AUSTRALIA and NEW ZEALAND PROPERTY JOURNAL

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The impact of political risk on Australian house prices

Leaky buildings and tax in NZ

Bridging the affordable rental housing gap

An overview of the child care industry

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API NATIONAL PRESIDENT'S REPORT

Nick McDonald Crowley

API National President

Notwithstanding the ongoing credit squeeze around the globe it is puzzling to fathom lenders' treatment of their clients and consultants following the Global Financial Crisis (GFC). Lending Institutions need to be responsible corporate citizens and work with existing and potential clients when the going gets tough – that is highlighted by Government's intervention in assisting some participants in the lending sector. Lenders also need to look at their own internal practices when losses are actually crystalised rather than "who can we go-for to recover our loss".

I applaud the members of the Institute who are upholding the Professional Practice Standards and principles of the profession with valuations and advice on property in today's climate. It is not easy with such external pressure. The principles of the valuation process have stood the test of time in circumstances of cyclical change. The GFC and other market downturns do not mean that the profession's valuation principles and practice standards need to change, on the contrary. Stability and sustainability with the Institute's Valuation Standards are one of the foundations for economic recovery and future development and this approach is just as relevant today as it was pre-GFC – perhaps even more so. And when it comes to "blaming the valuation", as suggested in the financial media recently, then have consideration for the deals brokered by lenders who were actively engaged in aggressive lending policies.

The fact remains that the valuations done by members of the Australian Property Institute pre-GFC used exactly the same Valuation Standards as applied post-GFC, and I urge all members to regularly review and revise these important documents.

The critical importance of members participating in continuing professional development (CPD) programs and further education is being magnified by the current climate. I urge all members to actively pursue the Division's CPD programs and events to help keep property experts at the leading edge of their profession.

The International Valuation Standards Committee (IVSC) has published an Exposure Draft of proposed new International Valuation Standards. This follows global and national regulators calling for the standards of international practice to be raised. The Institute has a responsibility to review the global recommendation but it does not mean it is either relevant or necessary considering the high level of regard our members have in all sectors of the industry. The Institute, through the National Professional Board, will review the Exposure Draft with the expressed purpose of making sure the highest level of standards continue to be adopted in this country and effectively presented to our members.

Since my last report, the Institute has presented three submissions to the Australian Government. These are:

1. Submission to the Business Tax Division of the Australian Government Treasury on its consultation paper "Native Title, Indigenous Economic Development and Tax".
2. Joint submission (with Spatial Industries Business Association Australia) to the Productivity Commission on "Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments".
3. Submission to the Department of Climate Change and Energy Efficiency on its public discussion paper, "National Building Energy Standard-Setting, Assessments and Ratings Framework".

Separately the Institute has provided a submission to the ACCC on the Valex/RPData merger. The National Director and I, along with a selection of NSW State representatives, also met with the Australian Prudential Regulation Authority to discuss the role of Property Professionals and Valuers in the current economic environment.

The increase in members involved with valuation determinations is also noted by the Institute. Members will be aware of the proposal for an API Capped Liability Scheme. Whilst this has the support of Professional Standards Australia, it is not possible at this stage to run the program nationally. The Institute is seeking endorsement in those states in which we can run the policy and I am pleased to announce that the roll out will continue. A new entity, the Australian Property Institute Valuers Limited, has been established to operate and manage the Capped Liability Scheme for members – a requirement of the Professional Standards Council. It is worthwhile noting that the scheme will be mandatory for Institute members who undertake the valuation of Real Property.

These are positive moves for the Institute and are a direct result of National Council's commitment to embracing change. But the Institute is not just actively addressing market influences and liability issues. Internally, the challenge has been to move to an improved administrative operation under the new Content Management System (CMS). As I noted to you in my last Journal column the roll out has not been without its problems. The technical advances and resulting challenges are confronting, particularly for our staff, and I continue to be appreciative of their efforts in this regard. Emerging issues, now being assessed, were impossible to quantify at the time of commissioning the CMS and these issues are having a snow-ball effect on some service deliverables, like the website. The priority for National Council is the financial reporting capability and I must thank the tireless efforts of the CMS Task Force, lead by Tony Gorman (WA), who are channelling resources to support Divisions for this statutory requirement.

Nick McDonald Crowley

President

Australian Property Institute

PINZ PRESIDENT'S REPORT

Ian Campbell
PINZ President

The Valuers Super Summit held in Auckland in June was well supported with more than 330 delegates treated to a broad and relevant selection of topics for today's professional. The day event included the annual general meetings for both the Property Institute and New Zealand Institute of Valuers (NZIV). I am very pleased to acknowledge the election of Nicola Bilbrough as NZIV's new president, replacing Blue Hancock after his solid term in office. Thank you to those members who attended the AGMs and the VRB risk management seminar. The Summit provided the opportunity to launch the Property Institute's new logo and the evening comprised a centennial dinner that recognised more than 100 years of valuation in New Zealand, our annual awards, a presentation on New Zealand's first valuation and concluded with some light entertainment.

Our Property Institute awards provide an opportunity to recognise the outstanding achievements of individuals or companies within the property industry. This year we continued the tradition of awarding some high achievers within our ranks and industry. We were pleased to award Dr Sandy Bond of Lincoln University with this year's academic award recognising her continued support to academia; Rachaelanne Oswald of Darroch Limited as this year's young property professional; Jazial Crossley, property reporter at the NBR, for this year's media award; and Jones Lang LaSalle (represented by John Church) for this year's innovation award. This year the JM Harcourt Memorial Award (first awarded in 1975) was awarded to Prof. Bob Hargreaves of Massey University for his outstanding contribution. The Institute elevated seven senior members to fellowship status. Once again, our warm congratulations are offered to all recipients of this year's awards and fellowship advancements in recognition of their support of the Institute and the property industry.

Since launching this year's valuation celebrations and recognising the first formation of the Auckland Real Estate Valuers Association in 1910, branches around New Zealand have initiated their own functions including the Otago Branch, who held a centennial luncheon in July. This was the perfect opportunity to recognise and acknowledge both past and present valuer members who service the Otago region. Their celebration was specially showcased in the local media. Pleasingly we have been fortunate to capture on video some of our retired senior valuers from around the provinces to record their stories. Video interviews can be seen by members on the Institute's YouTube website – http://goo.gl/sXO9

As we are more than halfway through the current year, I am able to report that the Institute finances are tracking well and to budget. Our combined Institute membership now holds at more than 2,600 members and there are a number of initiatives for 2011 including proposed changes to Valuation standards, as proposed by the IVSC. Also, the Institute has been busy mustering support to address regulatory issues presented through the Commerce Commission concerning licensing of Property Advisors under the Financial Advisers Act and the potential for licensing of Property Managers under the Real Estate Agents Act. These matters were still to be resolved by the regulators at the time of writing.

On a general note, commentators continue to report that the New Zealand economy is gradually improving, albeit weakly. Members may be aware of these trends. In the media we continue to read about offshore investor interest into New Zealand's productive rural sector, an early indication perhaps of the demand for our products and the value that these products have in other countries.

By contrast it is problematic that within New Zealand, it continues to be difficult to fund projects or raise capital for projects. On this basis it is likely that we may well see a fresh wave of the traditional NZX listed offerings, including property listings, to attract domestic capital. Given that the Reserve Bank base lending rate is currently 3.0 per cent but tracking slightly higher, and with a future cut in company tax rates from 30 per cent to 28 per cent to apply, I believe the stage is set to support an increase in economic activity leading into 2011 and next year's general election.

Throughout the year the Property Institute has continued to engage with its members, sponsors, the public, report in the media, lobby central government and the property industry generally. One of our primary goals has been to reinforce our position as New Zealand's leading Institute for property professionals.

As reported by the Ministry of Economic Development, New Zealand may not be a nation of small shop keepers, but with 90 per cent of enterprises having five or fewer employees, it is certainly a place of small and medium enterprises.

I know that for the Institute's part, nearly all of our members contribute in some way to the economy, ensuring that enterprises whatever their size are offered qualified professional advice. There is never any shortage of the need for professional advice.

Ian Campbell
President
Property Institute
of New Zealand

This article has been peer reviewed

The Impact of Political Risk on Australian House Prices

By **David M. Higgins** and
Wejendra Reddy
of RMIT University

Abstract

In several countries, high house prices have emerged as a significant social and economic issue. This exploratory study examines if house prices can be linked to the political cycle, specifically at election time, as governments realise home owners represent a large voter base and house price movements will influence their voting intentions. To examine this relationship, the research utilises 40 years of quarterly Melbourne house price data to examine the relationship between the movement in real house prices one year before and after local (state government) and national (federal government) elections.

Over the last four decades, Melbourne quarterly real house prices increased by 1.24% (annualised 5.05%). One year before an election, on average, the quarterly real house price increased by 1.21% federal and 2.33% state. This compared to one year post election of 0.84% federal and 0.60% state. At state government election time, depending on the political parties, there is a divergence on house price movement. As this research clearly identifies major variations in house price performance around election time, residential property decisions should make reference to the political cycle.

Introduction

Clearly housing is more than a unique and valuable investment asset class. It is a key component of societal wellbeing in providing shelter and as a source of economic activity. As housing is an important component of a country's prosperity, controlling the various aspects of housing is clearly a core long-term government mandate.

In acknowledging government's responsibilities for housing, the type and timing of policies across various levels of government can have far reaching effects on house prices. The extent of the

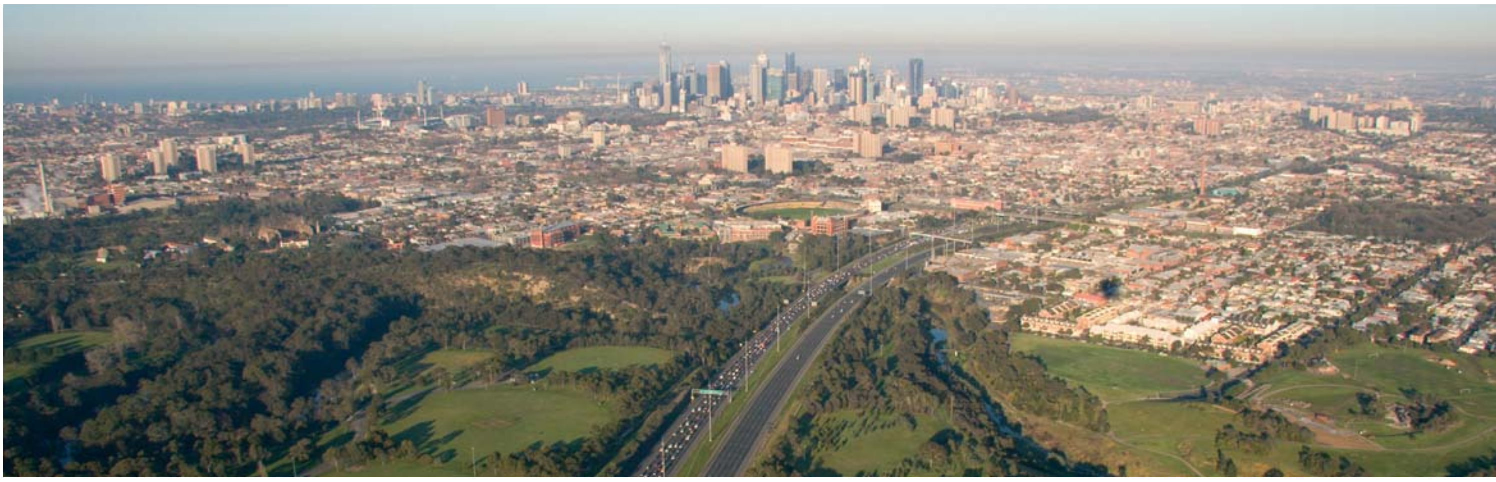
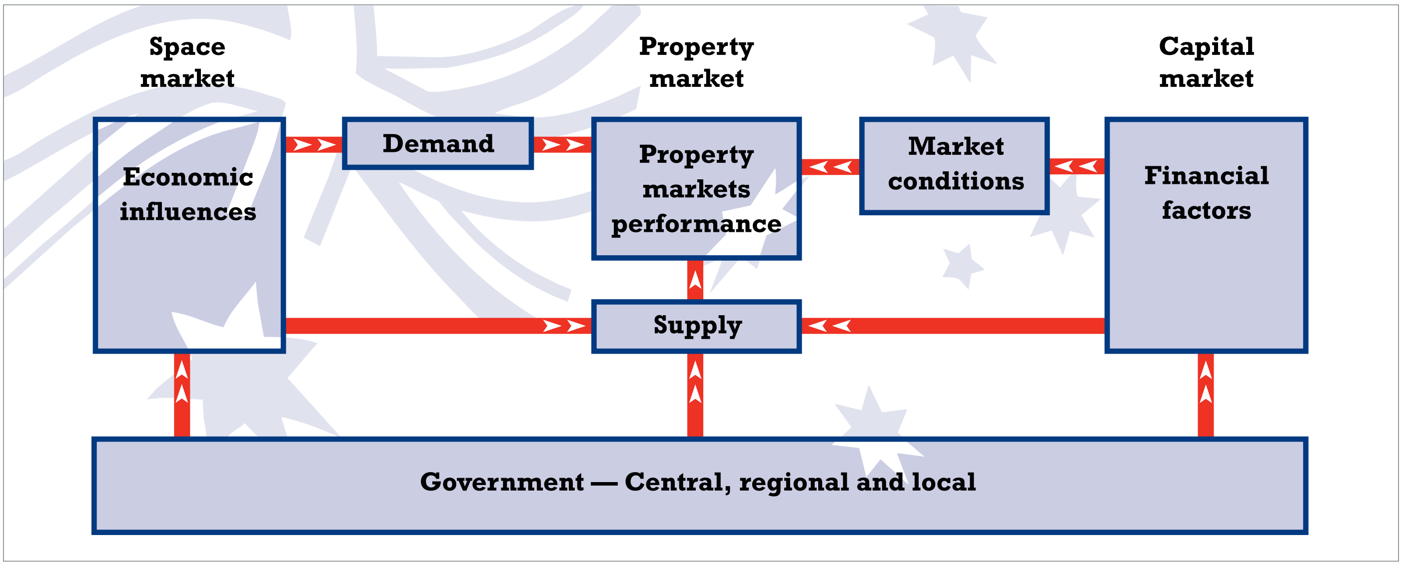


Figure 1: Property Market Structure



Adapted: Archer and Ling 2007

government policies can be illustrated by examining the structure of the property market, with reference to Figure 1 showing the established three-market model which shows the relationship of the property, space and capital markets.

Figure 1 illustrates governments' influences across the property, space and capital markets. Government policy examples which can impact on house prices are as follows:

i. Space market (Demand)
   - Population policies (quotas on overseas migration)
   - Incentives for first-time home buyers
   - Opportunities for overseas owners to purchase residential properties

ii. Capital market (Finance)
   - Monetary policies (money supply, government bonds)
   - Changes in property taxes (negative gearing, transaction tax – stamp duty)
   - Regulations that impact on alternative asset classes
   - Changes in superannuation policies (in an indirect way)

iii. Property market (Property market conditions and supply)
   - Release/rezoning of new residential land
   - Changes in planning policies (housing density)
   - Building regulations (sustainability agenda).

In detailing government housing policies, policy timing and implementation can be used to manage and stimulate the housing market. The impact of these policies on house prices could be gradual or immediate. As home owners represent a large percentage of the voter base those policies implemented close to an election may influence their voting intention. If a link can be established, future research on house-price movement may relate less to traditional property cycle features and more to the political cycle.

The purpose of this research is to study the behaviour of house prices under various national and local political environments. This can be achieved by examining real house-price performance over time for a specific residential property market. For this research Melbourne house prices was used as a representative case study. In grouping house-price movement before and after elections, the impact of the political cycle can be compared to long-term real residential property returns.

It should be noted that this research is not intended to endorse particular political parties, but rather to illustrate an approach for evaluating the impact of the political cycle on house prices. Similarly, it is outside the scope of this research to examine specific political factors which have impacted house prices.

Following this introduction, Section two provides a literature review on housing and political cycles. Section three details the selected residential property market data with national (federal) and local (state) political elections and the research methodology. Section four provides the empirical findings and the implications. The last section provides the concluding comments.

Literature Review

Economic theory has evolved, with major milestones providing new ways of thinking about the nature and theory of managing economic markets. Work by Marx (1867), Keynes (1936) and Friedman (1962) have introduced new concepts that have shaped economic strategies.

Importantly, Keynes (1936) acknowledged the role of governments to use all powers at their disposal to influence aggregated demand. Governments have available fiscal measures including changes in tax rate and spending alongside monetary measures associated with the management and supply of money.

In providing the tools to manage the economy, government actions may be politically motivated to assist in their re-election. Nordhuas (1975) presented the "*Political Business Cycle*" whereby suggesting government policies can manipulate the economy for electoral gain. These have been identified in three key areas:

i. Macroeconomic outcomes: economic growth, lower inflation and lower unemployment etc
ii. Beneficial rewards: voter tax breaks etc
iii. Monetary policy: money supply and interest rates (in some countries interest rates are set independently by an appointed organisation, for example: Bank of England, Reserve Bank of Australia).

Source: Ladewig (2008)

In detailing government strategies that can affect the political business cycle, there is criticism that the literature is often theoretically and empirically weak surrounding these key areas (Drazen 2000, Keech 1995 and Suzuki 1991).

