (GAO) identified real estate and its management as a high-risk federal program due to under-investment. In that same year the GAO testified that federal property was deteriorating badly and decision makers lacked reliable data.

As a result, in February 2004, Executive Order (EO) 13327 was signed by president Bush, adding improved real property asset management to the president's management agenda. The EO defined real property as any real property owned, leased or otherwise managed by the federal government domestically and internationally and includes improvements to federal lands.

The EO established the Federal Real Property Council (FRPC), under the administration of the Office of Management and Budget (OMB), to serve as a centre of best practice and assist the efforts of Senior Real Property Officers (SRPOs), a role described further below.

The structure of the FRPC is set out in Figure 5.

The Council comprises the SRPOs, the Controller, and, Deputy Director of Office of Management and Budget (as Chair), the Administrator of the GSA and any other officials or employees deemed necessary by the Chair. The Council is seen as a mechanism to assist SRPOs develop and implement agency property asset management plans. The Council, in conjunction with the Administrator of the GSA, works out appropriate performance measures for real property. As part of its remit, the FRPC has also produced a template for property asset management plans to be rolled out across agencies. These plans are reviewed by the OMB as part of the normal budgetary review process and in achieving government-wide property management priorities.

The SRPO is required to submit an initial asset management plan to the OMB which:

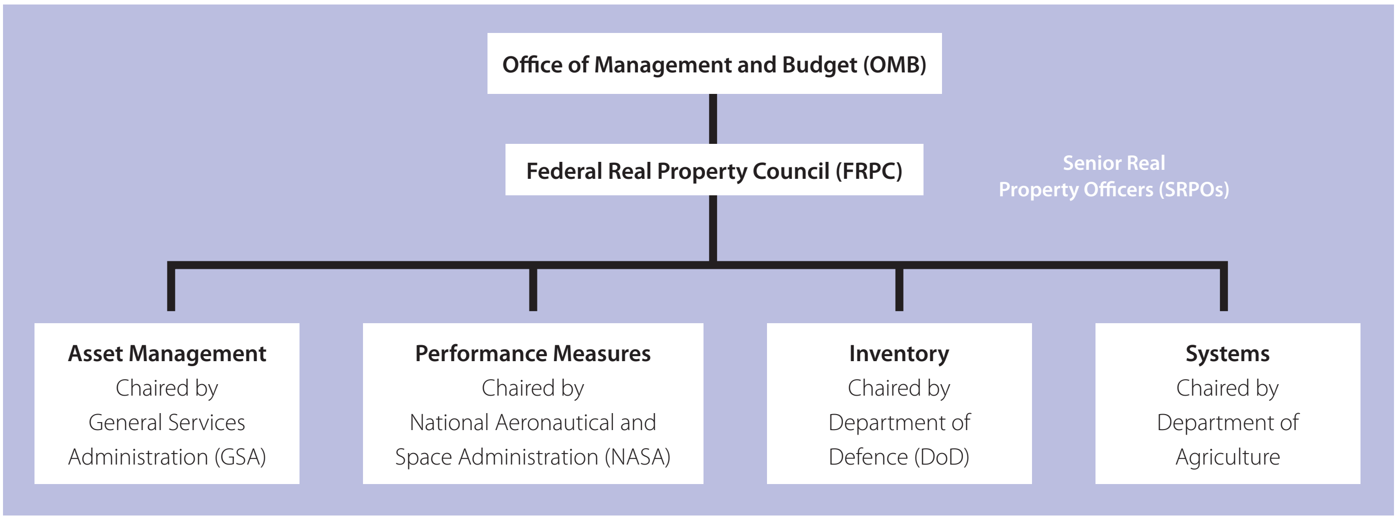

Figure 5: The Structure of the US Federal Real Property Council

- identifies and categorises all real property owned, leased or managed by the agency within and outside the USA;
- prioritises actions to be taken to improve the operational and financial management of the agency's real estate;
- makes lifecycle cost estimates of these actions;
- identifies authorities also required to address the priorities established;
- identifies and pursues goals, with appropriate deadlines, consistent with the asset management plans, measuring progress. Incorporates planning and management requirements established under earlier EOs for heritage property and for environmental management;
- annually lists and describes property assets under the control of the agency.

Every agency must determine what it owns, what it needs and what it costs to manage its real properties. It must develop and implement property asset management plans and performance measures. Surplus properties are to be sold.

The role of the GSA has been expanded to include establishing and maintaining a government-wide real property inventory database and reporting performance measures.

So in the USA, under-investment triggered the development of a mandatory property asset management process. A national body oversees the development and dissemination of best practice and a series of KPIs have been established for measuring the performance of property assets over time.

Summary

While the US and Australian models of property asset management have developed from different drivers, there are a number of similarities and differences that could inform a UK model of excellence:

- The US and Australian "models" both recognise the need for a central coordination committee to develop and disseminate best practice in property asset management; for example, the FRPC in the US and the GAMC in the NSW state government.
- The US approach has been mandated by Presidential Executive Order.
- The US and Australian models link the property asset management planning process into budgetary cycles.
- Both countries have produced best practice guidance centrally; state governments in Australia have also developed their own approach and a review of three of these (NSW, WA and Queensland) indicates close similarities and consistency of approaches and some marked differences.
- The US model has set out the requirement that a named individual at strategic level in all major agencies should be held responsible for property asset management.
- The ANAO has conducted a number of formal audits of the embedding of asset management and property asset management in central government departments and agencies.

Appendices

Appendix 1 sets out in tabular format comparisons of the asset management structures in Australia, New Zealand and the USA. Appendix 2 shows, again in tabular form, comparisons between asset management arrangements for the states of Western Australia, Queensland and New South Wales.

Appendix 1: Asset management policy comparisons

	Australia	New Zealand	USA
Regulatory framework	Regulation/accounting requirements (e.g. IAM 2002): • AAS27 (local government) • AAS29 (government departments) • AA31 (government)	Centralised control to legislation Accounting reform and asset management reform The degree of separation of ownership from management and info systems • *State-Owned Enterprises Act* 1986 • *State Sector Act* 1988 • *Public Finance Act* 1989 • *Fiscal Responsibility Act* 1994	Presidential Order: Executive Order (EO) 13327 (Improved Asset Management)
Governance	Australian National Audit Office (federal government) Public Works Committee in respect of major works	Different organisations: • LINZ • The Treasury • NZ Accounting Standards Review Board • Property Institute of NZ • NZ Institute of Chartered Accountants • Institution of Professional Engineers • Building Industry Authority • Territorial Local Authorities	Government Accountability Office
Extent of devolution	State level government responsibility and regulation	The above organisations set the regulations and standards, whilst many departments, Crown Entities and Crown-owned Enterprises, State-owned Enterprises contract out the property management functions	
Publications	*Asset Management Handbook*	No central government guidance, although some research being undertaken by the Treasury. The National Asset Management (NAMs) group publish manuals and guidelines for best practice	Property asset management plan. General Services Administration Department issued material on procedures and progress
Key features	Asset management should be viewed as a business enabler. Agencies: • lack strategic approach • are required to use accrual accounting and capital charging • lack a central register of property assets	Autonomy for state entities allows innovation and advancement. A capital charge regime focuses entities to reduce capital – virtually all state departmental offices are leased from private sector. Could be seen as a world leader – for example road network management Transit NZ. • Roles and responsibilities are clear • Policy, regulatory functions and operations are separated • Asset management is decentralised and flexible • Private sector management practices are widely used • National wealth accumulated in Crown property is properly recognised • Fiscal administration and accounting encourage accountability and effectiveness • Accrual accounting is used by all government agencies • Disaggregation of portfolios has led to a reduction in focus on standards of asset management	• High-risk federal program resulting from years of under-investment • Federal property deteriorating badly • Decision makers lack reliable data

Appendix 2: Asset management comparisons – Australian states

	New South Wales	Queensland	Western Australia
Responsible ministry	Commerce and Fair Trade	Public Works, Housing and Racing	Housing and Works, Treasury and Finance
Framework for asset planning	Total Asset Management (1992)	Strategic Asset Management Framework (2002)	Strategic Asset Management Framework (1994)
Governance	NSW Treasury and Office of the State Property Authority (SPA) and Government Asset Management Committee (GAMC), a functional department within the SPA	Auditor-General Minister for Public Works	Auditor-General (WA)
Prescribed reporting	Annual strategic asset management plans from each agency to GAMC	Annual strategic asset plans for the portfolio and individual assets	Annual strategic asset plans (from each agency to ministers)
Key components	• Acquisitions, disposals and developments • Strategic asset management • Capital charging regime	• Asset planning • Capital investment • Maintenance • Asset disposal	• Asset planning • Capital investment • Maintenance • Asset disposal
Objectives	International best practice and standards	Whole of government approach to asset planning	Rigorous approach to public asset management
Implementation authority	SPA GAMC as part of SPA	Department of Public Works	Functional Review Taskforce
Approach	Treasury strategy and uniformity implemented through the SPA SPA powers to implement Total Asset Management policy	Clear asset management policy, centralised management and reporting of asset strategies Whole lifecycle approach to procurement Market performance benchmarking	Stronger policy and practices Linkages between agencies Connect asset planning with corporate planning processes Asset lifecycle program – disposal plan
Portfolio size (approx)	1,081,000m^2	844,000m^2	477,000m^2
Percentage leasehold	72.5%	47%	39%

Self storage – the Industry and Valuation Issues – (The Money or the Box)

Scale of the self-storage industry

The self-storage industry was established in Australia in the early 1980s after Mr Jim Miller and Mr Neville Kennard had observed the operations of the industry in the US and replicated the concept in Australia. Early operators in the industry established the Self Storage Association of Australasia (SSAA) with the aim of establishing standardised industry practices and equitable storage agreement structures. This early action has allowed the self-storage industry to develop in a self-regulated environment and current-day operators are not subject to any industry-specific legislation or regulation.

