VALUATIONS OF BUILD TO RENT PROPERTY

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Guidance Papers

Objectives

The principal objective of a Guidance Paper (*GP*) and Resource Pack (if applicable) is to clarify professional and industry processes, best practices, and procedures and to discuss their use and implementation.

A *GP* is designed to be of assistance to *Members* and those who use *Members'* services. They serve as a guide and measure of acceptable professional practice and conduct of a *Member*.

The intention of a *GP* is to:

a) provide information on the characteristics of different types of assets that are relevant to the advice;

b) provide information on appropriate practices and their application;

c) provide information that assists *Members* in exercising the judgements they are required to make in specific situations; and

d) convey elements of what is considered "competent professional practice" for Australian Property Institute (*API*) *Members*.

A *GP* is not intended to provide comprehensive training, instruction or prescriptive practices and procedures, or direct that a process, professional approach, or method should or should not be used in any specific instruction or situation.

Member Obligations

The *Member* is responsible for choosing the most appropriate approach in a matter based upon the task and instruction. It is a matter for each *Member* to decide the appropriate practice in any situation, and if they are unclear, seek professional advice from others, or contact the *Institute*. *Members* have the responsibility of deciding when it is appropriate to depart from the guidance and practices contained in a *GP*.

The *Institute* does not warrant that anything contained in this, or any *GP* is the definitive or final statement on any issue. *Members* must perform their own work pursuant to their own professional expertise and experience and if required, seek additional advice which might include legal advice.

Court or Tribunal Reliance

A court or tribunal may consider the contents of this *GP* to be relevant when deciding whether a *Member* acted to a standard required by law.

Currency of Publication

This *GP* is current at the time of publication, based on current case law and legislation.

Departure or Non-Compliance

Where a *Member* considers that a circumstance exists that warrants the departure from or non-compliance with any of this *GP*, the *Member's* report (or other advice) must include a statement that outlines:

a) the reasons for the departure or non-compliance with this *GP*; and

b) any impact the *Members* departure or non-compliance may have on the content of the report.

Members are advised to seek legal and/or other advice before departing from practice recommended in a *GP*.

Enquiries

If any *Member* considers any information or advice in this *GP* to not be accurate or up to date, or wish to raise any issue for consideration arising from the contents of this *GP*, please refer this to

API contact: standards@api.org.au

1.0 Introduction

1.1 Scope of this GP

This *GP* applies to *Members* who undertake valuations of Build to Rent (*BTR*) property. The objective of this *GP* is to address circumstances whereby *Institute Valuer Members* (*Valuers*) are instructed to undertake the valuation of a *BTR property*.

Members providing valuations must do so to the standard of professionalism and skill required and consistent with membership of the *Institute* and in compliance with the law.

The purpose of this *GP* is to provide information and guidance to promote a consistent approach to the valuation of *BTR properties*.

This *GP* addresses the principles and concepts relating to;

(a) *BTR property* that is constructed, completed, and operated in accordance with, if it exists, any applicable Build to Rent Scheme legislation/regulation (or similar) in the jurisdiction that the property is in; and

(b) *BTR property* either proposed or under construction.

This *GP* is not applicable to, or intended to cover the valuation of the following asset classes:

- Purpose Built Student Accommodation (PBSA)
- Single (stand alone or part of a cluster development) residential properties
- Other residential stock not included within the *API* defined term of Build to Rent property

This *GP* is not intended to outline methods of valuation but may comment on matters that should be addressed in reports in respect of certain property types or uses. Methods of valuation are covered in other professional standards papers and authoritative texts.

Valuers are reminded to consider requirements, including definitions, contained within both international and local accounting standards where applicable to the valuation purpose.

This *GP* should be read in conjunction with any other relevant *GP*s, professional standards papers, and any other relevant professional guidelines published or adopted by the Institutes.

1.2 International Valuation Standards

International Valuation Standards (IVS) published by the International Valuation Standards Council (IVSC) are adopted by the Institute.

It is the Valuers responsibility to comply with the IVS applicable at the date of valuation, keep informed of any changes and, apply them appropriately and consistently when providing valuations.

This *GP* is also intended to be consistent with the concepts and definitions contained in the IVS, however, there may be departures from the IVS to reflect Australian law and practice. This *GP* refers to and uses IVSC definitions to promote consistency.

2.0 Definitions

The definitions contained below and used in this GP are applicable to this GP and have been included to assist with the interpretation and understanding of certain stated terms used within this GP. Where a defined term is included in this GP it is shown in italics.