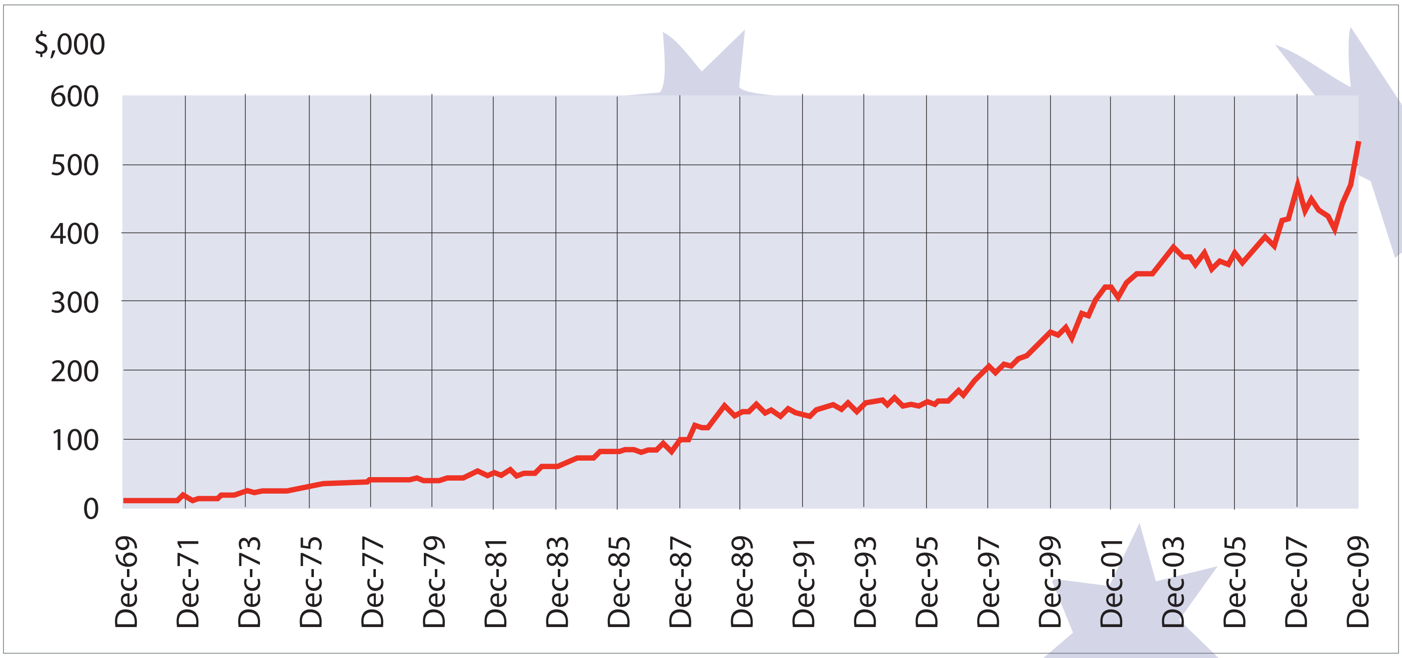
Contrary to the debatable links to the economy, research, particularly in the US, has coupled the political business cycle to investment asset classes. The relationship to equity and bond markets is centred on the performance of the asset classes, with reference to the political parties that were in power. The research provides conflicting evidence as to which political party provided overall better returns (Powell *et al* 2007, Ramchander *et al* 2009, Santa Clara and Valkanov 2003).

For Australia and New Zealand, Anderson *et al* (2008), extended the political cycle literature by considering the links between governments and the equities, bonds, and property markets. The findings suggest that all asset markets are affected by the inflationary effects of government policies. These differential inflationary patterns have consequences for investment markets, with property offering a natural hedge to inflation. The study did note that the differences in nominal returns, real returns and market risk premiums for the property market were insignificant across the Australian federal government parties.

Alternatively, Abelson *et al* (2004), looked to explain real house-price movement over the long term (1970-2003). Significantly, the research discovered a broad range of real house-price determinants (inflation, unemployment, mortgage rates and the supply of housing) all which are affected to a greater or lesser degree by government policies.

Berry and Dalton (2004) likewise commented on the security of a "*bricks-and-mortar*" investment being

Figure 2: Melbourne Median House Prices: 1970-2009



Source: REIV 2010, BIS Shrapnel 2009

supported in the past and continued to be influenced by government housing and social policies. The persistence of government policy interventions can change housing market outcomes with a range of effects, some being unintended and some contradictory.

In summary, many house-price drivers are linked to government macroeconomic policies, which are made within a political framework. Consequently, in this environment, housing outcomes, although difficult to validate, can be an important election vote winner as home owners represent a large voter base.

Data and Methodology

Data

Across Australia, determinants of the residential property markets can vary with local influences. For example in spring 2009, both the Perth and Brisbane residential property markets were performing above other state capitals, as these cities were associated with the booming resource sector (ANZ 2009).

In looking at a specific housing market, state and federal political cycles can be compared to residential property market movement. In Melbourne, the *Real Estate Institute of Victoria* collects and publishes established median house prices. Combined with an extended database from *BIS Shrapnel,* a quarterly 1970 to 2009 Melbourne median house data series was created. Figure 2 details the Melbourne median house price over the last 40 years.

Figure 2 illustrates the movement in Melbourne median house prices. The quarterly house-price movement represents 2.65% (annualised 11.05%). The level of movement varies over time with substantial growth occurring during the past decade, particularly over the last 12 months.

In detailing Melbourne median house price movement, annualised Melbourne inflation ranged from -0.4% to 17.7% over this time period. The changes in inflation would impact on comparison of different time periods. Therefore the research examined real house-price movement with inflation removed. This approach best reflects the movement in house prices separate from external factors.

The democratic political system in Australia comprises three tiers of government. Key political decisions are at federal and state levels, with local government generally being responsible for community services. The elections for federal and most state governments are held on a three-yearly basis with compulsory voting for those over 18 years of age.

A breakdown of the Australian political system and the government responsibilities is shown in Table 1.

The Australian political system is dominated by two parties, Liberal (conservatives) and Labor (democrats). Table 2 and Table 3 show the respective federal and state governments and the election dates. To coincide with the quarterly property data, the election dates are shown on a quarterly basis.

Table 1: Australian Government Responsibilities for the Economy

Level of government	Economic Infrastructure	Social Welfare
Commonwealth government	- Aviation - Telecommunication and post - National highways	- Tertiary education - Public housing (shared) - Health facilities (shared)
State government	- Roads (rural, urban, local) - Railways - Ports - Electricity supply - Dams, water, sewerage - Public transport (train, bus)	- Education institutions - Child-care facilities - Community health facilities - Public housing (shared) - Sport and recreational facilities - Cultural facilities - Libraries - Public order and safety
Local government	- Roads (rural, urban, local) - Sewage treatment - Water supply and drainage - Electricity supply	- Child-care centres - Libraries - Community centres - Nursing homes - Recreational facilities - Open spaces

Source: Higgins et al, 2007

Table 2: Federal Government and Election Details

Prime Minister	Party in government	Election Quarter	Assumed Office	Retired from Office	Period of service (Quarters)
John Gorton	Liberal Party*		Dec-68	Mar-71	13
		Sep-69	Sep-69	Mar-71	5
William McMahon	Liberal Party*		Mar-71	Dec-72	7
Gough Whitlam	Labor Party		Dec-72	Dec-75	12
		Dec-72	Dec-72	Jun-74	6
		Jun-74	Jun-74	Dec-75	6
Malcolm Fraser	Liberal Party*		Dec-75	Mar-83	29
		Dec-75	Dec-75	Dec-77	8
		Dec-77	Dec-77	Sep-80	11
		Sep-80	Sep-80	Mar-83	10
Bob Hawke	Labor Party		Mar-83	Dec-91	35
		Mar-83	Mar-83	Dec-84	7
		Dec-84	Dec-84	Jun-87	10
		Jun-87	Jun-87	Mar-90	11
		Mar-90	Mar-90	Dec-91	7
Paul Keating	Labor Party		Dec-91	Mar-96	17
			Dec-91	Mar-93	5
		Mar-93	Mar-93	Mar-96	12
John Howard	Liberal Party*		Mar-96	Dec-07	47
		Mar-96	Mar-96	Sep-98	10
		Sep-98	Sep-98	Dec-01	13
		Dec-01	Dec-01	Sep-04	11
		Sep-04	Sep-04	Dec-07	13
Kevin Rudd	Labor Party		Dec-07	- **	8

** Coalition government ** Outside the period of this data set, Kevin Rudd was replaced by Julia Gillard in June, 2010.*

Table 2 details the elected Australian prime ministers for the 40 years up until the end of 2009. The three-yearly electoral cycle produced 16 elections over the period leading to seven changes of government. The shortest period of government was the William McMahon government (20 months). The longest was the John Howard government of more than 10 years, having been re-elected three times.

The Victorian state government and election dates are shown in Table 3.

Table 3 shows that for the 40 years, there were 16 Victorian state elections with eight premiers. The shortest period of government was the Lindsay Thompson government of nine months, whilst Robert Hamer was in power for more than nine years and re-elected four times.

Methodology

To examine the relationship between the political cycle and house-price movement, the data was initially examined using descriptive analysis over each decade of the 40 years. In addition, the performance during each elected federal and state political party was examined over the time period.

In analysing the performance of the political parties, the political cycle can be examined using the performance of Melbourne house prices one year before and one year post election. An important consideration while interpreting the results is that the data only accounts for governments that have served for more than an 18-month post election period.

Table 3: Victorian State Government and Election Details

Premier	Party in government	Election Quarter	Assumed Office	Retired from Office	Period of service (Quarters)
Henry Bolte	Liberal Party*		Jun-55	Sep-72	69
		Jun-55			
		Jun-58			
		Jun-61			
		Jun-64			
		Mar-67	Mar-67	Jun-70	13
		Jun-70	Jun-70	Sep-72	12
Rupert Hamer	Liberal Party		Sep-72	Jun-81	35
			Sep-72	Jun-73	3
		Jun-73	Jun-73	Jun-76	12
		Jun-76	Jun-76	Jun-79	12
		Jun-79	Jun-79	Jun-81	8
Lindsay Thompson	Liberal Party		Jun-81	Mar-82	3
John Cain	Labor Party		Mar-82	Sep-90	32
		Mar-82	Mar-82	Mar-85	12
		Mar-85	Mar-85	Sep-88	12
		Sep-88	Sep-88	Sep-90	8
Joan Kirner	Labor Party		Sep-90	Sep-92	9
Jeff Kennett	Liberal Party*		Sep-92	Sep-99	28
		Sep-92	Sep-92	Mar-96	14
		Mar-96	Mar-96	Sep-99	14
Steve Bracks	Labor Party		Sep-99	Jun-07	31
		Sep-99	Sep-99	Dec-02	13
		Dec-02	Dec-02	Dec-06	16
		Dec-06	Dec-06	Jun-07	2
John Brumby	Labor Party		Jun-07	-	10

* *Coalition government*

Table 4: Melbourne Real House Prices Descriptive Statistics
Quarterly Data: Jan 70 - Dec 09

	1970s	1980s	1990s	2000s	Total
Mean	0.89%	1.54%	1.13%	1.28%	1.24%
Median	0.32%	1.41%	1.00%	1.63%	0.84%
Standard Deviation	6.41%	9.22%	5.91%	5.83%	6.91%
Kurtosis	- 0.03	0.41	- 0.87	- 0.31	0.57
Skewness	0.49	0.01	- 0.21	0.13	0.11
Range	26.20%	42.44%	21.40%	24.12%	42.44%
Minimum	-10.10%	-18.99%	-10.40%	-10.15%	-18.99%
Maximum	16.10%	23.45%	11.00%	13.98%	23.45%

In testing the robustness of the results, the analysis compared different performance periods over the dataset. Statistical significance tests provided inconclusive evidence that the means of the two groups were statistically different. It is possible that any house-price movement and the political cycle relationship are simply due to co-movements with external factors, for example, global financial crisis and natural disasters.

Results

The first step was to review the descriptive statistics for the Melbourne residential property market over 10-year intervals. This is shown in Table 4.

Table 4 shows that over the last four decades, the average quarterly percentage change in Melbourne real house price ranged from 0.89% to 1.54%. The 1980s provided strong returns, being 30% above the long-term trend. House price movement over the last decade was very close to the long term average.

Apart from examining the mean and the variation to the mean (standard deviation), the shape of the data can provide valuable information. The skewness shows the symmetry of the data around the mean (low figure preferred) and the kurtosis illustrates the "peakedness" of the data. A high kurtosis reading means the data is grouped close to the mean.

In each decade, the low skewness and low kurtosis readings demonstrate a flat bell curve as illustrated by high standard deviation readings above 5%, with a wide data range of between -10% and 10%. This shows that the movement in residential property market can be substantial and unrelated to movement in inflation.

The descriptive statistics for Melbourne house price performance under different federal and state political parties is shown in Table 5.

Table 5 details a relatively narrow quarterly house price range, 1.07% to 1.40%, for the federal and state political parties. This represents a relative

Table 5: Melbourne House Prices Descriptive Statistics – Federal and State Political Parties
Quarterly Data: Jan 70 - Dec 09

	Federal Labor	Federal Liberal	State Labor	State Liberal	Overall
Mean	1.31%	1.18%	1.40%	1.07%	1.24%
Median	1.69%	0.69%	1.74%	0.52%	0.84%
Standard Deviation	7.51%	6.43%	7.32%	6.49%	6.91%
Kurtosis	0.58	0.48	0.87	0.07	0.57
Skewness	0.12	0.07	0.06	0.15	0.11
Range	42.44%	34.48%	42.44%	33.35%	42.44%
Minimum	-18.99%	-16.74%	-18.99%	-15.62%	-18.99%
Maximum	23.45%	17.74%	23.45%	17.74%	23.45%
Count	72	89	83	78	160

difference of ±16% from the long term average of 1.24%. The difference in median values and to a lesser extent the standard deviation would suggest that Liberal federal and state governments have consistently less volatile returns to that of Labor federal and state governments. Although across the federal and state political parties, similarities appear to be evident with low skewness and low kurtosis readings. This data tends to illustrate no significant variation / differences in the Melbourne house-price performance either under the Labor Party or Liberal Party rule at both federal and state government levels.

Table 6 compares the Melbourne house-price performance during the first year of government by the Labor Party and the Liberal Party after each election at both federal and Victoria state government level.

Table 6 illustrates nominal differences in Melbourne house-price performance during the first year of Federal Labor and Liberal governments. The average quarter-on-quarter percentage change in Melbourne house price during the first term of Labor governments was 0.77%, slightly lower than 0.89% recorded by Liberal governments. However, at Victorian state government level, there is a notable difference, with Melbourne house prices recording a mean of 1.25% during the first year of Labor government, which is significantly higher than -0.04% recorded under the first year of Liberal rule. The major difference in performance at state government level may related to expenditure policies as Anderson *et al* (2008) argued that left-of-centre governments are more concerned with controlling unemployment than right-of-centre governments.

The Melbourne house-price performance one year before an election at both federal and Victorian state government level is shown in Table 7.

Table 7 shows similarities in Melbourne house-price performance at federal and state Labor and Liberal governments one year before an election. At the federal government level, the average quarter percentage change in Melbourne house price during the last year of a Labor government was 1.23%, slightly higher than 1.19% recorded by Liberal. At Victorian state government level, the Melbourne house price recorded a mean of 3.21% during the last year of Labor government, being close to double the 1.59% recorded under the

Table 6: Federal and State Governments First Year Election Performance Melbourne House Prices: Quarterly Data

First Year	Federal Labor	Federal Liberal	Federal Total	State Labor	State Liberal	State Total
Quarters	24	32	56	24	24	48
Mean	0.77%	0.89%	0.84%	1.25%	-0.04%	0.60%
Std. Dev	9.27%	6.01%	7.50%	7.56%	6.14%	6.85%

Table 7: Federal and State Governments Last Year Election Performance Melbourne House Prices: Quarterly Data

Last Year	Federal Labor	Federal Liberal	Federal Total	State Labor	State Liberal	State Total
Quarters	20	32	52	20	24	44
Mean	1.23%	1.19%	1.21%	3.21%	1.59%	2.33%
Std. Dev	6.23%	7.25%	6.81%	7.45%	7.46%	7.46%

last year of Liberal rule. These figures are well above the long-term 1.24% average for quarterly Melbourne house price performance.

For the entire data set, the quarterly performance of Melbourne house prices can be compared by examining the first and last year of the elected governments. This is exhibited in Table 8.

Table 8 illustrates how Melbourne house prices perform much better in the year before an election, compared to the first year after an election. For the federal government, there appears to be nominal difference between the parties. The overall performance of Melbourne house prices was close to 50% better in the last year of government compared to the year after the election.

In analysing the results, there appears to be a strong case that political parties see house prices as a key consideration prior to an election. This is evident in both federal and state governments. These pre-emptive policies by governments to support /stabilise house prices on the short-term could at a latter stage inflate house prices. The long-term effect on economic growth could be acutely suppressed by affordability issues across the residential property markets.

Conclusion

This study represents a systematic empirical examination of the political cycle's influence on Australian house prices. By examining the real long-term performance of Melbourne established house prices in relation to federal and state government elections, the impact and timing of their policies can be reviewed.

The key variation in house-price movement appears to be one year before and after federal and state elections.

Over the last four decades, quarterly Melbourne house prices increased by 1.24% (annualised return of 5.05%). There appears to be nominal variance in Melbourne house-price movement between the elected federal and state Labor and Liberal parties. The key variation in house-price movement appears to be one year before and after federal and state elections. Melbourne house-price performance is significantly better the year before an election compared to one year post election. This is evident at both federal and state government level, to varying degrees.

In recognising policy makers' active management of house prices for political gain, the short-term benefits of appealing to a large number of voters may conceal underlying long-term flaws in the residential property market. Leaving these issues unaddressed could be more complex than often perceived.

These findings identify an array of potential areas of study. By placing political cycles as part of the residential property research agenda, those that are linked to the residential property markets should include the political framework as part of the decision-making process.

Table 8: Federal and State Governments First and Last Year Performance Melbourne House Prices: Quarterly Data

Mean	Federal Labor	Federal Liberal	State Labor	State Liberal
First Year	0.77%	0.89%	1.25%	-0.04%
Last Year	1.23%	1.19%	3.21%	1.59%
Overall	1.08%	1.18%	1.20%	1.07%

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Six years in a leaky boat

This article has been peer reviewed

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Lindsay Ng

Stephen Rutherford and Lindsay Ng are members of the New Zealand Institute of Chartered Accountants' tax division. This article first appeared in the *Chartered Accountants Journal*, published by the NZICA, and has been republished with permission. The issue of leaky buildings has become particularly prominent in New Zealand in recent years and the underlying principles discussed here may also have potential ramifications for Australia. API thanks the NZICA for allowing re-publication of this article.

When what has become known as the leaky building syndrome first developed in New Zealand there were calls for all owners to be allowed a tax deduction for the remediation cost. There were also calls for the Government to allow GST refunds to all owners of leaky buildings for costs associated with the repairs and associated expenditure.[1]

In many, if not most cases, the owner of a leaky home will be using the premises for private purposes. Accordingly, the expenditure incurred by the owner of a leaky home will not be deductible, as it is expenditure of a private or domestic nature.

In the absence of any special legislation, this article concentrates on owners who will incur remediation expenditure in respect of deriving assessable or excluded income, or when the remediation expenditure is incurred in the course of carrying on a business. That is, owners who used the affected property in the course of deriving income.

Repair or renewal?

The treatment of expenditure incurred or compensation received in respect of remediation work is a classic capital versus revenue issue. Does the expenditure amount to a "renewal" (capital) or "repair" (revenue) of the asset?