Rapid expansion in the number of facilities occurred in the 1990s. The continued growth of the self-storage industry has seen the establishment of major national brands operating across several states. These include Kennards Self Storage, Storage King and National Storage. Other multi-site operators have focused operations in one metropolitan area. These include Fort Knox (Melbourne), Rent-a-Space (Sydney), Storage Choice (Brisbane) and U-Store-it Self Storage (Adelaide). Acquisitions and expanded branding arrangements have led to a consolidation of ownership and operating entities in the industry from 2004 to 2008. Kennards Self Storage now operates in excess of 50% of the self-storage stock in Sydney. However there remains a substantial level of single-operator facilities, particularly in Brisbane Melbourne, Perth and Adelaide providing further opportunity for consolidations of the industry within established major operator groups.

Research conducted by Blackwell Consulting has recorded 427 facilities in

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Table 1

	Brisbane*	Sydney*	Melbourne*	Perth*	Gold Coast*
Population	1,676,389	3,641,422	3,371,888	1,256,035	454,436
No of Facilities	100	110	116	48	53
Sq Metres Space	306,352	490,153	389,157	152,547	131,993
No of Units	30,640	54,241	46,043	16,126	11,975
Number of people per unit	54.7	67.1	73.2	77.9	37.9
Sq Metres of space per person	0.18	0.13	0.12	0.12	0.29

**Population statistics are Census Data 2006 Urban Centre/Locality for each city.*
Source - Blackwell Consulting Research December 2008

U-STOW IT, Fyshwick, ACT

the major metropolitan areas of Brisbane, Sydney, Melbourne, Perth and the Gold Coast. A break up of facility numbers and level of supply in each of these cities is shown in Table 1 on the previous page. The Self Storage Association of Australasia (SSAA) estimates that there are approximately 1,200 significant operating self-storage facilities throughout Australia.

Storage facilities range from very small-scale operations of between 40 to 60 units to large-scale sites accommodating in excess of 1,000 storage units. Mature facilities in Sydney, Melbourne and Brisbane typically comprise of between 400 to 500 storage units.

Owners of self-storage facilities derive income from the net operating income of the facility. While there are a limited number of self-storage facilities that operate under leasehold interests, this discussion relates to freehold interests of going concern, self-storage properties.

The majority of small-scale facilities of fewer than 100 operate off-site management arrangements, often with local real estate agents. Discussions in this paper focus on medium to larger scale facilities providing a full suite of on-site services including on-site management.

Storage facilities range from very small-scale operations of between 40 to 60 units to large-scale sites accommodating in excess of 1,000 storage units.

Storage agreements and storage revenues

Each storage customer enters into a storage agreement before occupying a storage unit. In effect the storage agreement is a licence to occupy a designated storage space. A standard form of rental agreement, clearly establishing the rights and obligations of both facility operators and customers, is promoted by the SSAA. Most operators use this agreement or have developed storage agreements that closely align with the fundamental structure of the SSAA agreement.

The fundamental principle underlying the agreement is that the storage customer controls access to the unit by simply placing their own lock on the unit. The storage facility operator does not exercise care, custody or control over the stored goods. As such the operator does not, at law, have responsibility for the stored goods and it is the storage customer's responsibility to insure the stored goods if this level of protection is required.

Self-storage operators typically apply a monthly storage fee. Storage fees vary depending on the size and location of the storage unit occupied. Because the licence agreement typically operates on a month-to-month basis, the operator may review the storage licence fee at any time. The frequency and amount of storage fee increases will depend on the management strategy of the operator. In practice storage fee increases are rarely applied more frequently than at

six-monthly intervals. However, storage fee pricing strategies are becoming increasingly sophisticated. More experienced operators and managers are applying dynamic pricing strategies including fee revisions triggered by target occupancy level on individual unit sizes, fee increases based on level of enquiry and price increases triggered by an individual customers' length of stay.

Under a standard form storage agreement, the facility operator is authorised to effect the sale of goods contained within the storage area in the event of any breach of the term, including non-payment of storage fees. The manager is entitled to deduct amounts owing from the proceeds of the sale of these goods.

In addition to direct storage fees, income is derived from late fee charges, merchandise sales (boxes, packaging etc), and customer goods insurance sales. Industry standards show these "other income" items to be typically between 4% and 8% of total revenue. However there are a number of examples where operators have achieved higher proportions of revenues from these "other income" areas. This most commonly occurs in high exposure locations where high standard merchandise display areas have been installed in the development.

Performance measurement and revenue maximisation

Occupancy levels and average storage fee revenue are the two basic performance measures for storage facilities. Both have a direct impact on total revenue.

Occupancy is measure on several bases:

- Unit Occupancy – occupied storage units as a % of total units occupied;
- Area Occupancy – occupied storage area as a percentage of total rentable storage area; or
- Economic Occupancy – actual storage fees achieved as a percentage of the amount that would apply if full schedule storage fee rates were applied to all available units.

Occupancy will vary from facility to facility in mature facilities. In practice storage facilities never reach 100% occupancy by area. Most commonly, successful, mature major facilities operate at between 85% and 90% although there are a number of facilities that have sustained occupancies above this level. It is generally accepted that once a facility consistently achieves occupancy level in excess of 90% there is an immediate opportunity to increase storage fee rates until there is fee level resistance and occupancy levels are constrained. This general dynamic demands that good operators constantly review and adjust storage fee pricing.

The second primary performance measure is the Average Storage Fee Rate. This is calculated by dividing the actual accrued storage fee revenue by the actual area of storage unit space occupied. This shows as a monthly rate per square metre. By convention this is adjusted to an annual rate.

There is commonly a differential between the schedule storage fee rate and the actual or achieved average storage fee

Table 2

Unit Area	Number of Units	Total Sq M	Number Occupied	Area Occupied	Occupancy by Area	Current Monthly Rent Ex GST
Storage Units						
0 - 5	205	746	176	640	85.81%	$20,091
5.1 - 10	166	1,263	160	1,221	96.70%	$26,086
10.1 - 15	65	811	61	757	93.34%	$13,892
15.1 - 20	28	490	25	442	90.20%	$7,605
20 - 50	16	463	14	418	90.33%	$6,007
50+	0	0	0	0	0.00%	$0
Total	**480**	**3773**	**436**	**3479**	**92.20%**	**$73,681**
Average Storage Fee Rate per sq m	$21.18 p.c.m.	$254.16 p.a.				
Total Current Monthly Storage Fee Revenue at current occupancy ex GST	*$73,681*					

rate. The schedule fee rate is the rate that would apply if full listed or asking fee rates were applied. In practice various forms of discounting apply or there are lags in adjusting existing customer fee rates to schedule rates.

Average store fee rates vary considerably. For example rates in the Sydney metropolitan area may vary between $200 per square metre p.a. ex GST and $370 per square metre p.a. ex GST of occupied storage space. Average storage fee rates are influenced by a range of factors including the location of the facility, the level of competition in the customer catchment area of the facility, the storage unit mix in the facility and the quality of management applied in the operation of the facility.

SSAA research shows the average unit size for facilities in NSW, Queensland and Victoria at between 9 and 10 square metres. However, it is traditional for inner city facilities to have a high proportion of smaller units (units less than 6 square metres) which in turn delivers an average unit size of between 6 and 8 square metres over the whole facility.

Smaller units will produce substantially higher overall income for a defined total rentable area. However there is sometimes a tendency for new developments to construct larger unit sizes and generate occupancy by area and earlier cash flow than if a higher number of smaller units were constructed and made available. In practice, fit-out is done on a staged basis. This allows modifications to unit mix based on direct experience of initial rent up.
Whether conducting initial feasibility or reviewing existing operations, analysis of unit mix and revenue utilising a matrix similar to that shown in Table 2 above will provide insight into the performance of a storage facility. This analysis tool allows examination of storage unit demand by unit size and the relative level of incomes produced. Results will indicate how unit mix may be modified to maximise rental income or areas of weakness in the existing unit configuration.