Institute	All references to *Institute* mean, as the context requires, the *API*.
Member(s)	A *Member(s)* of the *API*.
Residential Tenancy Agreement (*RTA*)	As defined under the Residential Tenancy Act in each respective State or Territory.
Build to Rent (*BTR*) property	A Build to Rent property is a multi-tenanted residential development held under either *Single Entity Ownership Structure* or a *Unified Ownership Structure*, managed by a single entity. A Build to Rent property is built, owned, and managed in accordance with, where it exists, any applicable Build to Rent Scheme legislation/regulation (or similar) in the jurisdiction that the property is in.
Unified Ownership Structure	An arrangement where two or more entities each hold a portion of the whole property without the allocation of interests or rights over specified portions of a property.
Single Entity Ownership Structure	An arrangement where a single entity is the registered proprietor of the whole property.
OpCo	The operating company (*OpCo*) in an *OpCo*/*PropCo* organisational model, where the *OpCo* manages the day-to-operations of the real estate assets owned by the subsidiary/property company (*PropCo*). The *OpCo* leases the assets back from the *PropCo* to carry out its business operations.
PropCo	The subsidiary/property company (*PropCo*) in an *Opco*/*PropCo* organisational structure, which owns all the operating company's real estate assets and associated debts. The *PropCo* buys the assets from the *OpCo* and leases them back to the *OpCo*.

3.0 Build to Rent

3.1 Build to Rent in Australia

There are a number of reasons why the build to rent real estate model, that flourishes in Britain, Europe, and the USA, historically failed to gain traction in Australia amongst institutional developers and investors. These include commensurately higher returns historically being available on other property types (e.g., office), an established institutional market mentality (across developers and financiers) of realising capital growth up-front through sell-down of residential properties, and limited experience in the operation and management of large-scale residential portfolios under lease, particularly in 'vertical' apartment-style properties.

However, over recent years, the closing of the capitalisation rate spread between the commercial and residential sectors has improved the "relative value" equation for institutional real estate investors contemplating an allocation to large-scale residential leased property.

Australia is now seeing the emergence of a new residential asset class whereby institutional investors are developing, operating, and owning large-scale build to rent projects in Australia.

3.2 What is Build to Rent property?

A *BTR property* is a sub-class of the residential investment market which consists of multi tenanted residential accommodation which is built, owned, and managed in accordance with, where it exists, any applicable Build to Rent Scheme legislation/regulation (or similar) in the jurisdiction that the property is in.

A *BTR property* is typically a purpose built and designed residential accommodation which is predominantly in medium to high rise apartment developments which are often institutionally owned, managed, and operated as a long-term investment asset for the revenue generated through the lease of the units.

Investment in *BTR property* is typically by property companies and/or institutional investors such as sovereign wealth funds, overseas insurance companies, pension funds, and/or superannuation funds.

A *BTR property* development will typically, but may not always comprise at least 150 self-contained units and is likely to possess the following broad characteristics;

- the development(s) is specifically designed or adapted to provide residential rental accommodation, and will typically include some form of shared amenity
- the development may also include non-residential uses
- the individual units are typically let separately under a Residential Tenancy Agreement
- management and oversight of the whole development will be under a single entity, typically with an onsite presence
- they may be held under either *Single Entity Ownership Structure* or a *Unified Ownership Structure*
- typically owned and operated under an *OpCo* and *PropCo* arrangement or within a fund structure-with third party property management

3.3 Investment Considerations

Investors are likely to apply detailed analysis of *BTR property* investments which may include, but are not limited to, in no particular order:

- Assessing the Net Operating Income (NOI) of the asset
- Review and benchmark operating expenses including statutory expenses
- Review of capital expenses and an understanding of lifecycle costings for key plant and equipment
- Review of income earning capacity of the development, benchmarking including occupancy and vacancy rates
- The level of rental rates, potential occupant demographic, rental growth by product type and rental affordability
- Management structure and capability

4.0 Instructions

4.1 In Writing

The *Valuer* must obtain instructions in writing that cover items listed in IVS 101 – Scope of Works paragraph 20.3.

The instructions should be agreed prior to the *Valuer* beginning work, and clearly outline the professional services agreement between the *Valuer* and the client.

Where the *Valuer* requires clarity or there is any confusion in relation to the instructions this should be referred to the instructing party/client. Any variations to instructions must also be in writing.

4.2 Role of the Valuer

The *Valuer's* role is to provide their opinion of the value on the *BTR property*, in accordance with the instructions agreed between the *Valuer* and the client.

The *Valuer's* report, or other advice, should reflect a demonstrated understanding of the subject property, the rental market for the property, income, and outgoings for the development, the *BTR property* marketplace including the motivations of market participants, and competition from other residential developments.

4.3 Accepting Instructions

Prior to accepting an instruction, a *Valuer* must possess the necessary expertise, knowledge, and experience to undertake the valuation. The *Valuer* should also have access to sufficient information to undertake and prepare a credible valuation.

If the *Valuer* does not have complete or appropriate access to market evidence, rental details in the subject development (income and outgoings) then the instruction should be declined or undertaken in conjunction with a *Valuer* who has access to such information.

The same is true for a *Valuer* who does not have experience, knowledge, and expertise in the valuation of *BTR property*.

5.0 Valuation Approaches and Application of Methodologies

5.1 Valuation Approaches

As per IVS, valuation approaches utilised in determining value are based on market observations.