It is not always clear where exactly the dividing line between "repair" and "renewal" lies, especially when it comes to fixing a leaky building.

Any leaky building expenditure that is a "renewal" will be of a capital nature and will not be deductible. Generally a "renewal" occurs if the whole or substantially the whole of the building is replaced or reconstructed. Similarly there will have been a "renewal" if the work carried out improves or materially changes the function or character of the building.

If none of these results occur the expenditure is a "repair" even if there has been replacement of some parts. It is all a matter of degree, the final answer will therefore be determined on a case-by-case basis.

Because the specific circumstances of each case determine the capital/revenue boundary, it is not possible to lay down any specific test. Indeed the NZ courts have not, and will not do so, on the grounds that such a test would be unhelpful and in some cases misleading. However the generally accepted approach in repair/renewal cases is to:[2]

- Identify the object to which the test of repair or replacement has been applied.
- Consider the extent of the work carried out, e.g. what is the cost of the work relative to the replacement cost or book value of the asset? Was there a replacement of defective parts or substantially the whole of the asset?
- Consider whether the work carried out improves or materially changes the character or function of the asset, e.g. has the useful life of the asset been extended or is the asset otherwise

improved or has the asset been returned to its original condition?

In the context of a leaky building, it is likely that the relevant object to which the test of repair or replacement is applied will be the whole building, rather than a particular part of a building (e.g. a wall or ceiling). This is based on the NZ Inland Revenue Department's view that an asset is a distinct physical unit that can function on its own.[3]

Example 1

An owner of a rental property has had to remove and replace the southern wall of her house due to water ingress. This has resulted in the removal and replacement of the bottom plate, studs and external cladding on that face of the house, together with the addition of flashings around the window. Internally the house remains the same, with the walls on the southern face being gibbed inside, together with painting and paperhanging in those rooms. Can the owner claim a tax deduction for this expenditure?

In our view, even though this is a substantial amount of work, the owner would be able to claim the expenditure as a repair because of the following.

- The asset to be considered in this case would be the house.
- The restoration cost would be substantial, compared to the original cost of the building and the book value of the house – however that is a function of this being a repair and perhaps the costs when the building was constructed compared with the present. The character of the building is still the same as it was previously.
- Has the unit been improved in some way? Although the building has not been altered, the flashings around the window would arguably represent an improvement. In these circumstances, it can be argued that the addition of flashings do not change the character of the building, they merely prevent water ingress (or at least they channel the water out again). Accordingly, the building is just the same, without the inherent defects that existed previously. In the Privy Council's decision in Auckland Gas Case (2000) 19 NZTC 15,702, Lord Nicholls noted that improvements in technology resulting in a replacement part that is better than the original and which will last longer or function better does not, of itself, change the character of the building.

Example 2

Veronica owns a rental property. The wall around the balcony (which is wooden framework covered by a texture coating system (i.e. polystyrene and two coats of acrylic plaster) has turned into mush, and the house has a musty odour. Her tenants have become sick and wish to terminate their lease. She calls in a remediation advisor, who undertakes moisture meter tests. The external membrane of the house is also covered in the same texture coating system, and Veronica is worried that the wooden framing of the rest of the house will be similarly affected.

The building has a Mediterranean look with recessed windows and no flashings. The remediation advisor recommends that she reclads and re-roofs the building, and installs head flashings above the windows. Veronica is worried that the house will lose its "X Factor", but definitely does not want this problem to occur again.

Another option is reclad the house in concrete block, which would be sealed with concrete plaster. This would enable the building to retain its Mediterranean look, which Veronica wanted. This would involve a far higher remediation cost, and would allow Veronica to alter the layout of the rooms in the house, which would make it a more desirable rental property. With the concrete block external membrane, the house will have a longer usable life, and this alternative will produce a higher rental.

- The asset to consider is still the house.
- We will assume (for these purposes) that:
  - The cost involved in recladding the house in concrete block is substantially more than other forms of cladding.
  - The concrete block has a longer useful life than the texture coating system.
  - The decision to change some of the rooms in the house has also resulted in additional expenditure.
- There is arguably an improvement in these circumstances, as:
  - The building will have a longer life (see Colonial Motor Company Ltd v C of IR (1994) 16 NZTC 11,361).
  - The character of the building is changed because of the alteration to the layout of the rooms and the improved rental this will bring to Veronica.

As can be seen from this, each case is very fact specific. The Privy Council in Auckland Gas Case (idem) issued the following caution:

> *"Authority on the question of repair or replacement is of limited assistance. The physical objects to which the test of repair has to be applied vary widely. So does the nature of the work done. Judicial dicta applicable to one set of circumstances may be unhelpful or misleading when applied in different circumstances. This is true even of the*

celebrated observation of Buckley LJ in Lurcott v Wakely & Wheeler [1911] 1 KB 905 at p 924:

> *'Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject-matter under discussion.'*

As shown by the above example of the demolition and reconstruction of the derelict wing of a house, sometimes repair may not be the appropriate description of work even though it falls far short of being a replacement of substantially the whole of the relevant subject-matter. The effect of the work on the character of the object is also an important consideration."

So each fact situation needs to be carefully considered in terms of the three criteria set out above.

Multi-user dwelling

What is the position, if the owner of a flat is required to contribute to remediation repairs by the body corporate?

The position may depend on the rules of the body corporate, but generally cases such as Taupo Ika Nui Body Corporate v CIR (1997) 18 NZTC 13,147 seem to indicate that body corporate is an agent of the owners. Accordingly, the deductibility of the owner's contribution will be determined in accordance with the tests discussed above.

However, we stress that the tests will need to be applied in the context of the rules of the body corporate and any other agreement or arrangement made between the owner and the other members of the body corporate.

Depreciation

Broadly if a leaky building is used or is available for use in deriving assessable income or in carrying on a business, the owner will be entitled to a depreciation deduction on that building (assuming no election has been made under section EE 8 of the Income Tax Act 2007 (ITA07) not to claim depreciation).

Under the tax depreciation rules, the leaky building is treated as being available for use while subject temporarily to repair or inspection if it was used or available for use immediately before the repair or inspection commenced (section EE10 of ITA07).

Note the references to "repair". If the leaky building expenses are not "repairs" then no depreciation can be claimed on the building in the period the remediation work is undertaken.

If the expenses incurred on the leaky building amount to an improvement (and therefore must be capitalised) the owner will be entitled to a separate depreciation deduction on those costs provided the improvements are used by you or available for your use in the income year (section EE 30 ITA07).

On completion, the owner can choose to treat the improvement either as a separate item of depreciable property or as part of the building that was improved.

If the owner chooses to do the latter, in the first income year following the income year in which the improvement was made and in which the property is used or the improvement is available for use, then the owner:

- if using the diminishing value method, must add the adjusted tax value of the improvement at the start of the income year to the adjusted tax value of the building at the start of the income year; or
- if using the straight line method, do the above and also add the cost of the improvement to the cost of the building.

Irreparable damage

A deduction may be claimed for the adjusted tax value at the start of an income year of a leaky building that is no longer used if:

- the building has been irreparably damaged and rendered useless for the purpose of deriving income;
- the damage occurs in the 2005/06 income year or a later income year;
- The damage has not been caused by the owner's actions or a failure to act or an agent's or associated person's action or failure to act;
- the building is no longer used in deriving assessable income or carrying on a business for the purpose of deriving assessable income;
- neither the owner, nor a person associated with the owner intends to use the building in deriving assessable income or carrying on a business for the purpose of deriving assessable income;
- the costs of disposing of the building would be more than any consideration the owner could derive from disposing of it.

Further, under the depreciation rules the irreparable damage of a leaky building is treated as a disposal of the building if:

- the building has been irreparably damaged and rendered useless for the purpose of deriving income;
- the damage occurs in the 2005/06 or a later income year;
- the damage has not been caused by the owner's action or failure to act or the owner's agent or associated person's action or failure to act.

If the above criteria are met, a tax depreciation recovery or loss must be accounted for in the income year the irreparable damage occurs. In determining whether a tax depreciation loss has been made, any insurance, indemnity or compensation received (exclusive of GST) for the irreparable damage must also be taken into account.

The term "irreparably damaged and rendered useless" is not legislatively defined. However the Inland Revenue Department considers this to mean the building has no continuing economic value to the owner. In addition, a building can be "irreparably damaged and rendered useless" even if it is still standing and needs to be disposed of, whether or not the owner chooses to dispose of it.

Demolition

It is possible that an owner of a leaky building may decide to demolish the whole building rather than attempt or continue to repair it. In this case the cost of demolition would not be deductible because it is capital in nature.

Similarly, if the demolition costs are incurred as part of a plan to rebuild from scratch. Under that scenario, it would be incorrect to treat the demolition costs as part of the costs of the rebuilt building and depreciate it as part of the cost of the new building. The demolition costs would be "black hole" expenditure (i.e. it will be non-deductible and non-depreciable).

Compensation

An owner may receive a sum in relation to expenditure or loss on the leaky building through an insurance policy, indemnity "or otherwise" (such as recovery of costs awarded by the Weathertight Homes Resolution Service or through an out-of-court settlement).

If the expenditure or loss recovered was for an amount that was an allowable deduction, the amount recovered will be taxable to the extent of the deduction. This income will be taxable in the income year. The amount is recovered under section CG 4 of the ITA07.

To decide whether the receipt is taxable, we consider the tests discussed at the beginning of this article. This also means that the recovery of any capital or private expenditure will not be assessable.

It is not always clear where exactly the dividing line between "repair" and "renewal" lies, especially when it comes to fixing a leaky building.

The owner may receive compensation for other matters associated with a leaky building. If so, the owner will need to consider whether or not the compensation is subject to tax. This is another capital/revenue issue.

The nature of the compensation will ultimately determine the tax treatment; for example, compensation received for the loss of rental income will be a revenue receipt and therefore taxable.

In many leaky building cases, awards for interest have been made by the Weathertight Homes Resolution Tribunal. The purpose of this type of award is to reimburse or compensate a claimant for losses incurred as a result of either borrowing money to effect repairs, or for the loss of opportunity from the claimant having to use their own funds for repairs.

In our view, the tax treatment of the interest may take its nature from the tax treatment of the damages payment. Most likely, a court would consider the "true nature of the payment in the hands of the recipient" to determine whether the interest was taxable (see Riches v Westminster Bank Ltd [1947] 1 All ER 469).

Another common award made in relation to leaky buildings is compensation for stress, anxiety, inconvenience and such like. This type of compensation is commonly awarded only to leaky building owners who personally occupy or live in the leaky building. It is likely that this would not be taxable as it arises in relation to damages that are not assessable, as the expenses are of a private or domestic nature.

Under the tax depreciation rules, if an owner receives an insurance, indemnity, or compensation payment for a leaky building, not being a payment for its loss or irreparable damage, the owner must make a deduction from the building's adjusted tax value (see section EE 52 of the ITA07). The amount of the deduction is the excess of the compensation received over the capital expenditure incurred. If this deduction results in a negative adjusted tax value, the negative amount is taxable as depreciation recovery income in the relevant income year.

Unliquidated damages

Where an owner has settled a leaky building claim for an unliquidated amount, an issue will arise as to whether this payment is subject to tax. An example of this is where the settlement payment is made "in full and final settlement of all and any claims arising out of the plaintiff's purchase of Number 2 Leafy Way".

Generally payments of unliquidated damages are considered to be capital in nature. This is because they are received in relation to the dispute and not the income earning process.

GST

If an owner is registered for GST and the leaky building is used by the owner for a taxable activity, the owner will be entitled to claim an input tax credit for the GST paid on the expenses incurred on the remediation of the leaky building.

An insurance payment received for a loss incurred in the course or furtherance of the owner's taxable activity is a deemed supply for GST purposes. This means that an insurance payment received for a loss incurred in relation to a leaky commercial building will be subject to GST.

If the owner is registered for GST and receives compensation for loss of rental income (not under any contract of insurance) this compensation will be subject to GST. This is because the payment is in respect of the owner's taxable activity of commercial rentals.

No GST would normally be payable on other types of compensation received. This is because compensation is not "consideration for a supply". In other words there is an insufficient connection between the compensation payment and a supply.

For the payment to be subject to GST it must be "in respect of, in response to, or for the inducement of, the supply of any goods and services". Broadly, it is accepted that compensation does not satisfy these criteria because it is paid to make good a loss or in recognition of a wrongful act. The payment does not give rise to enforceable reciprocal obligations between the parties. This reasoning also applies in respect to a receipt of unliquidated damages.

Final thoughts

For income tax purposes, whether costs incurred are deductible depends on the extent and nature of the work carried out. Similarly whether any compensation received (including insurance payments) for leaky building remediation is taxable, depends on what the compensation is for. Further any insurance or compensation received may have an impact on the future value of the building for depreciation purposes.

If the owner is registered for GST, the owner will need to consider the GST consequences, if any, of any insurance or compensation received in relation to the leaky building.

Unfortunately there is no "magic formula" that can be applied. The answer in each case will depend on its specific facts. In carrying out this analysis, it will be important to consider carefully all the documentation in relation to the costs incurred and any settlement arrangements made between the owner and other parties. ■

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[1] *New Zealand Herald, 10 August 2008, "Tax plea for leaky homes".*

[2] *See for example CCH Income Tax & Practice para 407-425. However, in Auckland Gas Co v CIR [2000] 3 NZLR 6, 10-11, the Privy Council reduced this to a two-step test – identify the object, and apply the test of repair or replacement to the object identified.*

[3] *Refer TIB Vol 5 No. 9; affirmed in paragraphs 9.18 and 9.19 of the Officials Issues Paper, "Repairs and Maintenance to the Tax Depreciation Rules," July 2004. See also draft interpretation statement IS0064, "Residential rental properties – Depreciation of items of depreciable property," February 2007.*

Note: Because the specific circumstances of each case determine the capital/revenue boundary, it is not possible to lay down any specific test. Under the tax depreciation rules, the leaky building is treated as being available for use while subject temporarily to repair or inspection if it was used or available for use immediately before the repair or inspection commenced

This article is a student paper

Project management during pre-construction phases

Theo Manifavas

About this paper

This paper has been prepared by a student undertaking his Bachelor of Applied Science (Project Management) at RMIT University in Melbourne, supervised by Associate Professor James Baxter. It provides a good review of the literature and commentary on pre-construction property development processes. Good project planning during due diligence and prior to acquisition is considered good practice and can avert development problems later on. We would welcome ongoing discussion from members about property development processes. An extensive reference list is available on request. Email: **editor@api.org.au**. The author, Theo Manifavas, completed his degree in 2008.

Brett McAuliffe, API Editorial Committee member and lecturer in development processes at QUT

Abstract

This research analyses the pre-construction phases of the property development process and examines how project management (and in particular, project planning) is applicable and taken into account by those in the development industry. The pre-construction phases are considered to be the most important to the success of a development. Project planning is considered fundamental and can increase the chance of project success. Therefore, the pre-construction phases and project planning share a common relationship. The study is based on a review of the property development and project management literature. Exploratory interviews were also undertaken with a small sample of management with experience in development. The findings suggest that there is a need for project planning within the pre-construction phases. This is driven by an environment of uncertainty and risk where decisions (which can affect the final outcome of development) need to be made. The discussion and application of project planning within the industry is minimal however. There is also confusion as to what project planning involves. This suggests that project planning (as advocated within the emergent project management profession), is not widely applied within the property development industry. The application of project planning will have an influence on project success.

Key Words: Property development process, project planning, project management

Introduction

There is no doubt that property development is a long and complex process and there are many aspects that need to be considered. Some of these are specific to the site and its characteristics, others are in relation to stakeholders and external forces. In any instance, the property development process involves decision-making in an environment of uncertainty and risk where information is needed. Most of the decisions to be made are within the pre-

Table 1: The pre-construction phases of the property development process (as listed in the literature)

Authors	Pre-construction phases of the property development process					
Cadman & Topping (1996)	1. Initiation	2. Evaluation	3. Acquisition	4. Design & Costing	5. Permissions	6. Commitment
Birrell & Bin (1997)	1. Opportunity/Site Identification	2. Market Analysis	3. Site Investigation	4. Feasibility Study	5. Professional Appointments	6. Financing
	7. Planning Application	8. Site Assembly / Purchase	9. Design	10. Tendering / Contracting		
Miles et al. (2000)	1. Inception of an Idea	2. Refinement of the Idea	3. Feasibility	4. Contract Negotiation	5. Formal Commitment	
Forlee (2007)	1. Inception	2. Preliminary Assessment	3. Acquisition	4. Planning, cost estimates, approvals	5. Commitment and Marketing	6. Technical

construction phases of the development process and these are considered to be the most important phases to the profitability of a development (Birrell & Bin, 1997). Planning must be undertaken in these early stages to ensure that a development has considered all the necessary issues. Project management, and project planning in particular, is considered to be fundamental in making informed decisions which may influence the success of a project. In the pre-construction phases, pre-project planning allows owners to develop strategic information to be able to address risk, allocate resources and ensure that the project has the best possible chance of success (Gibson et al. 1994, cited in Sherif & Price, 1999). It is therefore important that adequate project planning is applied in the pre-construction phases. Indeed, project planning is directly applicable to these pre-construction phases and well suited to the property development environment.

The aim of this research is to investigate how current project management (and in particular project planning) are applicable to the pre-construction phases of the property development process and how these practices are taken into account within the development industry. In order to achieve this aim, the research will seek to:

- show the link between the project lifecycle and the standard property development process;
- find discussion of project management and project planning within the property development literature;
- determine what project planning practices are currently undertaken within the development industry in the pre-construction phases;
- determine the perceptions of project planning from a sample within the development industry; and
- highlight project planning practices and techniques that are applicable to the pre-construction phases of the property development process.

It is envisaged that future research could draw on a larger sample of participants to further investigate perceptions of project planning and the type of project planning adopted in the pre-construction phases. The success of a property development project could also be defined and measured when project planning has been adopted against one without project planning. These factors were seen as limitations to the current research and provide the basis for any future research.

Literature review

The property development and project management literature was searched broadly in this study. The property development process, its

characteristics and the importance of the pre-construction phases were a key focus. Within the project management literature, the pre-construction phases are looked at from a project lifecycle perspective. Project planning as identified in the literature is also reviewed.
The search then focuses on project management and project planning as a topic within the property development literature.

The property development process (pre-construction)

The property development process is well covered throughout the literature and – although there is slight variation to wording and varying amount of detail into the specific components of the process – the overall stages which lead to construction (or any form of physical land development) tend to be similar. Examples of these similarities and how they are classified in the literature are shown below.