Table 3

End of month Statistics	May-07 1	Jun-07 2	Jul-07 3	Aug-07 4	Sep-07 5	Oct-07 6	Nov-07 7	Dec-07 8	Jan-08 9	Feb-08 10	Mar-08 11	Apr-08 12
Monthly Revenue	$62,636	$62,960	$66,487	$67,673	$66,810	$67,020	$68,654	$69,985	$72,465	$72,205	$70,028	$70,962
Area occupied inc open storage	3291	3321	3325	3354	3366	3388	3291	3477	3624	3600	3379	3311
Total Area	3796	3797	3797	3800	3800	3800	3800	3800	3800	3800	3800	3800
Occupancy % by area	86.7%	87.5%	87.6%	88.3%	88.6%	89.2%	86.6%	91.5%	95.4%	94.7%	88.9%	87.1%

Because of the dynamic nature of self-storage revenues, consideration of month-to-month performance over a period of time is necessary. This will allow the identification of occupancy and revenue trends in a valuation or investment conclusion. A sample of this form of analysis is shown in Table 3 and Figure1.

Operating costs

Each facility will incur direct site operating expenses. The most significant of these costs are attributable to:

- Facility advertising;
- On-site management staff salaries and costs,
- Insurance costs; and
- Rates and taxes.

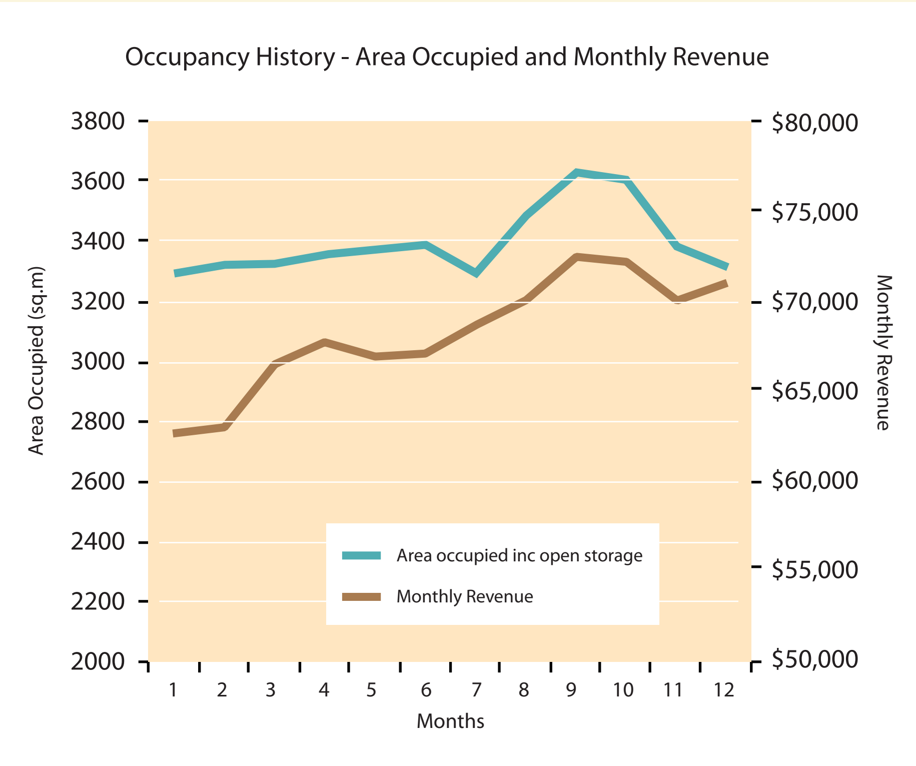
These items typically represent the major portion of direct site operating costs. There is, however, a range of other costs that are incurred in the normal operation of a storage facility. These include bank charges, telephone charges, printing and stationery charges, management software licences, repairs and maintenance, energy charges and cost or merchandise for resale.

Operating costs as a percentage of gross revenue can vary significantly from facility to facility but typically are between 25% and 35% for mature facilities. Percentages will be materially higher for facilities not operating at mature occupancy levels or which do not represent a full development of the site on which they are located. Lager facilities tend to achieve some economies of scale and will typically show a lower operating cost to revenue percentage. Operating costs are direct facility costs and exclude off-site management or corporate management costs.

An amount for off-site or corporate management charge should be included in valuation calculations or other financial return analysis. This charge is in addition to direct site operating costs. Whilst storage facility operators apply marginally different fee structures, off-site management fees are most usually calculated as a percentage of gross revenue for mature storage facilities. Most commonly, off-site management fees are calculated as 7% of gross revenue. However this may vary for portfolio management arrangements or where the facilities are in occupancy build-up phase and initial revenues are limited.

An off-site management charge may not be incurred as a direct expense where a facility is self managed. However a management fee would be incurred if the facility was to be purchased and operated on an investment basis.

Figure 1



Development and barriers to entry

Development of self-storage facilities faces the same fundamental issues of project feasibility as other commercial real estate investments. In recent years, the costs of the development inputs of land and building costs have outstripped increases in storage fee rates and end values to a point where new development is viable in only a very limited number of circumstances.

It is also evident that in many locations the existing supply of self storage has reached market saturation. The analysis of new self-storage development has become one of the more complex and demanding areas of valuation and consulting practice. Any consideration of new development must address the level of competing storage facilities within the customer catchment area and the performance levels achieved in competing facilities. New project feasibility analysis should include consideration of demographic detail of the customer catchment. Research (*Self Storage Demand*

Study 2008, Self Storage Association of Australasia and Blackwell Consulting, 2008) shows that approximately 75% of storage customers are drawn from within a 20-minute travel time from a storage facility). Accordingly competitor analysis and examination of the demographics of a potential customer base should focus on the area generally defined by a 20-minute travel time. The definition of a primary catchment will be affected by transport corridors, urban congestion and natural barriers such as waterways or reserves.

Building costs have also shown strong increases. This has been particularly evident in the period between 2006 and 2008. A very high component of typical self-storage building and internal unit fit-out is steel construction and increase in steel fabrication costs contributed to the greater proportion of self-storage building cost increases in recent years.

In addition to the usual barriers limiting general real estate development, barriers to development of new self-storage facilities includes:

1. The extended period required to develop reasonable levels of occupancy within a facility. It is usual for a new facility to take two to three years to develop occupancy levels in excess of 85%. Hence, the development of new facilities requires investors to be able to sustain the business with relatively low levels of income, withstanding operating losses in the initial trading period.
2. The requirement for specialised and experienced management. Efficient self-storage facility management requires:
   - Specialised marketing skills to attract storage customers;
   - Strong client relationships to ensure a good level of extended occupancy;
   - Continual monitoring of unit configuration and pricing structures to ensure maximisation of revenue; and
   - Strong financial control systems and practices to ensure rental delinquency is kept to a minimum and debt recovery is maximised.

Valuation and investment parameters

Both Capitalisation of Net Operating Income Methodology and Discounted Cash Flow (DCF) Analysis methodologies are applicable to valuation of self-storage facilities. The market places greater weight on initial yield in negotiation of transaction prices. However, informed purchasers are aware of the variations in income levels that occur with variations in occupancy and storage fee pricing policy. These and other variables are best displayed in DCF analysis. Accordingly the results of both methodologies are considered as appropriate in the assessment of the going concern value or other forms of financial analysis of self storage facilities.

Valuation of facilities at the commencement of operation or at lower occupancy levels presents significantly more complex considerations as occupancy build-up and mature revenue levels remain unproven. These areas stand as a major element of risk. In these circumstances DCF analysis is likely to provide the most transparent basis of assessment and the best means of demonstrating net cash flows over the early stages of the operation of the storage facility.

Transaction analysis provides evidence of a general strengthening in yields for quality self-storage properties to mid 2007. Yields for mature occupancy facilities showed a yield range of 8.0%

... the development of new facilities requires investors to be able to sustain the business with relatively low levels of income, withstanding operating losses in the initial trading period.

to 11.0%. The yield at the upper end of this range reflects earlier (older) sales evidence. This is consistent with general trend in other commercial real estate markets which also experienced significant yield compression up to mid 2007. Self-storage investment yields remained significantly above the yields achieved in more traditional forms of commercial and industrial use real estate investments.

Tightening of credit conditions and economic uncertainty has acted to constrain the market, softening yields and increasing IRR expectations. While there is a body of self-storage investors remaining in the market, it is evident that purchasers are taking a more restrained approach to acquisition negotiations. There is emerging evidence that recent conditions have resulted in a softening in yields in the range of 0.75% to 1.0% above the lower yield range shown in transactions occurring in 2007. ■

Valuation of Self Storage Facilities

(Exposure Draft) I March 2009

Exposure Draft

Valuation of Self Storage Facilities

As a result of discussions with the Self Storage Association of Australasia together with support by major institutional investors, the Institute established a working group to prepare a draft for consideration by the Australian Valuation and Property Standards Board and the National Professional Board.

The resultant document is now issued as an Exposure Draft and is also available on the API National website **www.api.org.au** in the News/ Information section.

The API would appreciate your feedback regarding the Exposure Draft. Please forward any comments to the API Professional Standards Manager, Tony McNamara via email **tmcnamara@api.org.au** by close of business 1 June 2009.