Each of the approaches is quite similar. For example, initiation is also listed as inception, evaluation could be taken as preliminary assessment, the process of design & costing would form part of a feasibility study and so on. Although some of the phases are not listed in the same sequence and different wording is used, as Miles et al. (2000: 5) comments: "the essence of the steps does not vary significantly." In general, a development will follow the same process. Some of the authors refrain from listing the process as a modelled sequence, however, and due to the many activities involved (which do not always follow the same sequence), choose to only provide a detailed overview of the whole development process (Collier et al. 2002; Harvard, 2002). Indeed, it is widely accepted that the property development process is not always linear and activities, or even phases, can occur at different times. The example is given of letting (usually associated with the final stage of a speculative development) being undertaken as one of the first activities, or the site being purchased "at the outset or not at all" (Fisher & Collins, 1999: 226). This association of development not always following a predetermined path is also acknowledged by Miles et al. (2000: 5) who comment that the process is "hardly straightforward or linear" and the process model they put forward is to "guide an understanding of development". In recognition of these characteristics, Fisher & Collins (1999) look at the process from a four-dimensional view and conclude that: the structure (economic-social-political-government-legal forces, technology and environment); the actors (stakeholders to the development); the events (related to the development process stages); and the site (location and characteristics of the land) are all important aspects which need to be considered when undertaking a development. This school of thought is not new however and Graaskamp (1992) depicts the real estate process (the events) as a site and improvements (the site) functioning within a political, social and enterprise system (the structure) influenced by three major groups: space consumers, space producers and the public infrastructure group (the actors).

... the property development process involves decision-making in an environment of uncertainty and risk where information is needed.

Complexity, uncertainty and risk

There are many components which form part of the process and may influence a development and its

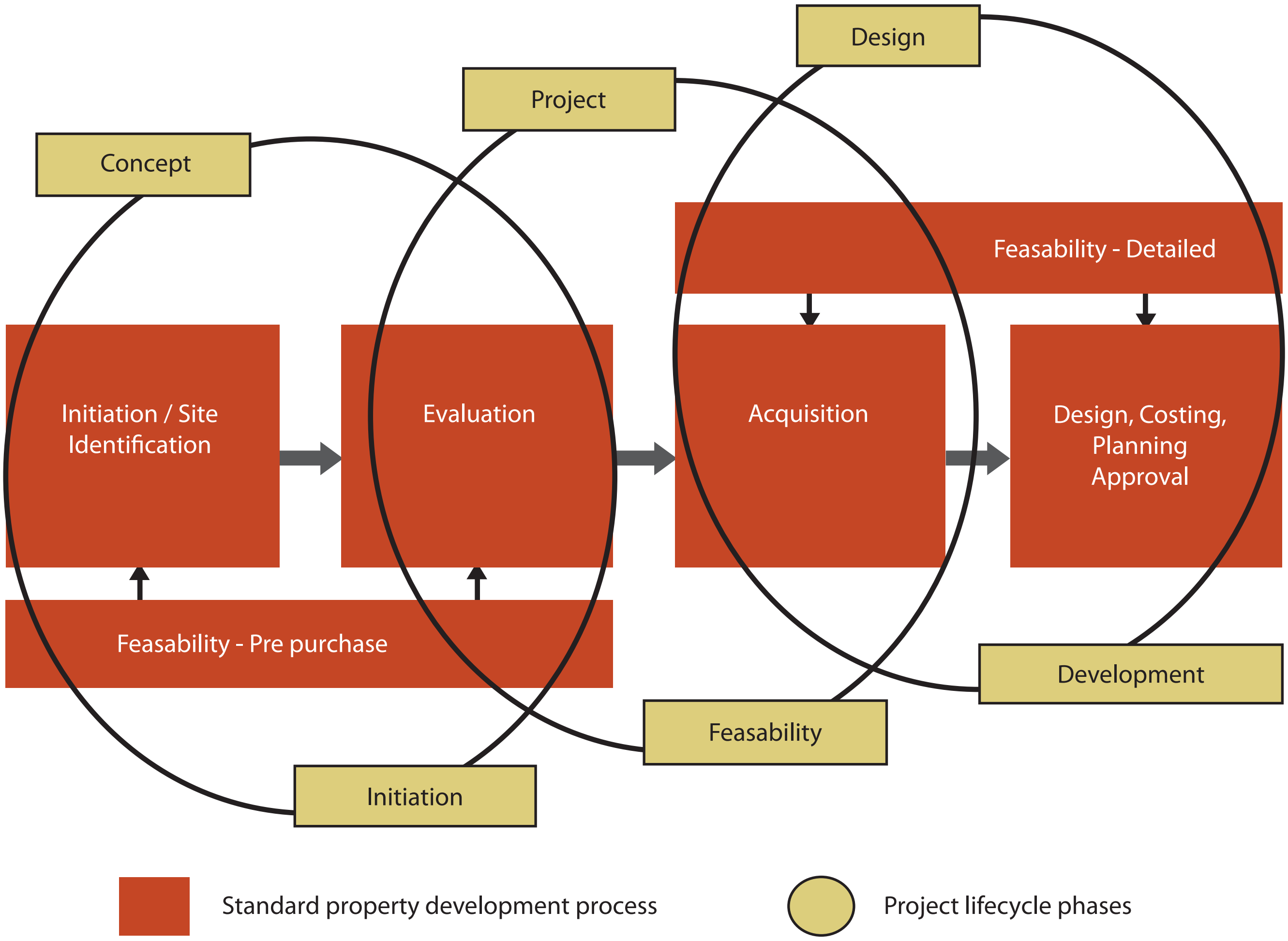
success. Many of these components also interact with one another and this adds a further level of complexity to the development process. Fisher (2005: 158) acknowledges this in commenting that property development is "a complex process that involves multiple drivers, stakeholders and contributions from many academic disciplines". Further to this, Harvard (2002: xxi) comments that property development brings together "many strands of skills, knowledge and resources". Stemming from this complexity is risk (which can be directly associated with uncertainty). Throughout the literature, there is much covered on market analysis, design, feasibility study etc. These activities are undertaken for their specific purpose (as their name suggests). However, undertaking them also assesses the risk and uncertainty of development (Birrell & Bin, 1997). Indeed, "uncertainty lies at the root of the process of property development" (Byrne, 1996: 1) and is the reason why much time and effort is spent in pre-construction phases with preliminary and investigative work. Byrne (1996: 4) comments that "at the start of the process developers have maximum uncertainty and manoeuvrability, at the end they know all but can do nothing to change their product". This implies that although uncertainty will always be part of the development process, developers are able to work freely and make decisions at the start of the process (manoeuvrability), whilst at the end, although uncertainties would have been realised, the final product is not easily changed if need be.

The importance of the pre-construction phases

The significance and importance of the pre-construction phases is highlighted by Birrell & Bin (1997) where in an interview sample of 100 property development experts it was found that the five most important phases to the profitability of a property development were: (1) letting (which may occur in the pre-construction phase), (2) market analysis, (3) the feasibility study, (4) design and (5) opportunity/site identification. The planning application phase also rated as one of the most important when the question was put solely to the developer group of the research sample. Without stating the obvious (in that without government planning permission a development cannot go ahead) Birrell & Bin (1997) attribute the importance of the planning application process to the opportunity costs of being able to meet market demand on time while also foregoing any extra repayments in finance costs. Further to this they conclude that the price of the site, as well as the value of the end product, will be determined "by the nature of the planning permission allowed" (Birrell & Bin, 1997: 5). Waterhouse (1991: 26) associates delays in the planning and approvals process with "extra design, engineering, and legal costs" where planning authorities can impose further requirements on a development and thus add to the time and cost of a project. Therefore the planning application and approvals phase can affect the profitability of a development. Just as important in relation to profitability, is the feasibility study which in its simplest form, is "undertaken to ensure that the cost of the development is realistic and to establish the potential profit in relation to the risk" (Forlee, 2007: 53). Graaskamp (1972: 67) gives a deeper definition where "feasible" is defined as the "likelihood of satisfying explicit objectives when a selected course of action is tested for fit to a context of specific constraints and limited resources". Therefore, the feasibility study can also be thought to include much more than a financial analysis but in either instance, profitability and finance are likely to fall within the explicit objectives and specific constraints of the project. The importance of the feasibility study is not underestimated in the literature and many authors dedicate significant portions and chapters to its content, requirements and preparation (Collier et al. 2002; Burke, 2006; Forlee, 2007). Miles et al. (2000) propose that the feasibility of the project be analysed at the conclusion of each phase prior to the formal feasibility (refer to Table 1) with the latter to include market analysis, preliminary design and cost estimates to name a few. Forlee (2007) also takes a similar approach where the feasibility study is split into "pre-purchase" and "detailed". In either instance, determining the feasibility can involve many activities and for a large development, the feasibility process can become "a complex and intensive project in its own right" (Walker & Rowlinson, 2008: 56). PRINCE2 (2002: 11) recognises this in recommending that "the optimum approach would be handle the study as a separate and distinct project" in itself and Burke (2006: 44) comments that the "feasibility study should be managed as a mini project" using planning and control techniques (as outlined in his text).

... the feasibility study can also be thought to include much more than a financial analysis but in either instance, profitability and finance are likely to fall within the explicit objectives and specific constraints of the project.

Figure 1: Conceptualisation based on project lifecycle phases and the relationship to the standard property development process



Project management & the pre-construction phases

From the property development literature, the search then focused on the project management literature and the discussion of project planning within the pre-construction phase of the property development process.

PMBOK (2004: 5) defines a project as a "temporary endeavour undertaken to create a unique product or service" whilst PRINCE2 (2002: 2) also takes a similar view where a project is defined as "a finite process with a definite start and end". "Projects always need to be managed to be successful" (ibid.2002: 2) where the appropriate knowledge, skills, tools and techniques need to be applied to project activities to meet project requirements (PMBOK, 2004: 8). Meeting the needs and expectations of stakeholders is also a fundamental requirement of project management and an emerging practice is taking a relationship approach to managing projects (refer to Burke, 2006 and Pryke and Smyth, 2006). This involves managing relationships which can lead to improved project performance and stakeholder satisfaction (Pryke and Smyth, 2006). Nickson & Siddons (1997: 3) relate project management with uncertainty stating that most importantly, "projects need to be managed because they exist in a changing world". Project management is therefore seen as a key function in meeting project objectives, managing stakeholders and managing the uncertainties that arise in a project. Most authors of the project management literature also divide a project into phases under the common term of the project lifecycle in order "to provide better management control" (PMBOK, 2004: 19). The phases of a project are termed similarly throughout the literature and most authors also include the feasibility study as part of the activities within the pre-construction phases of the project lifecycle (PRINCE2, 2002; PMBOK, 2004; Burke, 2006). Indeed, Schwalbe (2004, cited by Carroll, 2008) defines the pre-construction phases of "concept" and "development" under the heading of "project feasibility". It is interesting to note that the pre-construction project lifecycle phases are not only similar

Table 2: Pre-project planning practices & techniques (as described in the literature)

Authors	Pre-project planning practices & techniques
Nickson & Siddons (1997)	Formulation of agreed goals and objectives, risk identification, contingency planning, external dependency analysis, costing and cash flow, work breakdown structures, resource identification and analysis, task scheduling, assigning roles and responsibilities.
Sherif & Price (1999)	Scope definition, objective setting, risk analysis, quality control techniques.
Gibson & Wang (2001)	Scope definition, objective setting, alignment and requirements determination.
Dvir et al. (2002)	Milestone planning, definition of project goals and requirements.
Carmichael (2006)	Establish objectives and constraints, scope establishment, work breakdown, activity interaction/ sequencing, scheduling, resource planning.

amongst the literature, but also relate and are similar to the pre-construction phases of the property development process. This is shown graphically in figure 1.

As can be seen, "Concept & Initiation" relates to "Initiation/Site Identification", "Project Feasibility" encompasses both the "Pre-purchase" and "Detailed" feasibility phases and the "Design & Development" phase is similarly related to the "Acquisition" and "Design, Costing & Planning Approval" stage of the property development process.

Project planning

At the core of modern project management is project planning (Dvir et al. 2002) which in its most basic form "establishes how and what work will be carried out, in what order and when and with what resources" (Carmichael, 2006: 8). In relation to the project lifecycle, planning is also mentioned as a separate stage by Jaafari (2004) and Nickson & Siddons (1997) also list planning as one of two phases in the pre-construction phase of their project lifecycle. In any project, some sort of planning is carried out whether realised or unrealised by the project participants. Carmichael (2006: 7) compares this with planning being undertaken in a structured way as opposed to ad hoc planning. In either instance, all the project management and specific project planning literature agree that planning is a fundamental task which may influence project success. Planning can also be broken down into pre-project planning which encompasses all the tasks between project initiation and detailed design (Gibson and Wang, 2001: 2). More specifically, pre-project planning is defined by Gibson et al. (1994, cited in Sherif and Price, 1999: 437) as "the process of developing sufficient strategic information for owners to address risk and decide to commit resources to maximise the chance for a successful project". It is therefore recognised that project planning can be further defined and split into a pre-project planning phase that deals with gathering information and assessing risk in the pre-construction phases of a project. Many authors point out that the level of time and effort spent on pre-project planning, or the front-end phases, will directly influence the performance and success of a project (Sullivan et al 1997, cited in Sherif and Price, 1999; Burke, 2006). These authors (and others) describe many of the practices, tools and techniques involved in pre-project planning as shown in Table 2.

There are many similarities between the practices and techniques as given in the literature and the authors are generally aligned as to what pre project planning should involve. Gibson & Wang (2001) provide evidence that proper pre-project planning practices such as those described can enhance the predictability of project outcomes and improve project success from a cost, time and user (or owner) requirements perspective. Indeed, this view is also held by Dvir et al. (2002) and Sherif and Price (1999) who discuss how pre-project planning can reduce uncertainties, influence project cost and schedule performance and increase the likelihood of project success.

Project management and project planning in the property development literature

Within the property development literature, a common finding is that the discussion of project management and project planning principles is limited. Many of the authors confine project management to the construction phases with discussion of the possible appointment of a project manager to coordinate and monitor the performance of the building process (Cadman, 1996; Miles et al. 2000). Planning as a general requirement in the pre-construction phases is acknowledged however, with some of the authors either mentioning or hinting at its need to various degree. At a general level, Forlee (2007: 29) comments that a development will not happen unless there is "careful and thorough planning" with the objective being to minimise assumptions at each stage and base decisions on "the most accurate information" (ibid: 51). This view, and the notion of planning to minimise assumptions, is also held by Byrne (1996: 7) who discusses the importance of having adequate information to confront the problem of measuring uncertainty and thus being able to make informed decisions. Indeed Harvard (2002: xviii) directly associates the development process with decision making and also comments that "wider skills and knowledge" are needed from contemporary members of a development team in order "to successfully complete their tasks". At a specific level, Waterhouse (1991: 25) comments that although there may not be "much of a paper trail" showing the planning process undertaken by developers, even the most intuitive developers (referring to those who make successful decisions based on "gut feel") go through a "checklist of critical variables". Further to this, Waterhouse (1991) discusses the planning process as the development of a business plan to establish: project goals and development philosophies, the market analysis, the planning and engineering analysis, the financial analysis, and the implementation plan. The notion of developers making "intuitive" or "gut feel" decisions (as mentioned by Waterhouse, 1991) without careful planning is also given weight by Fisher and Collins (1999: 219) who comment that in commercial development, "decisions are often taken in private, based more on experience and instinct than on good information and research". For this reason, they conclude that "rational project planning is not well advanced" and development would benefit from decision support software that reduces uncertainty and increases confidence and objectivity in decision making (Fisher and Collins, 1999: 219, 229). The same authors also point out that it is impossible to prescribe a set sequence of events to the development process, as opposed to construction, hence the reason why project planning software is not used. Interestingly, project planning is often related to software packages that work on precedence network techniques to produce a bar chart of activity sequence (i.e. Microsoft Project). PRINCE2 (2002: 210) points out that "when asked to describe a plan, many people think only of some sort of bar chart showing timescales" and Carmichael (2006) also notes that some project management texts and project managers themselves view scheduling as project management (and thus project planning); the common thought being "if you have a computer package that does scheduling, then you have all that is needed to manage a project" (ibid: 7). It is therefore apparent, in both the property development and project management field, that there exists a lack of understanding and knowledge as to what fully constitutes project planning.

Summary

In conclusion, most of the literature has been concerned with the characteristics and importance of the pre-construction

phases of the property development process, as well as project management and project planning and its discussion within the literature. It is acknowledged that the property development process is complex and many variables can affect the final outcome. These variables also add to the complexity of the process which in turn creates uncertainty and risk in a development. Much of the project management literature acknowledges the feasibility study as being a key component of any project and advocates that it be considered a project in its own right (PRINCE2, 2002; Burke, 2006), especially for large and/or complex projects. Within the property development literature it was found that the feasibility study is one of the most important undertakings as well as many other activities which can also be considered to form part of the feasibility. In either instance, the activities which are considered to be the most important to the success of a development all fall within the pre-construction phases. It was observed within the project management literature that the pre-construction phases of a project's lifecycle were directly similar to the pre-construction phases of the property development process. The authors of the project management literature also consider planning, to be a key requirement of the pre-construction phases to reduce uncertainty and influence the success of a project (Sherif & Price, 1999; Gibson & Wang, 2001; Dvir et al. 2002). Most of the authors who discuss project planning also showed alignment as to the type of planning practices and techniques that should be adopted and utilised. In relation to these, as well as project planning in general, it was found that there is confusion and misunderstanding as to what constitutes project planning as based on the discussion within the literature. Indeed, this was found in both the property development and project management literature with the former containing minimal discussion on project management and project planning.

Research method

From the literature review, the following statements were generated which specifically relate to the issues identified:

1. Complexity, uncertainty and risk are all inherent to the property development process.
2. The pre-construction phases of a project (or property development) are considered to be the most influential on project success.
3. Project planning is considered to be a fundamental requirement of the pre-construction phases of the project lifecycle.
4. There is a common misconception as to what project planning is.

In order to investigate these issues, unstructured interviews were carried out which Saunders et al. (2000: 244) describes as informal interviews which allow the researcher to explore the areas of interest in-depth, and "the interviewee is given the opportunity to talk freely about events, behaviour and beliefs in relation to the topic area". This method suited the exploratory nature of the research as it would allow the issues to be discussed and would reveal whether the participant supported or opposed what had been revealed in the literature. A set of predetermined questions were also asked to guide the discussion and to gather specific data to explore the research outcomes. It must be noted these interviews were carried out as pilot study to ascertain the validity of the questions and the reliability of the data collected (Saunders et al. 2000). As such, the interview approach, as well as the resultant data, will establish the grounding for any possible future research.