"Warning. Draft Practice Standards (PS), Guidance Notes (GN) and Information Papers (IP) do not have any formal standing until such time as they are adopted by the National Council of the API as being suitable for use by members. They must not be relied upon, reproduced or used by any member or any other party for any reason whatsoever. Reliance should be given to currently adopted/approved/ sanctioned Practice Standards, Guidance notes and Information Papers only. Members and the general public are warned that Draft Practice Standards, Guidance Notes and Information Papers may be at various stages of the rigorous development and review process discussed within this Guide and that they may change or be amended during this development process. Therefore only current PS, GN and IP contained within the Australia and New Zealand Valuation and Property Standards manual should be used."

1 Introduction

1.1 Purpose

The purpose of this Guidance Note is to set out matters to be addressed in the valuation of operating self storage facilities. The items addressed in these notes are in addition to those required by ANZVGN2 Valuations for Mortgage and Loan Security Purposes and IVGN12 Valuation of Specialised Trading Properties.

1.2 International Valuation Standards

This Guidance Note recognises the International Valuation Standards 1 and 2, and International Valuation Application 2, prepared by the International Valuation Standards Committee. This Guidance Note is also intended to be consistent with the concepts and definitions contained in those standards, however, there may be departures from IVSC Standards to reflect Australian and New Zealand law and practice.

2 General Explanation of Self Storage Operations

Self storage operations involve the licensing of storage areas to private and business users for the storage of goods. Storage users may select from a range of storage unit sizes provided within the property.

Self Storage Operators typically apply a standard storage licence agreement and apply a monthly storage fee. Storage fees vary depending on the size and location of the storage unit occupied. Because the licence agreement typically operates on a month-to-month basis the operator may review the storage licence fee at any time. The frequency and amount of storage fee increases will depend on the management strategy of the operator, the level of competition and storage fees applied in competing facilities.

It is a fundamental element of operation of a self storage facility that the operator does not take care, custody or control of the goods stored. In a limited number of cases operators receive and hold goods on behalf of customers. This requires a specific, modified storage agreement.

In addition to direct storage fees, self storage facilities may also derive revenue from late payment charges, cleaning charges when storage units are vacated, sale of storage related merchandise, and sale of insurance for customer goods in storage.

3 Instructions and Basis of Valuation

3.1 The Role of the Valuer

The Valuer needs to demonstrate in a report an understanding of the operation of the subject property, the operator's management arrangements, the self storage market place, surrounding competition and any specialised features of the facility.

It is important that the Valuer obtains sufficient detail in relation to the current storage unit configuration, storage unit occupancy, current revenues, operating expenses and arrears status of occupied storage units. It is incumbent upon the party instructing the Valuer to ensure that the Valuer has access to records and information from which the above detail may be extracted.

3.2 Going Concern

The valuation should clearly state that it has been undertaken as a 'going concern' self storage facility on a 'walk-in walk-out' basis inclusive of all plant, equipment, furniture, fittings and merchandise stock as appropriate.

Going concern valuations are based on the net income associated with the operation of the whole of the self storage activities on the property.

3.3 Facilities Subject to Lease to an Operator

Some self storage facilities are subject to leasehold interests. Valuation of a self storage facility subject to a long term leasehold interest of land and buildings is not a going concern valuation. Valuation of self storage facilities subject to leasehold interests should reflect the net cash flow associated with the lease and the specific terms of the lease.

3.4 Accepting an Instruction

Prior to accepting an instruction, a valuer must be confident of having the necessary expertise and sufficient information to undertake the valuation. For example, if the valuer does not have complete or appropriate access to comparable sales and trading data for the subject self storage facility, then the valuation instruction should be declined, or undertaken in conjunction with a valuer who has the expertise and access to such information.

4 Operational Detail

Operational arrangements may vary from facility to facility and there are variations in management and operation arrangements in various regions. Accordingly the valuation should identify and describe the operation arrangements applied in the facility being valued. This would include a description of the following items:

- The form of storage agreement utilised;
- Storage unit fee payment arrangements;
- Late payment fee policies;
- Insurance of customers' stored goods;
- Arrangement for the display and sale of merchandise;
- Office operating hours; and
- Access hours for existing customers.

5 Building Improvements

5.1 Building Construction and Services

The valuer should consider the design characteristics and form of construction of the property, including specialised features that may impact upon the ability to attract self storage customers, viability of operation, and marketability.

The construction, design and general condition of improvements need to be considered in the context of their specialised use, with the following being examples of relevant factors:

- The form of construction and materials used including consideration of the buildings' ability to provide adequate ventilation, insulation against temperature extremes and protection against water penetration;
- The size and mix of storage units, accessibility of storage units including vehicular access, corridor layout and width and lift or hoist systems where multi-level storage is utilised;
- Signage;
- Size, location and appearance of reception and merchandise display areas;
- Onsite caretaker's or manager's accommodation;
- Customer parking and docking arrangements;
- Access systems including gate access controls and arrangement for after hours access; and
- General site security and unit security including perimeter access control, unit alarms and video monitoring.

5.2 Repair and Condition

The valuation should comment on the state of repair of the improvements of

the property, including any outstanding works to be completed and any modification or maintenance work required. Any item that may affect the continuing efficient operation of the self storage facility should be identified

An annual repair and maintenance expense allowance is a normal item of operating expense and the valuation should include a provision for repair and maintenance as part of normal operating expenses. However it may also be necessary to apply an initial capital expense amount in valuation calculations where building defects present an immediate impediment to continued efficient and competitive operation of a self storage facility

6 Valuation Calculation

6.1 Valuation Methodology

Capitalisation of net operating income is the most commonly applied method in valuation of self storage facilities.

Discounted Cash Flow (DCF) analysis is also a very effective and complementary methodology, particularly for substantial self storage facilities. The net operating income should be calculated before depreciation, amortisation, interest, tax and capital expenditure deductions. Such calculations being on a GST exclusive basis.

Experience suggests that the market initially places greater weight on capitalisation (yield) calculations in negotiation of transaction prices. However, informed purchasers and vendors are clearly aware of the variations in net income levels that occur with variations in occupancy. This and other variables are often best displayed in DCF analysis.

The results of both methodologies should be applied in the valuation of larger facilities particularly where occupancy levels may not have reached a full, mature level. Because of the static nature of capitalisation calculations, this methodology develops complexities and anomalies when applied to facilities operating at a less than mature occupancy level.

Calculations should demonstrate a transparent connection between actual calculations and current performance levels of the facility. If calculations apply revenue or expense details that vary from actual current amounts there should be a clear explanation and rationale provided for the variations.

An extensive range of operating expenses typically applies in the good management of operating self storage facilities. It is necessary to ensure that compete and realistic expenses are applied in the valuation calculations.

Calculations should display all critical assumptions and inputs, including the capitalisation rate applied. In DCF analysis there is a need to provide a disclosure of other valuation elements including escalation rates, discount rate applied to future revenues and value calculations applied at the end of the assumed investment period.

6.2 Revenue and Trading Performance

The Valuer should clearly establish the current, actual revenue of the facility at the date of valuation. This should be supported by disclosure of elements supporting the actual revenue. This will involve:

- Identification and description of the total net rentable storage area available.
- A clear disclosure of the units and unit areas that are occupied and accruing storage fees.
- Detail of the current actual storage fee rates achieved and accrued (excluding incentives or other distorting factors) for occupied storage areas.
- Details of other income amounts including such items as late fees, sale of goods in custody insurance, merchandise sales or other areas of incidental revenue.
- Analyse and make provision for customer delinquency and delinquency write-offs.
- A month-by-month history of occupancy level and associated accrued storage fees over time. A 12-month trading history is generally sufficient to identify any correlation between occupancy and revenue trends.

Accrued storage fee revenue is typically equated to a rate per square metre of occupied space per annum (rate per square metre per month X 12) for analysis and comparison purposes. Analysis of variations in the achieved storage fee rate per square metre will illustrate pricing performance over time. It should also be noted that storage fee revenue rates may be influenced by additions or modifications to the number of storage units or the mix of storage unit sizes.

Where a valuation applies a revenue or occupancy level that differs from the current level being achieved, this should be clearly stated. In these circumstances the Valuer should also state the basis upon which variation in revenue or occupancy will occur including the period over which the Valuer considers these variations will occur.

6.3 Operating Expenses/ Outgoings

The valuation should establish the operating expenses applied in the calculations.

Detail of full-year operating expenses associated with the normal operation of the facility should be included in the valuation. This should be provided on an itemised basis and include, but not be limited to, advertising costs, site management wages, insurance costs, rates and taxes, bank charges, power costs, telephone charges, merchandise purchases and maintenance costs.

An amount for head management fees should be included in valuation calculations. This amount is in addition to the direct site operating expenses. While this amount is not always incurred as a direct site expense, a management fee would be incurred if the facility were to be purchased and operated on a true investment basis.

The Valuer should critically review operating costs provided, and where it is evident that costs are out of line with industry standard management practices or where significant items have been omitted, the Valuer should make appropriate adjustments to bring costs in-line with industry standards. These adjustments should be clearly disclosed and explained in the valuation report.

6.4 Existing Licence and Management Agreements

It is not uncommon for facilities to operate under management or general branding agreement. The valuation should provide detail of these agreements where applicable including detail of fees and charges applicable under such arrangements. The valuation should clearly state if the assessment is subject to continuation of the Licence or Management Agreement.