The sample of interviewees (four) was selected based on managerial experience (all held upper management positions). The area in which the interviewees worked also had to be within (or have included) the pre-construction phases of the development process. In general, although the participants were specifically sought from the property development industry, their background and expertise was diverse, as shown in Table 3.

Having this diverse sample of participants who held different positions, worked in different areas yet still worked within the pre-construction phases of the development process enriched the sample of data collected.

Prior to the interview process each of the identified issues was considered in order to establish statements and questions that would be put to the participants to guide the discussion. It must be noted that although questions

Table 3: Interview participants and their background/expertise

PARTICIPANT	BACKGROUND / EXPERTISE
A	Development Manager (energy sector)
B	Development Planning (Government sector)
C	Various management positions within the property development field
D	Project Management and Property Development

and statements were put forward throughout the interview, these were in no predetermined order and all of the interviews followed no set sequence. This was expected with an exploratory approach and much of the data collected was from general discussion which followed on from the introduction of the research and what is was seeking to answer. To analyse the data, categories relevant to the research question and objectives were then devised from common key words that came from both the interviews and the literature. Key phrases/sentences from the notes taken during the interviews were then added where relevant to the appropriate category. Saunders et al. (2000) describes this as a selective process where relevant data is highlighted and put into a more manageable and comprehendible form. From here, relationships between the data and the literature could be derived and conclusions drawn.

Results

The information gathered from the interview discussions showed that various techniques are employed to plan for and manage the projects undertaken within the pre-construction phases. These include budgeting, cost tracking, planning what resources are needed and assigning them to tasks, and setting target milestone dates for the completion of activities/phases. It was noted in the interviews that the participants also mentioned the importance of other project planning techniques such as setting project goals and objectives, and risk analysis, however only Participant D indicated that these practices/techniques were formally adopted as part of the planning process. The same participant also indicated that formal project planning (documented in the form of a project plan) was beneficial as: information (including risks) was there for team members to see, everyone knew what needed to be done and who was responsible and informed decisions could then be made. The latter point was mentioned as one of the benefits of a project plan and the comment was made that "planning forces you to think about things". Indeed, Participant A indicated that the process of getting information such as goals, objectives and resources on paper would be a "useful exercise".

A common finding from the interview process was that stakeholders, relationships and their management were mentioned as an important point from all the participants. This came down to the fact that within the pre-construction phases, all of the participants indicated that they had to deal with third parties such as landowners, contractors and government agencies and this added risk and uncertainty to what they were trying to achieve. Further to this, a common finding was that having to deal with third parties added a timeframe risk (in terms of delay) to their projects. Participant C commented that the timeframe was uncertain until the planning permit was obtained and further added that "it is only then [when the permit is obtained] that traditional project management techniques can be applied". In terms of managing third-party relationships, Participant A commented that "relationship management is key to project management which developers should focus on more". How this should be undertaken (relationship management) was not specifically mentioned by any of the participants, however Participant D indicated that communication with stakeholders was important and stakeholder management was an important part of project planning.

In general, discussion of project planning as a specific project management technique was generally confined to the Participant D (who also had a project management background) and more generalised information surrounding project planning was recorded from the other participants. Indeed, prior to any discussion taking place surrounding project planning, those participants related project planning to project scheduling (and Microsoft Project). During the discussion, Participant C felt that project management techniques were limited in the pre-construction phases (referring to uncertainty and not being able to know exactly when things would happen) and Participant A made the comment that "you can't apply project planning [in the pre-construction phases] like if you were building a house". It was also indicated from Participant C that experience will dictate how project planning is undertaken and unlike project scheduling, experience can't be taught.

Discussion and conclusion

The information obtained from the interviews suggests that project planning practices within the pre-construction phases of the development process are present to some degree. However, these planning activities are, at their best, the minimum that one would expect of upper management in any project environment. It would also seem that they are undertaken as more of a natural planning requirement (to see a project proceed), rather than as a genuine attempt to formally plan for a project in a structured way; thereby increasing its chances of success. Indeed, all of the project planning authors agree that proper pre-project planning (as they discuss) will influence the success of a project. There is also general agreement from these authors as to what planning practices and techniques should be adopted; all of which are much more than what was mentioned by the interview participants. It was only Participant D (who had both a development and project management background) who adopted more project planning practices as part of his work practice in the pre-construction phases. This tends to indicate that outside of the project management profession, there is a limited view and knowledge as to what project planning entails. All of the other interview participants mainly associated project planning with scheduling and the sequencing of events. This was highlighted as an issue by PRINCE2 (2002) and Carmichael (2006) where even some of those within the project management profession do not see project planning for what it really is. Project scheduling is not mentioned by many of the authors in the pre-project planning literature (Sherif & Price, 1999; Gibson & Wang, 2001; Dvir et al. 2002). This clearly indicates that within the pre-construction phases, activity scheduling is not only what planning is about. The authors here (and the project planning authors in general) focus on planning as more of a project definition and information exercise where project goals, objectives and requirements are set. Risk is also identified and analysed against what the project is trying to achieve.

Many authors point out that the level of time and effort spent on pre-project planning, or the front-end phases, will directly influence the performance and success of a project ...

Some of the interview participants did acknowledge that setting project goals, objectives, and defining the project's requirements were important. All of them acknowledged that uncertainty and risk were a large part of their projects (from a reliance on third parties and a timeframe perspective). It was only the Participant D however, who indicated that project goals, objectives and requirements are defined, and uncertainty and risk are analysed as part of a project plan. This was the exception and indeed, within the property development literature, there are only a few examples of authors acknowledging the need for project planning and decision making tools in the pre-construction phases (Waterhouse, 1991; Fisher & Collins, 1999). This tends to indicate that the majority of those involved in the development process are unaware and/or misguided as to what constitutes project planning as advocated within the project management body of knowledge. Indeed, there is even confusion amongst those in the project management field as to what project planning is all about. This could be a case of older project management practitioners still preaching the implementation approach to project management which is heavily focused on the construction phases of a project (and where project scheduling is more applicable).

In recent times, the focus has shifted to managing the front-end of a project (Burke, 2006) and with this it can be argued that some project-management practitioners have not acknowledged or are unaware of the wider approach to project planning which has emerged. Thus, the same can quite easily be said of those within the development industry where the wider application of project planning has not developed. In relation to managing the front end of a project, a relationship approach to project management is also an emerging trend which seeks to add value to a project through stakeholder relationships. This of course involves some sort of planning. Relationships with stakeholders was emphasised by all the interviewees as being important to minimising the risks and uncertainties of dealing with third parties in a project. However stakeholder management was not undertaken by any of the participants as a formal project planning exercise (Participant D did acknowledge that it should form part of a project plan though). This suggests once again that there may be a limited view as to the project planning techniques that may be adopted within the pre-construction phases. It could also suggest that developers are more inclined to base their decisions on experience rather than on information and research. Indeed, one of the participants did comment that experience is what counts for the most in property development, and further emphasised that unlike scheduling, experience can't be taught. Of course, experience is something which planning on its own cannot provide, experience can only come with time. However project planning is much more than project scheduling as the findings suggest.

In conclusion, this research has identified that within the pre-construction phases of the property development process, project planning is not well advanced. Based on the emergent project management profession, there is a lack of knowledge within the development industry as to what project planning involves. Project planning is not only concerned with project scheduling. In the pre-construction phases of a project, the application of project planning practices and techniques are many and scheduling is not one of these. The pre-construction phases of a project's lifecycle are quite similar to that of the pre-construction phases of the property development process. Hence, there is no reason why project planning techniques cannot be applied in the pre-construction phases of the property development process. If anything, the complexity, uncertainty and risk inherent to property development calls out for proper project planning to be undertaken. Such planning may improve relationships with external stakeholders, reduce uncertainty and risk, and provide information for informed decisions to be made; all of which increase the chance of project success. ■

References available on request.
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Peer-reviewed student paper

Bridging the affordable rental housing gap

ESTABLISHING A VIABLE FUNDING MODEL TO ATTRACT INSTITUTIONAL INVESTMENT

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Michael has 22 years' experience in the sales, management, acquisitions, development and research of commercial and residential property in the private market, unlisted and listed property trust sectors. Michael's experience includes the risk assessment and investment strategies of listed and unlisted funds, plus the portfolio management of residential property trusts. Since completion of extensive research into the funding of affordable rental housing Michael has established a fund management operation developing investment vehicles for the affordable sector. If a reader wishes to obtain further information, they may contact the author directly at: mkerans@affordablehousingaustralia.net

This article is the 2009 winner of the Australian Property Institute's Peter Barrington Gold Medal for 2009. It is a summary of a thesis which Michael Kerans completed as part of a Masters of Applied Science in Building Studies (by research) at UTS, completed in December 2008. The Peter Barrington Gold Medal is a centrepiece of academic excellence and is awarded each year to the best academic student research.

Abstract

The OECD states Australia's housing is by far the most over-valued in the Western World. More than one million Australian households have housing costs which are unaffordable which reduces money available for other essentials such as food, health care and education. Without intervention the number of affected households is forecast to double by 2020. Government strategies increasingly focus on rental subsidy to assist low income households. This strategy has proved to be inadequate to meet the continuing growth in demand for affordable housing.

A new form of supply-led assistance is necessary. Government funding is limited and so the focus is on the private sector, specifically institutional investors to offer a viable solution. An issue for institutional investment is the gap between the perceived risk-adjusted return from affordable rental housing and that of alternate low risk asset classes. This gap is known as the rental or finance gap. To bridge this gap a viable funding model needs to provide: an efficient structure to minimise the rental gap and lower the associated investment risk; whilst complying with current government policies.

This research compares and contrasts the five leading affordable rental housing funding models that are currently prominent in Australia. These funding models are:

- Consortium or Bonds;
- Public Private Partnership;
- Pooled or Listed Property Trust;
- Not for Profit Housing Company; and
- Tax Credits.

To assist in identifying a viable funding model interviews were completed of key stakeholders of the affordable housing sector, including institutional investors, representatives of local and state governments, developers and not-for-profit housing groups. QSR's Nvivo software was used to analyse the stakeholders' views using a qualitative grounded theory approach with the findings considered against existing housing affordability literature.

The research showed that investment in the housing affordability sector was primarily dependent on the current political environment. The "*best*" funding model was a secondary consideration. In the current economic and political climate, the "*tax credit model*" met the key requirements. This was later confirmed

subsequent to the research with the introduction of the National Rental Affordability Scheme.

A secondary finding of the research included that as institutional investors focus on both the return and associated risk, both real and perceived, improved information on the sector would result in a reduced perception of risk and raise the potential of achieving an attractive risk adjusted return.

Background to the research

Housing affordability in Australia is currently at crisis levels. National Shelter (2007) stated that there are about 15 per cent of Australian households in housing stress, representing approximately 1.1 million households. One million of these households are classified as having a low to moderate income. Housing stress occurs when a household's accommodation costs are unaffordable which reduces the money available for other essential expenditure such as food, health care, transport and education to an unacceptable level. Of the people suffering housing stress the highest proportion were occupants of private rental accommodation.

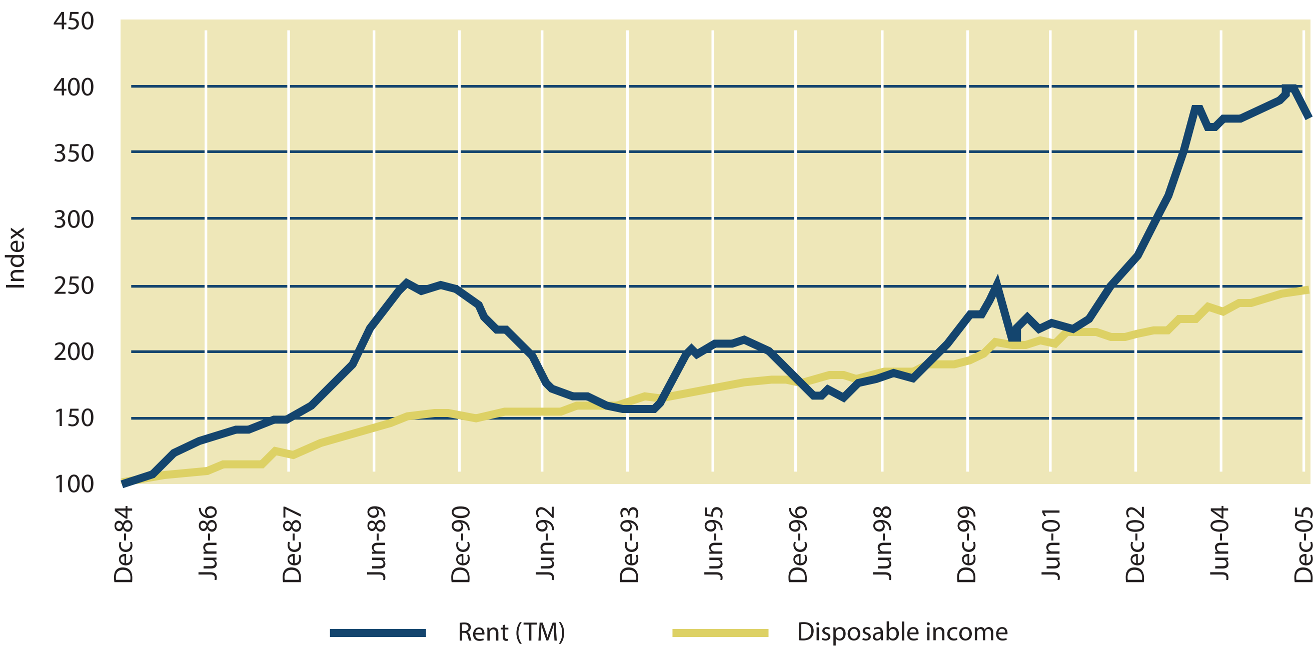
Privately owned rental housing represents 85 per cent of the two million tenanted properties in Australia (Australian Bureau of Statistics 2006). However supply is weighted towards higher value inner suburban accommodation with the number of lower value dwellings declining as low cost housing is redeveloped, largely as a result of inner city gentrification (Cooper 2006; Kothari 2007). The inadequate supply of affordable rental housing has therefore been the result of market forces.

Regardless of higher rentals, the private rental sector continues to accommodate a large portion of tenants due to an inadequate supply of public housing. The Australian Institute of Health and Welfare (2009) noted only 23,731 households were allocated public housing for the year to June 2008. Despite these placements a total of 177,652 households remained on public housing waiting lists. Some households have waited for 10 years to be allocated public housing (Kothari 2007).

The inadequate supply of public housing is a function of a shift in public housing assistance towards an increasing reliance on rent-based subsidies for eligible private tenants (Baxter & McDonald 2005). The result has been a reduction in the public housing stock of 30,000 dwellings between 1996 and 2004. (This situation is noted to have altered positively since the completion of the research was completed following the introduction of the Nation Building Stimulus Package which includes the construction of 20,000 new social housing units (AIHW 2009).)

Wilkinson (2005) reports that since

Figure 1: Australian Residential Rent and Disposable Income Movements: 1984 to 2005



Source: Housing Institute of Australia (2006) the 1980s, Australian governments had adopted a non-interventionist housing policy even when house prices were escalating faster than incomes. The trend of declining affordability therefore appears likely to continue at its current pace.

The combination of low vacancies and high demand has produced a period of strong rent growth and reduced rental affordability. Figure 1 compares the rate of Australian rental growth compared to disposable income for the period from December 1984 to December 2005.

Figure 1 shows the extent that rent growth has exceeded disposable income growth. For the period December 2001 to September 2005 rents grew by an average of 17 per cent per annum while disposable incomes only increased by 4 per cent per annum for the same period.

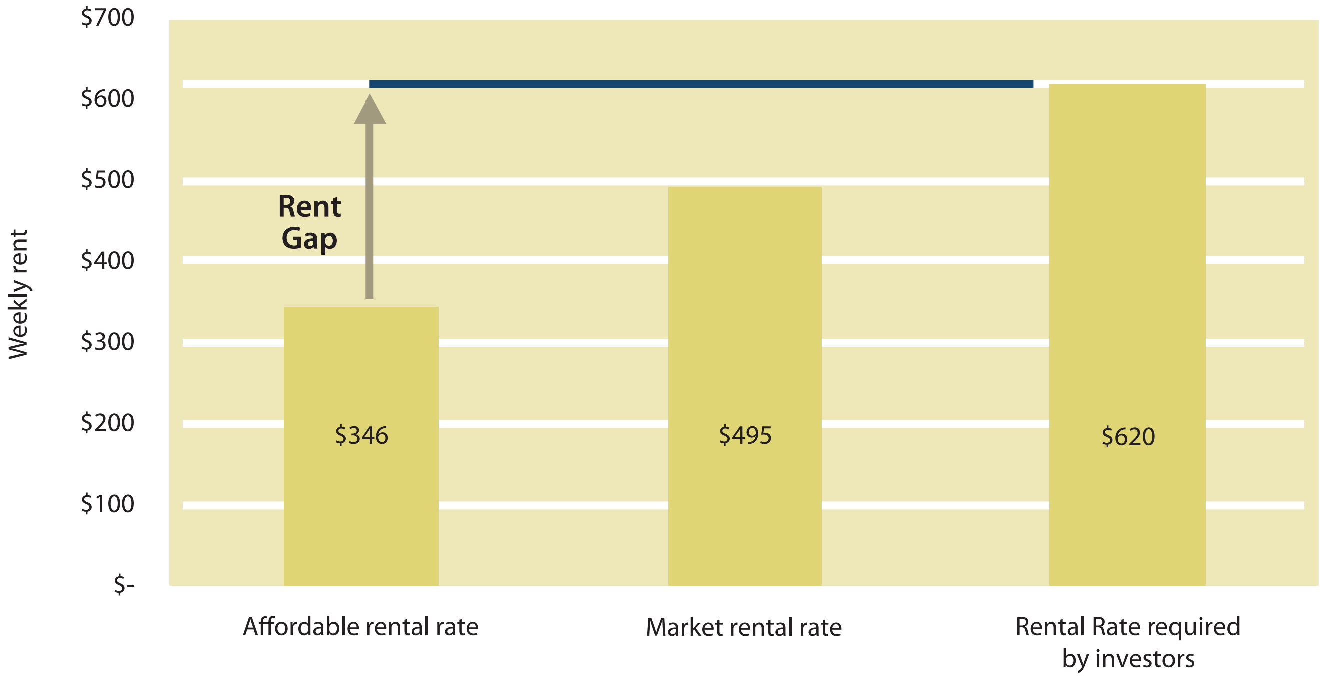
This period of low affordability is caused by the shortage of low-cost housing with some arguing the situation is not cyclical but structural (HIA 2007). Market intervention is therefore required to improve supply.

The combination of low vacancies and high demand has produced a period of strong rent growth and reduced rental affordability.

Various funding models have been devised in order to improve the supply of affordable rental housing through attracting private investment. However there are numerous hurdles to attracting private investment into the sector, mainly the relatively low return. The lower than market rental return results in a "Rental gap" (Yates 1994) or "Financing gap" as there is a gap between the rent return required by investors and that obtainable from affordable housing. Figure 2 illustrates the "gap" theory for the Sydney property market.

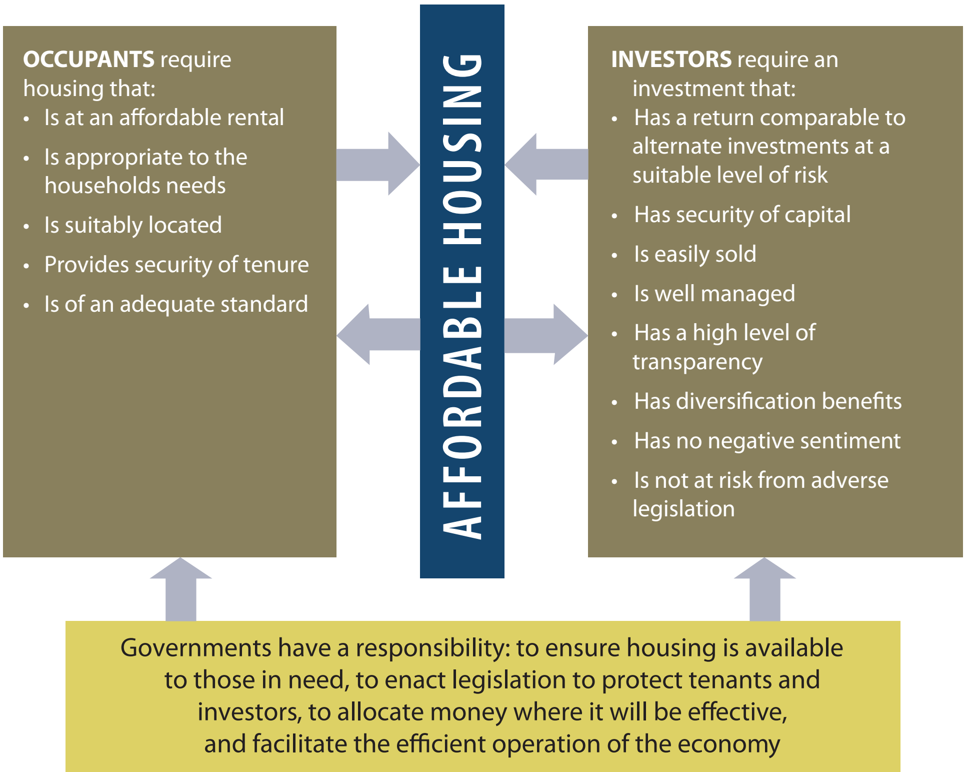
The market rental noted in Figure 2 is the rate which is required to be paid on the open market to obtain adequate accommodation to meet the requirements of a specific household. Figure 2 also reveals the weekly rent from an affordable house in inner Sydney has a rent gap of $274 per week. The affordable rent is broadly determined as being 30 per cent of a household's gross income of $1,154 per week being the 2006 Census median family income for Sydney. The rent gap is the difference between the affordable rental and the investors required rental. The rental rate required to encourage an investor is assumed to be 6 per cent of the market value of the property. An investors' required rental is $125 per week above the current market rental which in turn is $149 a week above an affordable rental for a

Figure 2: Rental Gap Model for Sydney Property Market



Source: (Allen Group 2004; Australian Bureau of Statistics 2006; Housing NSW 2007)

Figure 3: The role of stakeholders in the Affordable Rental Housing Sector



family on a given income. This rental gap needs to be "closed" before investors will agree to fund affordable housing. Many of the funding models analysed require a government subsidy to close this rental gap. At the time of the research no affordable rental housing funding model has been successful in attracting sustainable and significant institutional investment by meeting investors' income return requirements.

There are further requirements for the successful implementation of an affordable housing model. These requirements are depicted in the Figure 3.

Figure 3 indicates the range of requirements for a successful affordable housing investment scheme. Additionally it details the activities and interaction of the main stakeholders in the affordable housing sector. As there is ongoing debate over the most appropriate means to facilitate this scheme many of the above activities are not being fulfilled and therefore the sector remains in crisis.

A qualitative research method was used for the task of assessing the viability of the funding models. This method is a new approach for this area of study. The principles of grounded theory were adopted for the analysis of interviews of key industry stakeholders due to its potential to generate new theory grounded in experts' views. The application of grounded theory to this area of study represents a contribution to the current body of knowledge.

Key Features of the Affordable Housing Funding Models

Berry (2002) provides a broad method for distinguishing the funding models. Each of the funding models requires a means of financing. This financing means falls into two categories: debt and equity. A third category exists when there is

Table 1: Comparison of the Affordable Housing Funding Models Means of Financing

Funding Model	Financing Means	Source of Finance
Consortium or Bonds	Debt	Sole Government involvement and liability
Public Private Partnership	Debt / Equity	Debt is sourced from the private sector and equity is split between the government and the private partner through the public company structure, with private investor equity in the company
Not for Profit Housing Company	Debt / Equity	Equity is provided by the government which allows for limited raising of debt from the private sector
Pooled or Listed Property Trust	Equity	Equity is provided by private investors with government holding an equity interest
Tax Credit	Equity	Equity is solely from the private sector

a combination of both debt and equity. Considering each model's means of financing identifies various features which are shown in Table 1.

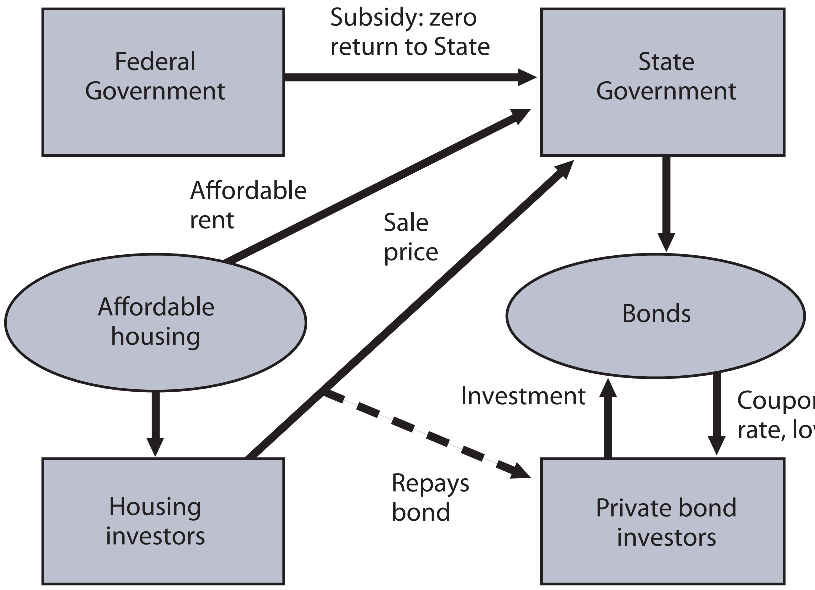
Consideration of Table 1 identifies the Consortium or Bonds model as the only model with sole government involvement and therefore all the liability of the scheme rests with the government. At the other end of the financing spectrum, the Tax Credits model is the only model where the private sector is the sole source of finance and therefore accepts all of the risk with the provision of housing. The other models result in a sharing of the liability between government and the private sector.

Looking more closely at the detail of each model the Allen Group (2004) suggested a number of measures for categorising the funding models. These measures are grouped as follows:

- Estimation of the gross financing gap
  - Risk allocations, borrowing costs, transaction costs and the base case which is representative of a broad spectrum of investors.
- Estimation of the net government impact
  - Taxation revenue clawbacks[1] and displacement effects[2]
- Impacts of additional investment on the economy and the housing market.

The above measures provide a thorough means for quantitatively assessing the models cost and benefits, however they do not consider the qualitative aspects of the schemes and the proposed stakeholders. Such qualitative aspects includes the attitude for acceptance of risk, either by the government or private investors, how the models fit with the government's philosophy nor the risk associated with each model, such as the market it operates in. The Allen

Figure: 4: Consortium or Bonds Model



Group (2004) have not mentioned the aspects which impact upon the viability of the funding models. These aspects relate to their structure, risk sharing and stakeholders involved. Stakeholders are an important element as some of the partnerships may not be considered compatible. For example, the partnering of the state government and the private sector for the delivery of affordable housing are referred to as "an uneasy pairing" due to the apparent conflict of interests involved (Phillips 2006). An alternate means of categorising the main features for each of the models considered are included in Table 2

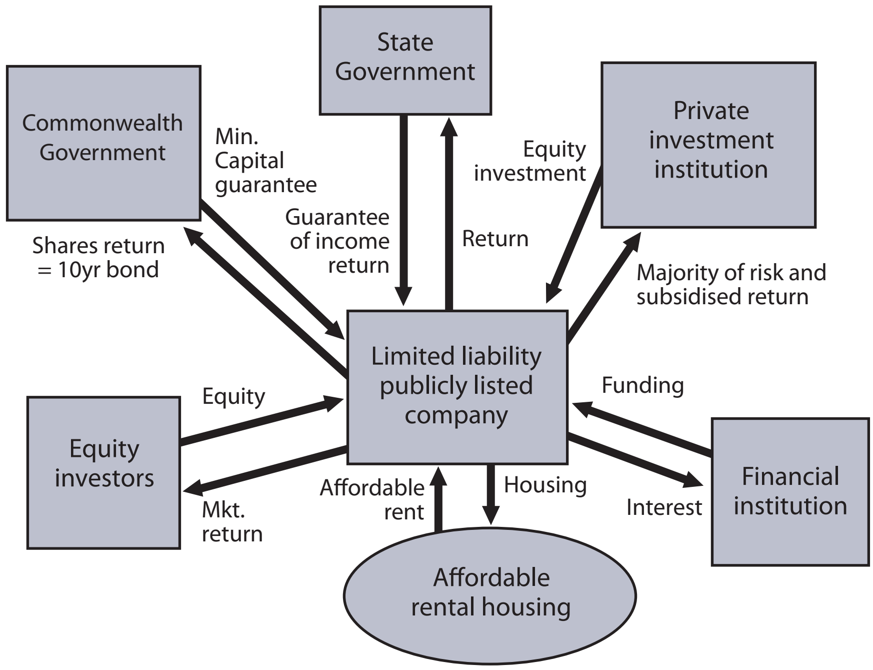
Considering the features for each model in Table 2 reveals the models which have acceptable features from a government's perspective. In respect to the form of subsidy, only the Not for Profit and the Tax Credit models have limited liability which is highly desirable by governments however the Not for Profit model has a limited capacity to improve supply. On an efficiency basis, the Bonds model exceeds all other models on a cost to government of capital basis except it lacks the potential for private sector innovation to drive improved systems and housing standards delivery. On a funding source basis, the Bonds and the Tax Credits model are the only models which do not involve the government for funding. As for partnering, the Not for Profit model has the least potential for conflict as there is only one level of government involved, while the Pooled Fund model involves a listed vehicle with a not for profit manager which is considered to be incompatible. Most models use the private sector for housing provision and should benefit accordingly with only the Bonds model using a public authority whose reputation is marred by past public housing experiences and little experience beyond that sphere.

On the grounds of the political philosophy most models, except for the Pooled Fund and Tax Credits models are discounted as they involve the government intervening in the markets operation by providing the housing assets.

Table 2: Affordable Housing Funding Models: Key Features

Features/Models	Consortium or Bonds	Public Private Partnership	Pooled Fund	Not-for-Profit Housing Company	Tax Credits
Subsidy form	State Government issued debt with Federal guarantee and tax free interest. Unrestricted liability to government	Government guaranteed subsidy of rental return and Federal government accepts capital risk. Unrestricted liability government	Government subsidy to boost income return. Unrestricted liability to government	Initial State Government grant plus developer contributions and private funding. Limited liability to government	Tax concession. Limited liability to government.
Efficiency	Lowest cost of capital due to high credit rating of government raises efficiency	Government involvement improves credit rating and lowers the cost of capital with strong private sector innovation potential	High rate of return required due to listed environment raises costs. High private sector innovation potential	Lower costs from tax free status and low risk. Limited gearing and innovation potential	Use of housing authorities not for profit status raises efficiency with private sector innovation potential
Funding source	Bond investors	Publicly listed company investment, initially by government and private partner at high cost, then from equity investors	Publicly listed property trust investment with partial government investment	State government grants, private debt funding and developer levies for planning bonuses	Purchasers of dwellings with approved tax credits via private financiers
Partnering involved	Federal and State Governments	Federal, State governments and private company or not for profit housing manager	Federal /State government with listed trust manager and not for profit housing manager	State with not for profit housing company	Federal, and State governments with not for profit housing manager
Housing provider	State authority	Private company	Private listed trust	Not-for-Profit company	Private developers
Political philosophy consideration	Provision of assets is contrary to policy. Known model for infrastructure	Provision of assets is contrary to policy. Known model for infrastructure	Assistance of market supplied asset is appropriate. Known model for property.	Provision of assets is contrary to policy. Used by State government	Assistance of market supplied asset is appropriate. Model used overseas
Scale potential	High as investor interest is strong	Moderate as project based model and not applicable to large scale roll out	High as easy to replicate and known model	Limited due to restricted funding sources and low private sector involvement	Moderate as complexity and compliance may restrict participation

Figure 5: Public Private Partnership Model



Some of the practical assumptions common to the models reviewed include;

- Governments are assumed to require management by recognised affordable housing associations. These will be responsible for tenant selection.
- Head leases with these housing associations would specify tenancy and maintenance standards plus incentives for excellence.
- It is generally assumed that vacancies will be low as the lower rental will attract a higher demand. This will have an impact upon the rental revenue

(Allen Group 2004).

Estimates of cost-effectiveness

According to the Allen Group (2004) the Bonds model was the lowest cost option followed by the Tax Credits model and the Partnerships model. It is expected the Pooled Fund and the Not-for-Profit models represent reduced cost effectiveness, although these models were not assessed by the Allen Group.

This lower cost effectiveness is thought to arise from the high rate of return required to operate in a listed property trust environment for the Pooled Fund model necessitating a higher subsidy (Berry et al. 2004). The Not-for Profit Housing company model involves large upfront costs to the government and limited private debt funding. The Not-for-Profit companies also depend heavily upon Government annual grants to compliment their rent revenue (Milligan et al. 2004). The Not-for-Profit model nevertheless benefits from a tax free status which improves its cost effectiveness (Cartwright et al. 2006).

The Bonds model has the lowest financing gap, followed by the Tax Credits model and the Partnership model. All three models have a net financing gap range between 3% and 4% as a percentage of the property value (Allen Group 2004). The financing gap is the difference between the derived return from the property when provided by the relevant fund model and the required rate of return of investors. Overcoming this financing gap is likely to be a key aspect of any funding model adopted in Australia.

On a net subsidy cost in dollars per household assisted per annum, the same

Figure 6: Pooled Fund or Listed Property Trust Model

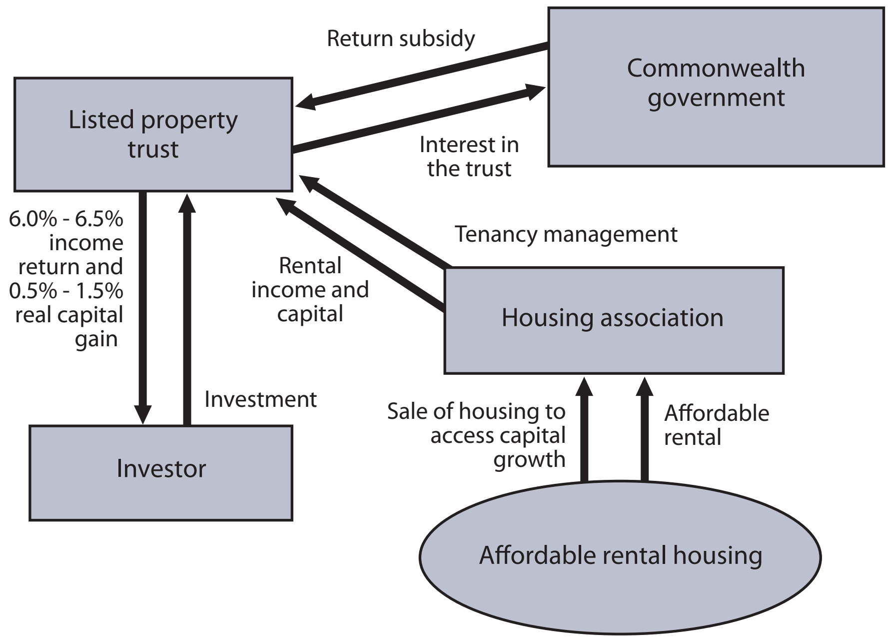
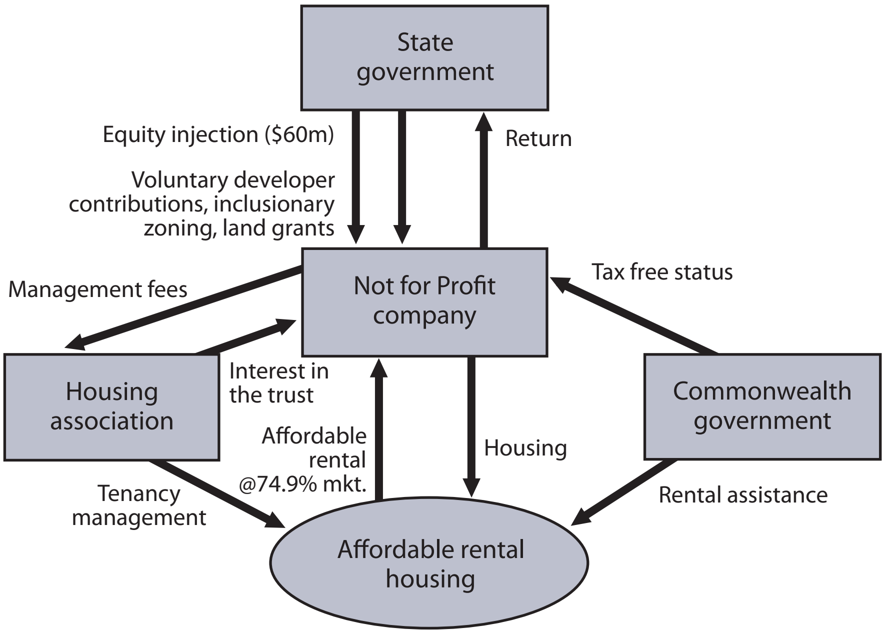


Figure 7: State Government Not-for-Profit Housing Company Model



order of effectiveness of the models applies as above; the Bonds model, followed by the Tax Credit model and the Partnerships model. The amount of net subsidy per household required for each of these three models ranges from $5,000 to $8,000 per annum. This cost to government is reduced due to taxation revenues from the investment of around $1,300 per annum for the Bonds model (Allen Group 2004).