6.5 Surplus Land/Additional Capacity

It is often the case that self storage facilities have not fully utilised the whole of the site or the whole of the building within which they operate. It is not unreasonable to attribute a value to undeveloped areas within a facility which are not currently income producing or at full income potential. However the value attributed to these areas should be realistically assessed and clearly described in the valuation. Application of revenues based on hypothetical potential does not typically provide a reliable assessment of the current market value. Values based on immediately achievable use are more reliable.

7 Competition

The performance of a self storage facility is impacted by the level of competition from other self facilities. The Valuer should be conscious of current and proposed competition within the customer catchment area of the self storage facility being valued and where possible discuss the performance of the competing facilities.

Customer catchment areas may vary and are influenced by the position and number of other self storage facilities in the area, transport corridors, natural barriers such as waterways and the demographics and population density of immediately surrounding suburbs.

8 Sales Evidence

8.1 Sales Analysis

It is not always possible to obtain sufficient information to fully analyse every sale. However, the valuer still needs an appropriate level of sales that have been adequately analysed in order to arrive at an opinion of value.

It is not uncommon for self storage facilities to be combined with other uses such as more traditional industrial premises or vacant land. Sales analysis and examination of property yields should identify these varying property uses and make specific adjustments to reflect the component elements.

The sale of 'going concern' self storage facilities typically involves the concurrent and interdependent sale of real property and a sale of a business. Accordingly reliance upon a reported property transfer amount that may be shown in general property data base material can be misleading as it is often only the property component of the transfer that is recorded. In analysis of sale of going concern transactions, it is essential for the Valuer to determine the total consideration paid including both property and business transfer amounts.

8.2 Initial Yield vs. Equivalent Yield

The simplest yield analysis is the calculation of the passing net income (gross revenue less operating expenses) as a percentage of the Purchase Price. This is referred to as the Initial or Passing Yield.

It is however, quite common for self storage facilities to be purchased at occupancy levels that are below a mature occupancy level. This will result in the initial yield being at a relatively low level. In practice, purchasers may pay amounts reflecting the expectation that occupancy levels will increase and there will be a corresponding increase in storage fee revenues and net income. The yield calculated on the basis of expected increased occupancies and associated net income is referred to as an Equivalent Yield.[1] In effect, this is the rate that the Valuer should compare to the adopted capitalisation rate.

9 General Issues

9.1 Leasehold Tenure

In cases of self storage held upon leasehold title, the impact of the ground rent on returns/incomes should be fully considered and reflected in the valuation calculations.

9.2 GST Caution

The valuer should consider the manner in which similar properties are bought and sold from a GST perspective and adopt the most appropriate treatment of GST accordingly. Properties transacted on a 'going concern' basis may be exempt from GST. ■

(1) Australian Property Institute, 2007, *Glossary of Property Terms,* Deakin ACT.

Legal Notebook

Recent cases, headline issues and new legislation

Innocent Party's Right to Termination on Breach of Non-Essential Terms of Contract

~ HIGH COURT OF AUSTRALIA ~

Koompahtoo Local Aboriginal Land Council v Sanpine Pty Limited [2007] HCA 61 (13 December 2007)

In the *Sanpine* Case, the High Court clarified the circumstances where an innocent party to a contract has the right to terminate the contract at common law even though the terms breached were non-essential.

The Joint Venture and the Agreement

On 14 July 1997 Koompahtoo Local Aboriginal Land Council and Sanpine Pty Ltd entered into a joint venture agreement for the development and sale of land near Morisset, north of Sydney. Koompahtoo contributed the land while Sanpine contributed its expertise in project management. Each party had a 50% interest in the joint venture. Sanpine was also entitled to receive a management fee equal to 25% of the total project costs.

The joint venture imposed several obligations on Sanpine which included the maintaining of proper books of account and financial records and to provide information on the financial position of the joint venture.

Despite incurring the costs of $2 million on the security of mortgages over the land, the joint venture failed to obtain approval to have the land rezoned for commercial use. This project involved sensitive environmental issues and was unattractive to financiers. Therefore, it was difficult for the joint venture to secure external funding to finance the project. In April 2002, a caveat was placed on the title of the land which impeded the prospects of further funding. In April 2003, the mortgagee went into possession of the land and an administrator of Koompahtoo was appointed in order to find out the financial position of the joint venture from Sanpine. By then, the administrator found out that Sanpine had failed to maintain proper books of account and financial records and was not able to deliver the information of the financial position of the joint venture as requested. In December 2003, as Sanpine had breached its obligations under the agreement, the administrator wrote to Sanpine to terminate the joint venture agreement.

Sanpine commenced proceedings in the Supreme Court of NSW alleging the agreement had been invalidly terminated by Koompahtoo. It also claimed damages from Koompahtoo for unlawful termination. Koompahtoo responded claiming Sanpine had breached its obligations which constituted essential terms of the joint venture agreement.

The High Court Findings

The High Court overturned the NSW Court of Appeal's decision and held that the joint venture agreement was validly terminated. The High Court considered there had been a sufficiently serious breach of a non-essential term under the agreement by Sanpine which entitled

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Koompahtoo, an innocent party, to terminate the agreement at common law, noting (at para. 58):

> *"This is a question of construction of the contract to be decided in the light of its commercial purpose and the business relationship it established ... Sanpine's obligations as to dealing with joint venture funds (which were borrowed on the security of Koompahtoo's land) and maintaining proper books and accounts were of importance, not only to working out the ultimate result of the joint venture when the land had been developed and sold, but also to enabling the parties (and a person such as the administrator) to know material facts, and to make decisions and judgments informed by that knowledge. The inability of Sanpine to inform the administrator, or even the trial judge, of the true financial position of the joint venture, and to produce informative joint venture accounts, exemplifies the point. It was not within the contemplation of the contract that it should have been necessary for Koompahtoo, at any time, to have engaged in extensive legal process in order to find out what had become of the money borrowed on the security of its land, or to assess the financial state of the joint venture."*

The High Court emphasised that *"the focus of attention should be the contract and the nature and the seriousness of the breaches"* (at para. 68) and confirmed that the primary judge's approach in this case was correct. The High Court held that even though the breaches by Sanpine of its obligations under the agreement were non-essential, Sanpine's breaches were gross and had serious consequences. The breaches went to the root of the contract. As a matter of construction of the contract, the breaches deprived Koompahtoo of a substantial part of the benefit for which it contracted and those breaches justified termination.

At para. 71 the Court observed: *"Even if one were to accept that all of the contractual obligations with which Sanpine failed to comply were inessential in that, on the true construction of the contract, not every breach would justify termination and that the obligations were intermediate terms in the sense earlier discussed, nevertheless, as Campbell J and Bryson JA held, the breaches of Sanpine were in a number of respects gross, and their consequences were serious. Once again, the experience of the administrator following his appointment, and the unsuccessful attempts at the hearing before Campbell J to explain the use of all the funds borrowed on the security of Koompahtoo's land, demonstrate that the breaches found by Campbell J, and in particular the breaches of cl. 16.5, went to the root of the contract. As a matter of construction of the contract, it ought to be accepted that breaches of that order deprived Koompahtoo of a substantial part of the benefit for which it contracted. Such breaches justified termination. On that ground, we would uphold the decision of the primary judge."*

The lesson in this case is that in order to avoid unnecessary legal costs and lengthy legal disputes on the validity of termination of contracts, both parties should, prior to entering into a contract, clearly identify within the contract those provisions which give rise to an entitlement to terminate the contract for breach thereof. The parties may also specify that certain breaches may only give rise to a right to damage claims rather than a right to terminate. The High Court also revisited the principles enunciated by Jordan CJ in *Tramways Advertising Pty Ltd v Luna Park* (1938) SR (NSW) 632 at 641-642 and this discussion was most instructive.

Terms of Lease Agreement Inferred from the Conduct of Parties

~ COURT OF APPEAL SUPREME COURT OF WESTERN AUSTRALIA ~

Lighting By Design (Aust) Pty Ltd v Cannington Nominees Pty Ltd [2008] WASCA 23 (8 February 2008)

The decision of the Court of Appeal Supreme Court of Western Australia in the *Lighting By Design* case highlights the importance for a new owner to re-examine the status of the lease with an existing tenant. The WA Court of Appeal upheld the tenant's claim that a new lease had been created based upon the doctrine of part performance.

The Facts

In May 2004, Lighting By Design as tenant entered into a written lease with Parkworld Holdings Pty Ltd to lease commercial premises in Cannington, for a term of seven years with an option to renew for a further five years. Lighting By Design did not register the Lease nor lodge a caveat in respect of the lease.

In July 2006, Cannington Nominees purchased the premises from Parkworld. Cannington Nominees did not enter into a new written lease agreement with the existing tenant, Lighting By Design. Cannington Nominees retained Parkworld's agent and intended to relet the premises at a higher rent but did not communicate such an intention to the existing tenant. Meanwhile, the agent continued to deal with Lighting By Design in precisely the same way as the agent had dealt with the lessee under the Parkworld lease.

Cannington Nominees had received legal advice prior to the purchase of the premises that they were not bound by the lease and they proceeded to find a new tenant to relet the premises at the prevailing market rent after the purchase. In

February 2007, after finding a new tenant, Cannington Nominees wrote to Lighting By Design confirming that Cannington had received an offer from a third party to lease the premises at a higher rent and that Lighting By Design had seven days to accept a lease on the terms and conditions offered by the third party. If Lighting By Design did not accept the offer, Cannington would serve notice of termination of the tenant's occupation of the premises. Lighting By Design did not accept the offer and did not vacate the premises. Instead, the tenant commenced court proceedings claiming that there was a new lease between itself and Cannington Nominees because it had sufficiently part performed the lease and the new lease was on the same terms as the previous lease.

The Issues

It was left to the Court to determine whether the various acts of the tenant constituted sufficient part performance of a lease and whether the terms of the lease should be inferred from the conduct of the parties. The tenant claimed that the dealings between itself and the owner gave rise to a new lease which should be on the same terms as the previous lease.

Sufficient Acts of Part Performance

The Court noted (at para. 155) that *"the doctrine of part performance requires that the acts of part performance, of themselves, without reference to evidence of an oral contract, demonstrate the existence of the contract. It is first necessary to exclude from consideration the evidence of any alleged oral contract between the parties and look at the acts relied upon in the light of the surrounding circumstances as revealed by the rest of the evidence."*

The Court, citing previous authorities, noted that the correct approach in this case is *"whether the relevant acts of the appellant are sufficient part performance of an agreement of the kind alleged by the appellant and then consider whether or not an agreement for lease in the terms asserted by the appellant should be inferred from the conduct of the parties."* (at para.160)

Elements of Part Performance

The Court stated that the acts of part performance must be unequivocally referable to the agreement as alleged, and the Court needed to look at all the relevant circumstances to determine whether the agreement had been partly performed. In this respect the Court noted (at para. 169): *"The acts of part performance that a plaintiff is required to establish must be his own acts, and not those of the defendant. However, acts of the defendant, whilst not amounting to part performance, may nonetheless be relevant. The referability of acts of part performance must be determined in all the relevant circumstances, and there is no reason in principle why from those circumstances there should be excluded or omitted those that consist in or result from the acts of the defendant: see Spry, I C F* The Principles of Equitable Remedies: Specific Performance, Injunctions, Rectification and Equitable Damages *(7th ed, 2007) 272."*
(at para. 168-169)

In the present case, the Court found that there had been sufficient acts of part performance by the tenant so as to give rise to a new lease on the same terms of the previous lease between the tenant and the new owner. The various acts of part performance included:

(a) the tenant continued in possession of the premises after the new owner became the registered proprietor coupled with the payment of rent at an increase rate subsequent to a rent review;

(b) the tenant continued to pay water rates, council rates and land tax;

(c) the tenant delivered insurance certificates to the agent as requested.

The owner bound by the terms of the previous lease

The Court agreed that the previous unregistered lease did not bind the new owner. However, as there had been part performance of a lease between the tenant and the owner, a lease did exist. As to what terms governed the lease, the Court needed to consider the conduct of each of the parties and examine what the parties appeared to have intended.

... the owner had continued to deal with the existing tenant as if the parties were still bound under the previous lease.

In this case, the Court found that the conduct of the owner *"would be understood by a reasonable person in the position of the appellant to establish or assume an agreement to lease between the appellant and the respondent on terms the same as the terms of the Parkworld Lease with any necessary modifications."*
(at para. 209)

The Court found that based on the conduct of the owner (as stated below) the owner had continued to deal with the existing tenant as if the parties were still bound under the previous lease.

(a) delivery of the invoice/statement of 1 August 2006 which was consistent with the owner permitting the tenant to remain in occupation of the premises on payment of one month's rent at the rate of the rent payable under the previous lease;

(b) letter of 30 August 2006 to the tenant with invoice/statement permitting the tenant to remain in occupation of the premises on the payment of rent and outgoings payable under the previous lease;

(c) letter of 19 September 2006 requesting a copy of currency of insurance and stated that it was required under the terms and conditions of "your lease";

(d) letter of 19 October 2006 to the tenant stating that the rent was in arrears and asserted that "under the terms of your lease all the rental and other payments are due on the first of each month".

In addition, there were a number of letters in evidence related to rent review, payment of water rates, council rates and land tax that referred to "the amounts payable under the terms and conditions of your lease".

The Court found that based on the above conduct of the owner, a reasonable person in the position of the tenant would understand that the owner had agreed to lease the premises on the same terms as those contained in the previous lease.

> *"Objectively viewed the appellant and the respondent conducted themselves as if there was an agreement between them for the respondent to lease the Premises to the appellant on the same terms as those contained in the Parkworld Lease, including the term of the Parkworld Lease that is for a term expiring on the Termination Date prescribed in the Parkworld Lease." (at para. 222)*

The Court allowed the appeal having found that there was a lease which had been sufficiently part performed by the tenant and that the lease was on the same terms as the previous lease with such variations as had been agreed by the parties.

Compulsory Acquisition with No Compensation if Betterment Value Exceeds Market Value

~ NEW SOUTH WALES COURT OF APPEAL ~

AMP Capital Investors Limited v Transport Infrastructure Development Corporation [2008] NSWCA 325 (27 November 2008)

This is a compulsory acquisition case decided by the New South Wales Court of Appeal under the *Land Acquisition (Just Terms) Compensation Act* 1991. The Court found (in dismissing the appeal) that the betterment figure for acquiring the subject land exceeded the sum of the market value and disturbance figures, and no compensation was payable to the landowner.

The Facts

After the approval of the Parramatta Rail Link (PRL) project by the NSW State Government in 2002, the Transport Infrastructure Development Corporation ("Transport") decided to acquire leasehold interests in part of AMP's premises, the Macquarie Shopping Centre ("the Centre") for the purpose of construction of a railway station next to the Centre. In April 2003, Transport acquired a leasehold interest in two lots of land which formed part of the centre.

In May 2003, Transport served a Notice of Determination of Compensation on AMP providing a sum of $683,150 in compensation for acquiring those two lots of land. AMP disputed the amount of compensation and commenced court proceedings claiming $21.46 million under the *Land Acquisition (Just Terms Compensation) Act* 1991 which made up of $2.34 million market value, $5.74 million for disturbance and $13.37 million for the decrease in value of other land due to injurious affection. Transport argued that there would be a substantial betterment to the land in dispute as a result of the public purpose behind the project and thus no compensation should be paid.

The Land Acquisition (Just Terms Compensation) Act 1991

The Issues

(i) The question of betterment of $15 million.

(ii) The failure to apply s.54.

(iii) The market value of the acquisition.

(iv) The identification of the public purpose.

The Decision

The Betterment of $15 million

The Court was satisfied that on any reasonable assessment regardless of particular expert opinion a shopping centre with the potential for a railway station next to it would be considered more valuable by a hypothetical purchaser than a shopping centre without that potential, as a railway station will bring greater patronage to the centre.

The Court also decided that it was likely that there would be a 5% increase in the value of the Macquarie Centre as a result of the PRL project based upon an expert valuer's evidence. The figure for *betterment* was estimated at $15 million which was the amount of value a prudent hypothetical purchaser was likely to pay in the circumstances.

The Court had to consider an expert valuer's evidence in order to determine the increase or decrease of the value of land in acquisition pursuant to s.55(f) of the Act.

The Court noted (at para. 41-42):

> *"s.55(f) requires the court to have regard to any increase or decrease in the value of land by reason of the carrying out of or the proposal to carry out the public purpose; and if there is some material capable of rationally supporting a decision as to such an increase or decrease in value, the court has to do its best to determine that increase or decrease: cf Hornsby Shire Council v Roads and Traffic Authority of New South Wales (1998) 100 LGERA 105 at 108-9, per Stein JA (Priestley JA and Sheppard AJA agreeing).*
>
> *In this case, there plainly was some such material. There was Mr Hack's (Land Economist and Planner) evidence as to increased patronage, and Mr Wood's (Valuer for Transport) evidence that this meant increased value in the order of 5 to 10% ... Mr Wood was an expert valuer, and in my opinion his opinion was admissible; and although the weight of the evidence may be considered slight because of the lack of reasons, it was nevertheless material capable of rationally supporting a conclusion."*

Application of s.54

It was argued by AMP (at para. 58):

> *"in circumstances where AMP was compelled to spend over $5.7 million in constructing ramps, it could not be considered as justly compensating AMP that it receive nothing, because of an extremely uncertain benefit which it might receive sometime in the future. Also, because of s.3(1)(a) and s.10(1)(a) of the Just Terms Act, the market value of the acquired land must be seen as the bare minimum that AMP should receive."*

AMP further submitted that the primary judge had failed to address the above considerations and that s.54(1) had not been applied.

Section 54 Entitlement to just compensation

(1) The amount of compensation to which a person is entitled under this Part is such amount as, having regard to all relevant matters under this Part, will justly compensate the person for the acquisition of the land.