As the cost effectiveness of the Pooled and Not-for-Profit models are lower the financing gap and net subsidy per household per annum is expected to be higher than the other models assessed by the Allen Group. The comparison shows that none of the reviewed models satisfy all criteria. This produces the necessity of identifying which facets of the models are predominant to stakeholders.

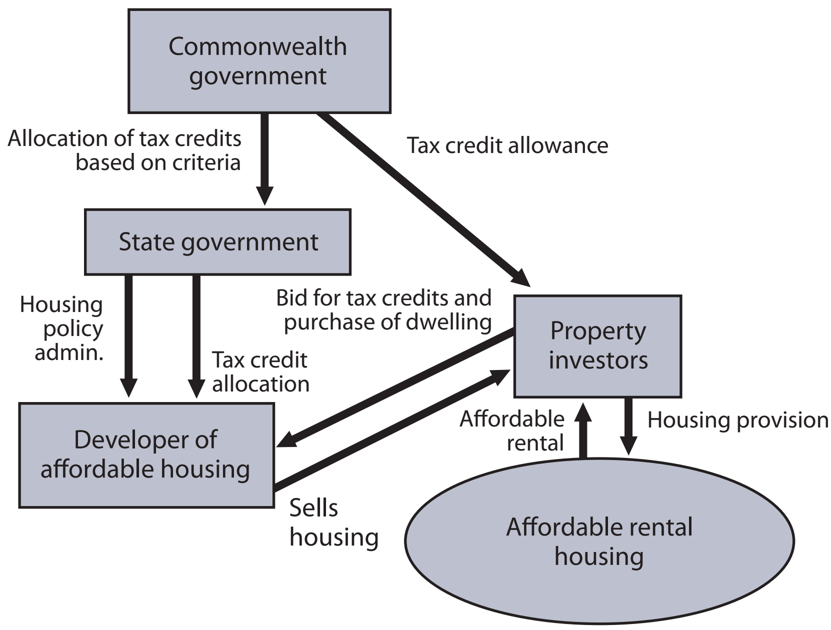
As all models produce a sufficient return, attention must focus on which risk or other stakeholder requirements are vital in determining a model's viability.

Summary of Funding Model Research

All of the funding models were noted to require a government subsidy with variation occurring as to how it was treated, the determinants which gave rise to the need for and the quantum of the subsidy. The variation arose from the differing structures and participants involved in the funding and housing provision process. The treatment of risk was a key determinant for the amount of the subsidy required.

For all the models reviewed the provision of a relevant subsidy is sufficient to produce an attractive return to institutional investors. Berry and Hall (2002) states that institutional investors need a suitable investment or asset class to provide the opportunity for large scale investment and that the Bonds, PPP and Not-for-Profit Housing company models achieve this goal. The Tax Credits and Pooled Fund models also achieve this end (Allen Group 2004). The models do not vary on this critical point, although the Not-for-Profit model has a reduced return. It is the means of achieving the acceptable return and the potential for providing for a volume of finance which varies between models. Each model has attractive elements, such as government bond security (Bonds), or a model which

Figure 8: Tax Credits Model



has been implemented successfully overseas (Tax Credits), or a model which is well known to domestic markets and readily adopted (Pooled Funds) and appeals to different sections of the investment community and government. While Berry and Hall (2002) refers to the Bond, PPP and Not-for-Profit models as all being viable, it is this similarity of the models which causes the dilemma of which model is *most* viable.

The 'best' model as determined from a financial assessment was the Bonds model, followed by the Partnership, Tax Credit, Pooled Fund and Not-for-Profit models. This determination was based upon the cost effectiveness and the ability of being able to address the need of providing a significant amount of affordable housing. Basing the feasibility and viability of a model solely on the level of cost effectiveness was seen to lack account of other important factors, such as the political appropriateness of the schemes. It is suggested that viability goes beyond what could 'work' to consider which model provides the best fit to the current circumstances and the main determinants which government' and investment communities' decisions hinge on.

These other factors are considered crucial in terms of providing a clearer understanding of what is the most viable funding model for affordable rental housing in the current Australian marketplace. The need for identification of the predominant requirements of stakeholders, apart from return, for a model to be viable is therefore considered essential.

Conclusions

Affordable Housing Funding Models

The prime finding of this research was identifying the criteria which indicate the funding model that would be viable in this current political and economic environment. Beer, Kearin and Pieters (2007, p. 13) provided a useful guide to undertaking this task:

> *"The implementation of policies relating to housing affordability in Australia must be examined with reference to the impact of neoliberalism, the history of housing policy and the welfare state in Australia, and the relationship between the three tiers of government."*

The factors mentioned by above were considered with the results showing that the funding models all have positive and negative attributes when considering their qualification as a viable funding option. However the Tax Credit model is the only model which satisfies all key criteria. Dodson (2006) argues that neoliberalism, to which current Australian political parties adhere, seeks to produce an environment where the individual takes responsibility for their own well being. Therefore the funding model which assists individuals to supply affordable housing is favoured. Only the Tax Credit model, based on the US model, achieves that end, as the other models include the supply of housing by institutions.

The Tax Credit model is known to work well in the US which gives the Australian government comfort regarding the policy. Beer, Kearin and Pieters (2007) notes that borrowing international policies is a hallmark of neo liberalism. Inclusionary zoning which was used in the UK prior its adoption by the NSW State government is an example. This characteristic of borrowing policies points to either the use of the Not-for-Profit housing company model used in the UK or the Low Income Housing Tax Credit (LIHTC) model used in the US. The PPP funding model also has the advantage of being a proven method due to it having been used extensively in Australia for infrastructure provision. Notwithstanding Susilawati and Armitage (2004) state that "many (affordable housing) stakeholders hold doubts about the specious attractions of such (PPP) models."

Berry and Hall (2002) supports the consideration of past governments' housing policy to identify the preferred funding option (Beer, Kearins & Pieters 2007), stating:

> *"Options that cut across or contradict well-established policy directions are unlikely to be introduced in the short to medium term."*

The long-term shift away from housing provision is clear with the focus of Federal Government rental housing policy on Rental Assistance to encourage private housing provision. Therefore regardless of the Bonds model being highly rated in a number of areas as shown in Table 2, particularly the efficient provision of housing, other means of assistance will dominate the government's decision which does not involve direct government housing provision. Such means include tax concessions rather than direct expenditure, as they offer the government lower risk alternatives (Wilson & Turnbull 2000). From a tax concession basis, of the readily scalable models, which excludes the Not for Profit Housing Company model, only the Tax Credit model satisfies this criteria.

The research identifies the need to consider the risk which the model adds to the process and how the model treats the existing risks. One local government respondent identified the counterproductive activity of the state government toward affordable housing. Another local government respondent provided evidence of where the state government had repeatedly reneged on policies regarding affordable housing and planning policies in general. Berry (2000) refers to the conflicts between the state and federal governments, while Flood (2003) identifies government bureaucracy as difficult to operate with and doubts whether it could act efficiently or in a co-ordinated manner. Randolph (2000) confirms these inefficiency was evidenced by the lengthy time taken to reach the contract stage for the redevelopment of the Bonnyrigg housing estate. These elements present as significant risk

The inadequacy of the governments' financial commitment to the affordable housing sector on all jurisdictional levels is the key reason that none of these funding models studied had been adopted at the time of the research.

factors for a funding model which is required to operate efficiently. Examining the relationships between the tiers of government, any model which relies upon the acceptance of risk by the state government and an efficient partnership between federal and state governments or state and local governments will be viewed as difficult to operate. Risk is seen as a strong deterrent to government which one respondent referred broadly to as the "risk-averse world" in which local government operated in. A state government respondent noted the reason why the NSW State Government did not like the Bond model was that it required them accepting the risk. Such government risk aversion benefits the PPP, Pooled Fund and Tax Credits model as the risk is not passed to the state governments.

A final financial consideration of governments' aversion is the risk of budget blow-outs, which leaves the Tax Credit model as the most favoured. The Allen Group (2004) state there are two means of lowering investor risk which come at a cost to government; subsidising the yield or a capital guarantee. Both costs present as a disincentive to government however a capital guarantee is the greater. The liability or risk responsibility varies across the models as shown in Table 1. Only the Tax Credit model involves no exposure to government, aside from the subsidy funding, as equity or ownership of the scheme is entirely with the private sector.

Ranking the models in terms of cost to the government, the Bonds model followed by the Tax Credits model and then the PPP model have the lowest cost. The Not for Profit housing company model has large initial upfront costs and the Pooled Fund operating environment requires a higher subsidy to match the yields of the listed property trust market. The Bonds model has the lowest rental or financing gap followed again by the Tax Credits and PPP models, all with a gap of about 3 to 4 percent of the value of the property (Allen Group 2004). Ranking the models according to the net subsidy cost has the same result with the Bonds model having the lowest cost (Allen Group 2004). In summary, the Tax Credit model has the benefit of meeting government requirements at an acceptable cost.

Research Summary

This research was expected to locate weaknesses in the models which rendered them unworkable and hence did not evoke support from government. The reasons which made the models unworkable were expected to be the inability to address the requirements of the investment community. However what was found was the models could all be successfully implemented if government provided an appropriate subsidy. The benefits of providing a subsidy were obvious, substantial and meaningful. The extent of these benefits raised questions regarding the government's motivations despite their rhetoric which proclaimed they were interested in assisting, and had a clear mandate, to provide for the people's housing needs, especially the less fortunate. Such statements were supported by the existence of government departments, both state and federal, set up to assist affordable housing, yet supply was slow and inconsequential compared to the need. Investors and government alike focused solely on the rental gap pointing to the shortfall in the investment return as the reason for the lack of investment. A more critical consideration was that the investment return failed to provide sufficient compensation for institutional investors relative to the perceived risks involved. As a result, supply remained limited. The inadequacy of the governments' financial commitment to the affordable housing sector on all jurisdictional levels is the key reason that none of these funding models studied had been adopted at the time of the research.

The existence of numerous feasible funding models supports the idea that the problem is one of devising a model which generates a return from an inherently low yielding asset in order to attract private investment. The true reason for this lack of investment activity is suspected to involve a consideration of what government prefers.

The normative theory of social choice includes the idea that the result of the operation of the social process is the socially most preferred option (Asher & Midwest Political Science Association (U.S.) 1984). On this premise it could be thought that the current affordable rental housing problem has occurred either as a result of society's intent to not be involved in a solution or because of society's lack of knowledge of the sector's need.

The research showed that the reason why none of these funding models had not been adopted was not because of their failure to provide a suitable vehicle which was acceptable to government but for other reasons. One of the main reasons was there has been no political will to significantly intervene in this sector to try and address the problem. The recent National Rental Affordability Scheme may yet prove there is now some political will. However as this scheme is yet to generate significant institutional investment into the sector, the degree of government will is still open for speculation.

In the interim and to avoid the associated risks which accompany government involvement, it is suggested that a solution which involves working within the current political and economic environment be developed to encourage and support private investment in the affordable rental housing sector. ■

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Risks and rewards of child care valuations

By Darren Trivett (AAPI/CPV)

Articles published in the Real Time section aim to generate debate within the property professions. The views expressed are those of the author. Additional contributions to the debate (articles, Letters to the Editor etc) are welcome.

General overview

The valuation of a child care centre is a complex one that should be undertaken only by those experienced in the industry. Like most specialised valuations, market knowledge and evidence is critical and it should not be underestimated how difficult it can be to secure suitable market sales and leasing evidence.

The child care industry within Australia has experienced an interesting 10 to 15 years. Most recently with the demise of the ABC empire but with a potentially larger influence being the involvement of the various Government structures and the support they provide to centre owners and operators and the families that have children within recognised care.

Various studies, both domestically and internationally have identified the experiences in the first five years of a child's life as being critical in the development throughout its school life and into adulthood. What makes this even more interesting is that the majority of carers within the industry are generally under the age of 24 who are charged with the highest level of care for young children. In recent years increasing pressures from parents, and as a by-product the legal industry in the form of Apprehended Violence Orders, have seen a great deal of responsibility put on young shoulders.

The next two to four years are likely to be interesting ones for the industry, particularly in light of the sale of 698 former ABC child care centres to a non-profit group. This group will now be in control of nearly 700 leasehold centres in Australia or approximately 62% of the former 1186 former ABC controlled centres throughout Australia including both leasehold and freehold facilities. When considering just leasehold facilities then this ratio will obviously increase. The question will then be how will a non-profit group, which by their own estimates will receive approximately $21 million per year in payroll tax exemptions, impact on established, private facilities that may not receive the same level of tax exemption. Personally I struggle to see how this new group will be any less dominating within the child care centre industry than was ABC – they certainly will have a total holding that is far greater than any other provider or group within the country with a stated view of expansion.

I will qualify this statement to a degree by saying that it may not be a bad thing for the industry as it will provide some form of stability after two years of great instability while this new group has guaranteed existing employee entitlements.

The industry will be an interesting one to follow in the following years with many operators reporting that they are experiencing falling occupancy levels. This was, in part, generated by a range of issues but largely driven by a perception of great profits (maybe perpetuated by the expansion of ABC which would seem to have been achieved, in part, by massive debt), banks appearing to be willing to lend on just about any form of development, media and government reporting of a dramatic shortage of spaces within the sector and developers keen to develop as theirs was a general belief that ABC was the end buyer of any product.

As history has shown us there are a wide range of factors that influence the success or otherwise of a child care centre which can make the valuation process extremely difficult, particularly as traditional "benchmarking" is hard to quantify.

The appeal of the industry over the course of the last 10 years and into the foreseeable future has been the level of Government financial support and this is likely to see the industry remaining popular with a range of operators and investors. It is one that will come under continued pressure from wage increases, occupancy levels, fee structures and now the presence of a massive new non-profit competitor.

The underlying strength of the industry is the support the Federal Government has provided over the course of the past 10 years which would appear set to continue for the coming years. On the other hand, recent announcements from both the federal and state governments, which include increased staff numbers in the rooms and qualification requirements, is likely to place substantial financial pressures on centres as they are implemented from 2012.

ABC – The rise and fall

This was, in a word, stunning. Stunning in the way the company grew from a modest beginning in 1988 (the first centre was an old church) to an equally stunning downfall in 2007.

The obvious question is: was ABC "broken"?

I don't believe so, however I will qualify this by saying I am referring to the *child care centre business of ABC only and not the corporate management or governance of the company*.

It is reasonable to assume that is was a solid business if comments from the chairman of the new purchaser are a guide, when he stated at the time the deal for the purchase of 698 former leasehold ABC child care centres that the group was nearly at break-even. A solid position if you consider that in the first months of receivership it was widely reported that centres would close, and the obvious concern this would have raised in the minds of parents.

Having regard to the level of debt the company was reported to be carrying, a large number of the centres would have been valued. Accordingly it is reasonable to assume that they were a reasonable business which was reflected in lenders extending facilities to ABC.

It seems obvious, based on comments from different sources, that a number of issues are likely to have contributed to the downfall of the ABC empire, but I am yet to be convinced that a major influence was how the individual centres were established or operated by the centre directors and staff. Issues which I believe in part, include:

- Public listing of the company – in the words of the new chairman of GoodStart, "We have no shareholders to feed – that's a great start.";
- It is generally accepted that public companies need to show an increasing bottom line to ensure that their shareholders see value in their investment;

- The listing of the company is reported to have generated significant funds which may have seen the company grow at a rate that it may not have been able to achieve if it remained in private ownership;
- Debt – it has been reported that ABC was carrying an enormous level of debt which must have placed pressure on the viability of the company;
- Growth – like many companies, ABC expanded in part by acquiring competitors, both domestically and internationally. As such, it is reasonable to assume that as a by-product of these acquisitions they acquired centres that did not fit their corporate profile or were in locations that were already well serviced by centres including existing ABC centres; and
- External competition – a large number of centres have been developed over the last 10 years following the support by the Federal Government which allowed many to enter the industry or expand their footprint.

A snapshot of ABC

- At one time a Public Listed company with some 8,000 employees;
- The company reported a turnover of approximately $1.7 billion in 2007;
- At the time of its demise it was reported to be the world's largest provider of child care facilities with more than 2200 centres worldwide and more than 1100 in Australia;
- In 1995 they started their own internal training facility eventually becoming known as the "National Institute of Early Childhood Education";
- By 1996 ABC operated 18 centres;
- 1997 – the federal government moved to abolish subsidies to the non-profit centres and move the child care payments from the centres directly to the families;
- By 1999 ABC had more than 30 centres;
- By 2001 it increased to 50 centres;
- In 2001 they listed on the Australian Stock Exchange;
- In 2002 they increased their holding to 94 centres and within a year this increased to 192 centres;
- By the end of 2004 the company controlled more than 325 centres;
- In 2004 ABC negotiated the merger with Peppercorn Child Care Centres Australia which effectively doubled the number of centres under the control of ABC;
- By 2005, ABC controlled 20% of the market in Australia;
- In 2006 acquired Kids Campus;
- 2006 also saw the first foray by ABC into the American market, acquiring the Learning Centre Group which operated more than 460 centres through the USA. At the end of this year they also acquired Children's Courtyard which provided a further 74 centres to their portfolio;
- In addition, 2006 saw them enter the UK market, acquiring Busy Bees and adding another 46 centres;
- 2007 was another active year in the acquisition of competitors. Locally they acquired Hutchison's Childcare Services while they expanded their holding in the UK by purchasing the Leapfrog Nursery group which added a further 88 centres to the group and made them the largest provider of child care services within the UK;
- 2007 saw a further commitment in the US by acquiring LaPetite Academy which gave the company a further 50 centres within the US.
- ABC also purchased 49 centres within New Zealand;
- In the end, ABC controlled 2250 centres in four countries.

This timeline shows the staggering expansion of a Company that in 1988 started life by operating a single centre within an old church to becoming the world's largest provider of child care.

What makes a good child care centre?