However, the Court noted that (at para. 62-63): *"One object of the Just Terms Act is to guarantee that compensation be not less than the market value of the acquired land (unaffected by the proposal), that is, the element of compensation provided by s.55(a). Section 10(1)(a) authorises the giving of a notice, stating that the Just Terms Act does guarantee this. Although this notice is not given in connection with actual negotiations for compensation or proceedings in which compensation is assessed, and although it cannot give rise to a civil cause of action (s.10(3)), it is plainly intended that the notice be truthful and not misleading. In my opinion, these provisions disclose a clear legislative intention that compensation be no less than that provided by s.55(a), even if there is "betterment" under s.55(f) that exceeds the other elements in s.55.*

I see this as consistent with and supported by s.54(1). Where land is compulsorily acquired, it seems to me just that the acquiring authority pay at least the market value of that land (unaffected by the proposal), even if the person from whom the land is acquired owns adjoining land which is increased in value by the proposal, and even if this increase is greater than the market value of the acquired land. Other persons owning land in the area may benefit equally or more from the proposal; so it seems to me unjust that the acquiring authority should get the acquired land for nothing, and that the person whose land is acquired should get nothing for it, just because of a benefit that may be shared by others. Thus a lower limit of the market value (unaffected by the proposal) seems just; and this is what s.3(a) and s.10 indicate is to be guaranteed."

The Court (at para. 73) rejected AMP's argument that there should be wider discretion to hold that "the compensation to AMP should be at least the market value of $5.7 million; because AMP had been compelled to pay out that amount; and because that amount should not be reduced by reason of a highly uncertain benefit that may come about some time in the future."

Market Value of the acquisition

The Court affirmed the primary judge's approach in the valuation of the market price of the acquired land and noted (at para. 87-88): *"what is acquired is an interest in land such that there is no reasonable possibility that there would be available for comparison sales of interests that are truly comparable; so that, as a matter of valuation technique, an acceptable method is to look for some different interest in respect of which there are comparable sales, and to extrapolate from those sales.*

In this case, if a judgment is correctly made that the highest and best use of the land is as part of a regional shopping centre site, it would be reasonable to conclude that the most realistic comparisons would be of acquisitions for amalgamation with such sites; and it is unlikely in the extreme that there would be acquisitions of that kind which would be acquisitions of a leasehold interest for six years. If one limits the comparable sales to sales of leasehold interests, one would not be dealing with comparable sales in respect of which the highest and best use of the land is given effect to."

Identification of Public Purposes

The Court found that the judgment made by the primary judge, that planning changes, to which the PRL was a contributing factor, but which also involved discretionary decisions by other authorities, should be disregarded for the purposes of s.55(f), was correct.

The Court noted:

> *"Section 55(f) refers to "... by reason of the carrying out of ... the public purpose for which the land was acquired". The land was acquired by the State Rail Authority (now TIDC) under the Transport Administration Act. I consider that given those specific words in the section there is a short answer to TIDC's submission that the public purpose for which the land was acquired includes the planning changes mooted for Macquarie Park in the EIS for the PRL. TIDC, the acquiring authority, is not responsible for, and indeed has no power to effect, rezoning of land. The proposed planning changes referred to in the EIS relied on by TIDC simply cannot therefore be within the public purpose contemplated by TIDC in undertaking this compulsory acquisition." (at para. 92)*

ERRATUM

The December 2008 Issue of the Australian and New Zealand Property Journal

Legal Notebook at page 685

In referring to the case of *Minister Administering the Crown Lands Act v NSW Aboriginal Land Council* [2008] HCA 48 (2 October 2008), the summary in the first paragraph in column two of page 685 is *correct* where it says:

"On the basis that there had been no actual or practical use of the crown land by the government at the time of the claim, the majority found that the claim to Land Rights should not have been refused by the Minister, and upheld the NSW Court of Appeal decision."

However, an error was made in column three on the same page in respect of the last paragraph where it said:

"The appeal by the Minister of Lands against the Land Rights claim was successful. The Wagga Aboriginal Land Council's claim was unanimously dismissed by the High Court of Australia."

It should have read:

"The appeal by the Minister Administering the Crown Lands Act against the land rights claim was unsuccessful. The High Court agreed with the NSW Court of Appeal decision that the land claimed by the Aboriginal Land Council was claimable Crown land."

Accounting for Owner-Occupied Property: Goldmine or Landmine?

David Parker SF Fin

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Adoption of AIFRS may have been expected to provide increased transparency in financial statements. However, the failure by corporates to adopt the flexibility and transparency offered by AIFRS for reporting owner-occupied property potentially creates landmines and goldmines, rendering financial statements less useful to recipients and raising risk management issues for shareholders, analysts and other interested parties.[1,2]

Since their introduction for annual reporting periods beginning on or after 1 January 2005, the Australian adaptation of the International Financial Reporting Standards (referred to as AIFRS) has attracted sustained criticism in the Australian financial press. Regular sources of complaint have included a lack of flexibility and a "one-size-fits-all" approach, resulting in claims of reduced transparency in financial statements and diminished usefulness to recipients.

While the requirements of accounting for owner-occupied property under AIFRS may be considered extensive, arguably, they also offer flexibility to suit the varied uses of property by different corporates. Such flexibility may encourage increased transparency in financial statements, leading to potentially enhanced usefulness to recipients. However, it is unclear as to what extent corporates are availing themselves of the flexibility offered in accounting for owner-occupied property and whether there is any resulting increase in transparency rendering financial statements more useful to recipients.

Owner-occupied vs investment property

In examining the implications for AIFRS of owner-occupied property, it is relevant to focus on property which is owned by a corporate principally for occupation and use by that corporate. This may be distinguished from property which is owned principally for the purpose of investment, such as the property held by a real estate investment trust or listed property trust.

Under AIFRS, accounting for owner-occupied property is considered in AASB 116 (AASB, 2006) and investment property is considered in AASB 140 (AASB, 2006). Both AASB 116 and AASB 140 are based on the premise that the corporate is a going concern, requiring the entity to intend to retain the asset in continuous use (otherwise classifying such an asset as surplus) and also that the asset meets the test of adequate potential profitability in relation to the whole of the entity's assets.

Owner-occupied property is addressed in paragraph 6 of AASB 116, superseding the previous relevant Standard, AASB 1041 Revaluation of Non-Current Assets.

As will be considered further below, under AIFRS, corporates essentially have a choice between two alternative methods

to account for owner-occupied property in financial statements – either the cost model or the value model.

Prior to the introduction of AIFRS, Leo et al (2001) noted that, while the value model provides more relevant information than the cost model, it is also more expensive to adopt due to valuers' fees, management review time and record keeping costs.

A survey of corporate Australia's adoption of AASB 1041 (Revaluation of Non-Current Assets) (Ernst & Young, 2002) provided some interesting insights into the attitude of corporates towards the cost model and the value model. The survey analysed the impact of the adoption of AASB1041 by 129 corporates, finding that 30% of entities previously adopting the value model continued to do so following the introduction of the Standard.

Significantly, however, 40% of entities chose to change the basis of measurement from the value model to the cost model, with none choosing to adopt the value model instead of the cost model. Further, 60% of the changes to the basis of measurement were found to occur in the "Land and Buildings" class.

The authors concluded that cost effectiveness and flexibility were two key factors affecting management's decision in choosing the measurement basis, citing references in the notes to financial statements that the costs of complying with the value model (being the potential requirement for regular independent valuations) exceeded the benefits (being improved relevance and reliability of financial information) that would be gained.

A clear undercurrent of comfort with the cost model is evident in some accounting texts, with references such as "the valuation treadmill" (Deegan, 2004) indicative of a negative view of the value model.

It may be contended that the level of cost incurred in managing a valuation program for an owner-occupied property portfolio would not be significant relative to the total value of the portfolio. Similarly, with the increasing use of web-based reporting and decreasing use of printed financial statements, the costs incurred in reporting the greater level of data arising with the use of the value model would also appear to be insignificant.

The general lack of interest in and attention to the value model in financial statements is echoed in legal texts. Interestingly, Baxt (2005) notes case law concerning a failure by directors to value property purchased by the company, which was considered careless behaviour but was excused as the inadequate valuation of assets was not critical.

Accordingly, in the pre-AIFRS environment, a propensity to adopt the cost model to account for owner-occupied property in financial statements may have prevailed. To determine if this propensity continues in the post-AIFRS environment, a small cross-sectional study was undertaken, with the results being detailed below, following a brief consideration of the differences between the cost model and the value model under AIFRS.

Cost model vs value model

Paragraph 15 of AASB 116 requires owner-occupied property, plant and equipment to be measured at cost on recognition. However, after recognition, an entity may choose to adopt either the cost model or the value model for application to an entire class of property, plant and equipment but, if the cost model is applied to land, this is not subject to depreciation.

The cost model requires determination of cost less accumulated depreciation and accumulated impairment losses, being the amount by which the carrying amount exceeds the recoverable amount. The recoverable amount is the higher of the fair value of an asset less the cost of sale or the value in use of an asset, which is an entity specific assessment. Accordingly, if the cost model is adopted, the recoverable amount for an asset should also be determined at balance date, requiring data from both the cost model and the value model for comparison.

For a large, complex, business-specific property, such as a manufacturing plant, the cost model may be more appropriate. Such property may be designed and constructed to suit the specific requirements of the business and is assumed to have an ongoing use within a going concern. Accordingly, cost less depreciation is a logical method of determining fair value for the purposes of financial statements.

However, determination of the recoverable amount is potentially contentious. If the value model is adopted to determine fair value as the recoverable amount, a variety of challenges may arise. The alternative uses potentially permissible by a planning authority for the site may be unclear, the extent of costs associated with site remediation may be uncertain and so forth. Similarly, an entity-specific assessment of value in use may be far from straightforward to determine.

Unless the determination of the recoverable amount is comprehensively undertaken, there is the potential for such aspects as site remediation to be understated and the value to be overstated, potentially creating a landmine in the financial statements.

Conversely, for smaller, less complex generic property such as warehouses or offices, contentious issues such as allowable uses under planning regulations and costs of remediation are potentially far less significant. However, escalating underlying land value or increases in market value levels for warehouse and office investments may produce a result using the value model that is far in excess of cost less depreciation. Where such a recoverable amount is higher, the corporate may elect not to realise this until disposal, potentially creating a goldmine in the financial statements.

The challenge for the recipient of the financial statements is then to determine which are the appropriately assessed assets, the landmines and the goldmines and the relative size of each in order to understand the net impact on the financial position of the corporate.

When using the cost model, AASB 116 notes that users of financial statements may find the gross carrying amount of any fully depreciated property, plant and equipment that is still in use to be "relevant to their needs". This prevents the building element of owner-occupied property from falling off the radar simply because it has been fully depreciated though it may still be of value and capable of sale or require expenditure for remediation. It does, however, question the validity of the cost model where the depreciation rate adopted would appear greater than the rate of depreciation occurring, effectively leading to mis-depreciation.

... cost effectiveness and flexibility were two key factors affecting management's decision in choosing the measurement basis...

After recognition, a corporate may select the value model which requires fair value to be measured on a regular basis, to ensure that it does not differ materially from the carrying amount. The fair value of land and buildings is usually determined as their market value by appraisal from market-based evidence undertaken by a professionally qualified valuer (paragraph 32, AASB 116). While AASB 116 is not as detailed in its guidance on property valuation as its predecessor, AASB 1041, many of the relevant concepts for property valuers are addressed through the requirements of International Valuation Standards (IVSC, 2005).

A required frequency of valuation is not specified, but encouraged to be frequent for assets with "volatile changes in fair value". This is, however, qualified by a requirement that the entire class of property to which the asset belongs should then be revalued.

With more than 100 commercial, retail and industrial property sub-markets in Australia, it is challenging for a corporate to monitor the relative volatility of each to determine the frequency of valuation. It may, therefore, be anticipated that corporates determine manageable classes of property and establish and maintain a rolling program of revaluations for the respective classes of property.

AASB 116 also requires the disclosure of whether an independent valuer was involved, the valuation method(s) adopted and, significantly, the carrying amount that would have been recognised had the assets been carried under the cost model for each class. For completeness, use of the cost model under AASB 116 also encourages disclosure of the amount that would result under the value model.

Adoption of a range of classes of owner-occupied property and provision of the above information for each, in accordance with AIFRS, may be expected to provide a high level of transparency in financial statements leading to potentially enhanced usefulness to recipients and a reduction in the likelihood of landmines or goldmines in such financial statements.

Approaches adopted by corporates: a case study

As noted above, previous research found that a propensity to adopt the cost model in financial statements prevailed in the pre-AIFRS environment. To determine if this propensity has continued into the post-AIFRS environment, a small cross-sectional case study was undertaken with the results detailed below.

The cross-sectional study comprised an analysis by web search of the most recent annual reports and financial statements for the 20 largest corporates by market capitalisation listed on the ASX at close of trading on 25 January 2008. While this approach to sampling captures Australia's largest corporates, it also provides a sample that is skewed towards the financial services and mining sectors.

The 20 largest corporates analysed had total balance sheet assets of $2,464,903 million of which property, plant and equipment comprised $125,161 million or 5.1% of total assets. Within property, plant and equipment, property represented only $16,025 million or 0.7% of total assets. Therefore, although the total property portfolio of Australia's 20 largest corporates is of substantial value, it only comprises less than 1% of total assets, which may influence the level of attention focused on its measurement by corporates.

Findings of case study

While AASB 116 favours the use of the value model, 80% of corporates by number have adopted a cost-based measure with only 20% by number adopting a value-based measure. For the five mining or energy companies, the use of the cost model may be justified by the absence of market based evidence or the specialised nature of their assets, but there is no such justification for the balance of 11 companies.

Although a corporate could create a range of classes of property for transparent reporting using a sectoral (warehouse, office, residential, etc.), geographic (NSW, Queensland, Victoria, etc.) or operational (administration, manufacturing, storage, distribution, etc.) basis, 80% of corporates by number adopted three categories or less with land, buildings or leaseholds most common.

Within the 80% of corporates adopting the cost model, 50% explicitly addressed the issue of impairment losses thereby indicating that such corporates had actively considered the issue. Exactly how they had then addressed this in the preparation of financial statements was unclear, as was how the remainder had considered impairment losses. Only one corporate adopting the cost model disclosed an amount for fully depreciated property, plant and equipment on the balance sheet.

Within the 20% (four) of corporates adopting the value model:

- three explicitly addressed the frequency of revaluation;
- two explicitly addressed the date of valuation, with one specifying the day/month/year and the other specifying the year;
- only one explicitly nominated the independent valuation practice used, despite the additional confidence that the use of a specified valuer known for his/her expertise in a particular type of asset may provide to readers of financial statements; and
- three explicitly addressed the valuation method(s) adopted.

Although three corporates adopted an annual valuation frequency cycle, the approach of the minority was unclear.

Of the 20% (four) corporates adopting the value model, three stated the amount that would apply under the cost model, whereas, of the 80% or 16 corporates adopting the cost model, only two referred to the value model and none quantified the relevant amount under the value model. Effectively, 85% by number either were unaware or did not report the corresponding model.

Although AIFRS provides corporates with considerable scope to report a range of matters in financial statements that would assist with transparency, the overall reporting of such matters is surprisingly limited. It is particularly disappointing that

the information which may be of most assistance to users of financial statements in determining the possible existence of landmines or goldmines, being the corresponding valuations under the cost model and the value model, was not reported by 85% by number of those corporates analysed, indicating a potential risk management problem.

The challenge for the recipient of the financial statements is then to determine which are the appropriately assessed assets, the landmines and the goldmines...

Conclusion

It is ironic that AIFRS has been criticised for a lack of flexibility and a "one-size-fits-all" approach, resulting in claims of reduced transparency in financial statements and diminished usefulness to recipients. In the context of reporting owner-occupied property in financial statements, the reverse would appear to be the case.

Through continued reliance on the use of the cost model, with limited supporting information, corporates are generally failing to avail themselves of the flexibility offered under AIFRS in accounting for owner-occupied property.

While adoption of the cost model is, in itself, less transparent than adoption of the value model, the unwillingness of corporates to then disclose all that AIFRS encourages to be disclosed under the cost model is particularly disappointing. The failure by corporates to adopt the flexibility and transparency offered by AIFRS for reporting owner-occupied property potentially renders the resulting financial statements less useful to recipients.

The reluctance by corporates to adopt the value model is perplexing. While corporates may claim that the value model is disproportionately expensive and time consuming, with owner-occupied property comprising less than 1% of total assets this would not appear likely to be a significant impost, particularly as owner-occupied property represents around $16,025 million of shareholder funds, which deserves a greater level of transparency.

Further, in periods of high levels of stock market volatility, it may be argued that information concerning the value of an owner-occupied property portfolio (even if only disclosed in the notes to financial statements) may be of considerably greater use to recipients than information concerning cost, which seriously questions the relevance of the cost model for financial statements.

The provision of details of fair value under the value model, the valuer and the approach adopted to determine fair value, together with the amount that would have been recognised under the cost model, potentially provide a high level of transparency in financial statements.

Regular revaluations and their grounding in current open market transactions limit the potential for goldmines to become hidden in financial statements, thereby optimising shareholder value. Similarly, the investigation of alternative uses potentially permissible by a planning authority, and the potential costs of remediation etc. within the revaluation process limit the potential for landmines to become hidden in financial statements, providing there is an effective additional source of risk management.

AIFRS provides a framework within which accounting for owner-occupied property in financial statements could be both very transparent and very useful to recipients. Regrettably, corporates currently choose not to fully avail themselves of the flexibility and transparency available under AIFRS, which limits the usefulness of such financial statements to recipients. This choice effectively renders it almost impossible for shareholders, analysts and other interested parties to ascertain whether a corporate's owner-occupied property portfolio includes any potential goldmines or landmines despite the consequent impact on shareholder value. ■

Endnotes

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[2] This paper has previously been published in the Financial Services Institute of Australasia's *JASSA* (quarterly Journal of Applied Finance).

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