Ten years ago the old adage "Position, Position, Position" was the driver for what was to be considered a good centre. Now it is all about "Staff, Staff, Staff". If parents had a concern about the quality of care for their most important asset then the obvious outcome would be to seek alternative care in another centre.

Staff are expected to be carers, educators and disciplinarians and it is critical to establish, firstly a director with a solid knowledge of the industry and the ability to manage a team that comprises often young staff who are dealing with highly stressful issues. Think for a moment if you had to deal with some of the following:

- Children acting in a violent way towards each other or speaking in a completely inappropriate manner towards staff – the language a five-year-old can use towards an adult is truly amazing;
- A parent turning up at your place of employment and telling you they are unhappy with the way you are dealing with their child;
- A parent who has an Apprehended Violence Order turning up at your office demanding to see one of your staff, often acting in a violent and threatening manner;
- A child who has a severe nut or other serious allergy and a food to which they are allergic is brought into the centre;
- An outbreak of medical issues such as swine flu and how this should be managed; and
- An ever increasing level of government regulations.

These are only some of the unusual and varying issues that staff have to deal with on a daily basis.

Room layout and licence numbers are other variables that require careful management.

If you speak to a room of child care operators they will all have different opinions on what makes a good child care centre.

Some will swear that you need a nursery while others will be equally determined that they are a loss maker and unnecessary.

As an example, take a 12-week-old baby in care for five days a week for 48 weeks a year (full time working parents) @ $68 per day = $16,320 per annum. Keep in mind that this is a net amount with a parent having to earn an excess of $20,000 in gross wages to pay for this one baby. It is important to remember that this is before any subsidies a parent may be able to claim through the various government rebates.

The difficulty for an operator is that a nursery generally caters for eight babies under a single licence and the staff ratio is 1:4. In comparison, take the older preschool room where room capacity is around 24 children with a staffing ratio of 1:12.

In general, centres operate on a single licence capacity but can operate as double centres depending on a range of issues. The most common licence is 75 places while room configuration can be on the following basis:

- 75 places, 5 activity rooms – 6 weeks to school age
- 75 places, 4 activity rooms – 15 months to school age

Ultimately, the dynamics of a successful child care centre has changed. Staff will largely determine the success or otherwise of a centre. Parents talk at sporting carnivals, school concerts, tuckshop, etc and you can guarantee they will be quick to discuss issues that are damaging to a centre before they will tell you how good their experiences have been.

Overall, passion, professionalism and leadership will determine whether a centre is successful. The challenge for the valuer is to try to decipher the hints that will allow them to determine if the centre is a long term viable business. A profit and loss statement will tell you part of the story but the site inspection and the questions asked will tell you much more.

GoodStart

A group of non-profit organisations, including Mission Australia, has acquired 698 leasehold centres through the "ABC 1" offering. In total, Mission Australia will have involvement in more than 700 leasehold centres throughout Australia with non-profit centres now reported to control approximately 40% of the child care centres within Australia.

I will reserve my judgement on whether this will be good for the industry, however it is a little difficult to see how it is much different from some of the criticism levelled at ABC which was that one group had too much control within a single industry.

The deal however guarantees the entitlements of the existing staff, a significant positive for an industry that is generally regarded as being at the lower end of the pay scale. This will no doubt give a great deal of confidence to what is obviously a loyal staff base together with giving the parents of children attending those centres peace of mind knowing that those they trust with the care of their children will continue to do so.

Little information is available and I think the balance of 2010 will be a bit of a wait and see situation.

Nonetheless, the feedback I have received to date from owners and centre directors is one of general concern, not only that there is a feeling that they now have another large player replacing a former large player, but concern in how the $21 million in tax exemptions will be distributed back into the business.

I remain hopeful that this new group will be respectful of those already in the marketplace and the hard work that these "private" centres have undertaken already. I remain confident that all will work for the betterment of the industry with a clear understanding that the welfare of children is the ultimate goal.

The business of child care

In general, most people would recognise a child care centre as providing daily care for children from birth to school age in what is referred to as a Long Day Care facility. The most recognisable of these have been the ABC Centres with a distinctive street presence and an equally distinctive owner.

One of the main issues to recognise is that care for these young lives is generally undertaken by women under the age of 24 in an industry which is generally considered to be at the lower end of the pay scale. My experience over the course of the past 10 to 15 years has been that those carers within the industry are there not for money but for a genuine care for the wellbeing of the children.

What has appeared over the last 10 years, in my view, has been that the behaviour of some children is at times challenging for their carers and it is clear, not all children are little angels. Over the course of recent years the attitude has changed from "what is wrong with this child?" to "what can I do to help this child"?

This has been a major change in attitude of the carers and industry participants and recognition of the importance of the first five years of a child's life. The industry, together with government, has worked hard to establish business practices to enhance the quality of care received by all children under supervision.

Quite obviously, all participants within the industry have a duty of care to the wellbeing of children within a child care facility however none more so than those charged with the daily care of the children. A failure of this care, no matter how minor, could have dire consequences. Some of the issues that these young carers have had to deal with in recent years have included:

- Allergies and how they are dealt with have become more prominent in recent years;
- Swine flu and how to manage potential cases;
- Changing government regulations and the difficulty in staying on top of what is a constantly changing playing field;
- The behaviour of parents – I have seen parents become particularly demanding over the most minor of issues and they will gladly take it out on those caring for their children;
- The behaviour of children – this can be in the form of just generally bad behaviour, violence towards other children or even the carers and exceptionally poor language;
- A pressure not often considered is domestic violence. It has become more common for Apprehended Violence Orders to be on the back of say a storeroom door. These young carers are expected to deal with these potentially volatile issues together with the pressures of a "normal" day.

As a general observation, a child care centre will be licenced for 75 children in say a five-room configuration. Ideally a freehold going concern centre would need to be operating at an occupancy of say at least 75% and more preferably

80%+. The obvious concern with a low occupancy is the potential for an erosion of the care that can be offered.

As an overview, child care is unlike any other industry in Australia. The income and underlying profit is generated solely from the care of young children, generally administered by young adults. It is an industry that is supported heavily by government, however is also burdened by increasing legislative requirements.

As can be seen from the experience of ABC and the subsequent receivership, it is one that can be influenced by public comment and perception which ultimately can see the occupancy levels decrease dramatically and quickly.

Issues for valuers

The first issue should be "do you have the necessary experience to accept the instructions to undertake the valuation". Very little evidence will be sourced from the normal data providers that a valuer may use. Sales evidence is generally tightly held by the selling agent and property owner and if you do not have a solid and respected relationship with the agents within the industry then it is almost impossible to undertake the valuation.

It is then necessary to determine what you are valuing.

Last year we declined instructions on at least five centres after discussing our initial brief with the clients. In one instance I had one client telling me in great detail of what they wanted, which seemed to be a going concern valuation (still not sure though after 20 minutes). Ultimately my decision was made when they advised "surely you just add the land and buildings together and that is the value of the business". Unfortunately they are not all that easy to identify.

The instructions are accepted so what are you valuing?

- Lessor's Going Concern;
- Lessee's Going Concern;
- Lessor's (Passive) Interest;
- Alternative Use.

When I first started valuing centres in the 1990s you wanted to see a centre on a main road, next to the primary school and enjoying a high level of exposure.

> ***Very little evidence will be sourced from the normal data providers that a valuer may use. Sales evidence is generally tightly held by the selling agent and property owner and if you do not have a solid and respected relationship with the agents within the industry then it is almost impossible to undertake the valuation.***

Now it is not so clear cut. My belief is now it is all about the staff. I have recently valued 20 centres for the one group and the staff appeared to be outstanding. The way they interacted and spoke to the children seemed to be of the highest order. The children were settled and when the need to speak to a child arose I watched as the carer took the time to speak quietly and at eye level with the child and the responses were very positive.

Over the past 10 years I have come to appreciate that the valuation of a child care centre starts with your perception or feel of how the centre is operated. Obviously any change in the staffing dynamics can dramatically alter the performance of a centre, however how the centre feels at the time of inspection remains an important factor and that only comes with experience.

I am certain that most operators would say word of mouth and reputation generates most of their business. Remember, we are dealing with parents who are at the tuckshop, school plays, school sporting carnivals, weekend sport, birthday parties, etc and they will be quick with a negative comment.

Room configuration is a term often used and refers to the number of activity rooms in which the children are cared for, while there will be ancillary areas such as reception, toilets, kitchens, etc. The most common room configuration under a single 74/75 place licence is either four or five rooms. A centre can operate under a "double" licence and there is no standard for this. We have seen double centres offering 2 x 75 place licences while another has been based on 2 x 58 places.

Once you have completed the inspection you will need to "drill" into the Profit & Loss Statements. Like any going concern valuation you would like to have at least three years of trading performance, something that continues to be difficult to obtain within the industry.

Many industries use "benchmarking" when considering the expenses a business incurs, however this can be extremely difficult in child care centres as so many factors can impact on the profitability or otherwise.

Generally we like to see wages sit at a certain level, and if it is a leasehold centre we have an idea where we like the rent to sit and then ultimately we like to see the Net Operating Profit to reflect a certain percentage range. In between there is a wide and varied list of expense items a centre may incur and it your responsibility to determine whether these are justifiable.

Outside of Gross Income, wages are likely to be the most critical component in the viability of a child care centre.

Wages can make up anywhere between 40% and 60% of the total expenses for an operational centre on a going concern basis. We have been presented with financial statements for a centre showing a wages component of 42% which we thought should have been at least at 50%. Once we dug a little deeper it became evident that a number of the owner's relatives were working in the business but not shown in the figures provided.

Occupancy rates are another issue to be considered. You will need to run an income check to see if the Gross Income represented in the financial statements as provided is one that is achievable based on the occupancy and room rates provided. While not completely accurate it provides a good start in determining the initial position of the business.

The implementation of Prep Year in state government schools, which is free, has further clouded the occupancy position of a centre.

Child care is an industry where a valuer must be able to not only read a Profit and Loss Statement but also the business at the time of inspection. Understand how the centre feels, do the children look settled and entertained, how do the staff interact, where and what is the level of competition. These are only some of the issues, and as can be evidenced over the course of the past two years (ABC and government regulations) the valuation of a child care centre can be fraught with danger.

There are a number of scenarios to consider when valuing a child care centre, however most will centre on the assessment of a yield against the Net Operating Profit.

Like most going concern valuations it will often be necessary to make adjustments or consider expense items as "add-backs" before determining the final trading position of any particular centre.

Like the bulk of the non-residential property market in Australia, yields have generally been softening over the course of the past two years.

Like all "investment" property the yield achieved can be heavily influenced by the land content together with the rental component in the case of leasehold centres. Newly developing regions obviously see an increased level of development in centres, driven by an expanding population base and a perceived low buy-in price for the land component. The difficulty in those areas closer to established, major business precincts is that often these areas are developed with higher density residential holdings and land availability, particularly say 2000 square metres required for a modest child care centre, one is rare and two is expensive.

While the market will look at a return on income, lenders can also put considerable weight on a dollar rate per licenced place. This is a widely varying number and one that can only be considered on an individual basis and then must also be considered in conjunction with the overall real estate holding.

In recent times we have seen more and more sales of freehold going concern operations being sold with two contracts of sale. Generally a price is agreed for the overall operation and then the contracts will be prepared, one for the leasehold interest in the business and the other for the real estate holdings.

Industry strengths and weaknesses

The most obvious strength, and some would say weakness as well, is the level of government financial support provided to the industry. In general, many centres would show approximately 50% of their income being from government rebates and obviously, if the government was to withdraw or reduce its support then it is reasonable to assume that the occupancy levels and profitability of a centre may also reduce.

This being said, it is considered unlikely that the government would seek to diminish the level of support it provides to the industry, particularly in light of the recently announced changes to staffing ratios that will start to take effect in the coming years.

The demise of ABC gave the government and the market the perfect opportunity to see more diversification within the ownership structures of child care centres throughout Australia.

The sale of former leasehold ABC centres has seen one group reportedly in control of in excess of 700 leasehold centres throughout Australia. Many within the industry will have some reservations in relation to this level of ownership on the back of ABC, however the guaranteeing of staff entitlements was obviously a major consideration for the government and receivers.

The increasing awareness of parents of the quality of care that should be expected from a child care centre and thus creating a more "educated" staff has also enhanced the overall operational position of centres.

The industry has also acknowledged the importance of providing a nutritional menu in those centres offering daily meals. We have seen the old meat pies and sausage rolls replaced by fresh fruit and more rounded meals.

The industry has matured over the years but it has certainly gotten far harder as well. Parents seem more difficult and challenging, children can tend to be more demanding, staff remuneration remains at the lower end of expectations, continued development of centres has created an over-supply in certain areas. Increased legislative requirements will also continue to place pressure on centre owners while wages growth will see fees increase in the coming years.

Conclusion

Overall, the next two to five years are likely to be increasingly difficult for the industry and will include among other things:

- A large new player in the market place who receives significant payroll tax exemptions;
- A wages component that will increase which will need to be passed on to the parents, in at least the privately owned centres;
- Increasing government regulations;
- Increased competition – history tells us, no matter what, someone will build a new centre in an area with little capacity for further places;
- Older centres v newer centres;
- Increasing internal pressures such as swine flu outbreaks and the enforcement of AVOs.

The demise of ABC is obviously the issue that has had the greatest impact on the industry over the course of the past two years. I am of the belief that the business model was sound, which would seem to have been confirmed by statements from the new chairman of the GoodStart group, however I am less confident in the corporate model and the expansion phases of the company. As will be seen in the time line within this article, ABC grew dramatically on the back of significant acquisitions, both locally and offshore. Based on reports this was achieved with massive borrowings which would appear to have been a major factor, together with the GFC, in the overall downfall of this group.

Hence my belief that ABC as a model seemed to be working quite well, but debt levels and the general decline in the world economy would seem to have been the triggers for the demise. Indeed, the level of interest in both offerings, ABC 1 and 2, would seem to indicate that there was strong demand for those leasehold centres when offered to the market.

Overall the child care industry is one that will continue to fluctuate and our job as valuers is to be able to identify these peaks and troughs, the reason behind them and then to determine the impact, if any, they will have on the value and viability of a centre.

I have found the valuation of child care centres highly rewarding, with the industry comprising a dedicated and hard working staff that seemed focused on the safe and productive care and education of young children. The inspections are varied and almost never follow a normal routine. Kids are inquisitive and your inspection will no doubt be one that will generally require significant levels of concentration as the distractions are wide and varied.

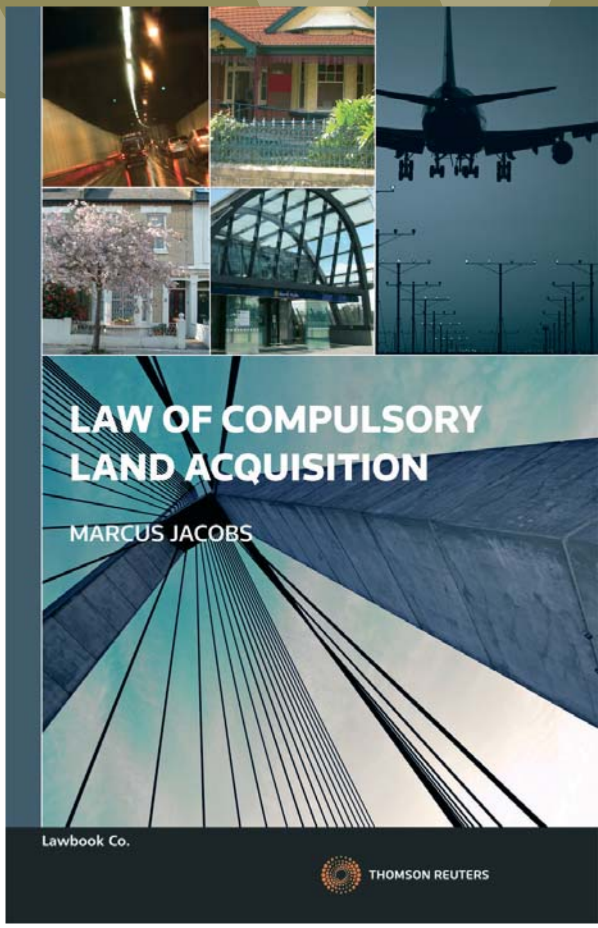
But don't be misled, these inspections and subsequent investigations can be extremely difficult and I would caution those wanting to enter the valuation of child care centre centres without the necessary experience to do so with trepidation. ■

Book review

Law of compulsory land acquisition

Marcus Jacobs, Lawbook Co, Thomson Reuters, 2010. 947 pages, $219.95 (soft-cover)

Reviewed by Matthew Townsend



Matthew Townsend is a member of the Victorian bar and practises in planning and environmental law and the compulsory acquisition of land.

The yardstick against which Jacobs' book is to be judged is Alan Hyam's *The Law Affecting Valuation of Land in Australia* (Federation Press, 2009). Hyam, now in its fourth edition, has been the valuations lawyer's court companion for some time.

> ***One of the book's strengths is its regular comparison of relevant legislation. That is, many chapters commence with sections of commonwealth, state and territorial laws to allow a reader to quickly assess the merit in searching another jurisdiction's authorities.***

Jacobs work is described as "encyclopaedic" in the Hon Michael Kirby's foreword. At just under 1000 pages, it is certainly comprehensive. However, it presents more as a book of cases and materials on valuations law and some cases are cited at length with little or no analysis. This is not to say that the case references are irrelevant, but the brevity of some introductory paragraphs can mean that scanning the text for a citation on a point can take slightly longer.

One of the book's strengths is its regular comparison of relevant legislation. That is, many chapters commence with sections of commonwealth, state and territorial laws to allow a reader to quickly assess the merit in searching another jurisdiction's authorities.

There might be said to be some NSW bias to what aims to be an Australian text, but given Jacobs' domicile and the vibrancy of the NSW valuations jurisdiction this is understandable, if not unavoidable.

Jacobs frequently cites Canadian and American authorities. This is both interesting and helpful, given that many valuations principles apply across common and civil law jurisdictions, and such cases may otherwise not be readily discovered through the use of local search engines. Jacobs warns in his introduction, however, that some of those references have not updated since the first edition of this book in 1998.

Jacobs is perhaps more comprehensive in its discussion of valuations procedure than Hyam, however, 80 pages of the text are dedicated to forms. This collection might be interest to administrators, but it would be a brave (if not inefficient) practitioner that relied upon a form from a text rather than downloading the most recent version from a tribunal's website.

When taking into account Hyam's slightly superior accessibility, hard cover and slimmer profile, Jacobs' text is unlikely to become a valuations lawyer's preferred court companion, but given its greater depth on many topics, Jacobs' book deserves its own place in any valuations library. ■

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