The principal valuation approaches as defined in IVS are

(i) market approach,
(ii) income approach, and
(iii) cost approach.

Within these approaches, there are also various methodologies.

Valuers should refer to IVS 105 Valuation Approaches and Methods for further information.

It is incumbent on the Valuer to identify what the key market drivers (value determinants) are for the subject property class. Valuers should consider the detail and accuracy of information available and ensure that whichever approach is selected, it is supported through analysis of the most appropriate evidence.

The selection of the valuation approach should consider the basis under which the evidence relied on has transacted.

The analysis process will also provide the Valuer with an opportunity to identify the most appropriate methodology to utilise for the valuation, such as the capitalisation of actual or imputed income

The primary valuation approach chosen by the Valuer should also consider the purpose for which the valuation is undertaken.

Typically, investors in BTR property are interested in the income earning capacity of the asset.

The IVS indicates that the 'income approach' should be applied where "… the income-producing ability of the asset is the critical element affecting value from a participant perspective, …".

The income approach provides an indication of value by converting future cash flows to a single current value for the asset.

5.2 Valuation Methodology

The primary driver for a purchaser of a *BTR property* is the value of current or future secure long-term income. The valuation approach and methodology(s) selected by the *Valuer* should be consistent with the motivation and practice of market participants (the purchasers or potential purchasers of *BTR property*).

Both the capitalisation of actual or imputed income method and the discounted cashflow method are considered appropriate for the valuation of income generating assets, that is, investment properties.

Where market evidence is available and appropriate, the sales comparison method may be utilised as a secondary, or check, method to validate the conclusions from the primary method are reasonable and supported.

It is the *Valuers* responsibility to choose the appropriate method(s) for the valuation.

5.3 Assessment of Gross Income

The *Valuers* should assess the income that the *BTR property* development can achieve in the local market as at the date of valuation. This income may include actual rents under existing *RTAs*, or imputed rents for vacant units, as well as other sources of income such as parking spaces, storage, services, and utilities (e.g., cleaning, broadband), furniture hire, etc.

In assessing the market rent for the individual units within the development, the *Valuer* should have regard to actual/passing or asking rents in the subject development and those in competing developments. The *Valuer* should make adjustments between the available rental evidence to the subject asset, considering factors such as location, unit size/aspect, age, quality, design, amenity, and tenure offering.

Valuers should arrive at their own opinion as to the market rent for the whole of the *BTR property* development. The market rent should represent the total potential gross annual rental income.

The valuation should take into account any units within the development that may be subject to affordable housing requirements. This could be in the form of discount to the market rent, affordable housing or social housing rents and may be imposed as part of planning obligations or other statutory restrictions on the development.

Other sources of income (actual or potential) should be considered in the assessment of income for the development. It is important that all income be fully analysed and compared to market evidence, with appropriate adjustments included in the valuation to reflect differences between actual/passing income and market prices.

5.4 Assessment of Expenses

A detailed analysis of the expenses for the *BTR property* development should be undertaken. In addition, a benchmarking exercise comparing the subject *BTR property* development with comparable developments should be undertaken.

Property related expenses to be considered in the analysis could include;

- Rates and taxes
- Insurance
- Vacancy allowances
- Allowances for bad debts/rental shortfall(s)
- Repairs and maintenance
- Property administration fees
- Property management costs

6.0 Valuation Considerations

When valuing a *BTR property* development it is important for the *Valuer* to consider benchmarking key components from a management, operations, and trading performance perspective, in the context of the wider Build to Rent asset class as well as from a local market context.

Items that the *Valuer* should consider and, where appropriate, provide comment on could include:

- Product type, size, configurations, amenities, and parking provisions
- Residents profile including demographics and targeted cohort
- Capacity of local market to absorb and maintain the additional rental stock
- Vacancy levels
- Let up periods
- Incentives
- Income and any potential income growth or threats to future income earning capacity
- Level of management and ability to deliver the service and experience offered
- Operating expenses/property outgoings for the development and other applicable costs
- Maintenance and write down costs
- Rental assessment benchmarking
- The relationship between the sale market and the value of *BTR properties*

6.1 Market Evidence

Market evidence includes not only sales but also rental transactions. Asking prices may also be considered, although benchmarking against actual transactions is critical before reliance is placed on asking prices.

The identification, selection, reliance, and analysis of market evidence in a specific market should consider and discuss differences (real and/or perceived) that are evident in transactions of individually titled units, to those that are part of a *BTR property* development.

Valuers should always investigate and reflect market conditions and sentiment, as at the valuation date, in forming their opinion of value.

Where there is a shortage of transactional evidence, as at the date of valuation, it is imperative that *Valuers* compile as much evidence as is reasonably necessary to ensure that the valuation is properly supported.

Where there is no direct transactional evidence for comparison purposes Valuers should consider benchmarking of other asset classes to assist with the formation of an opinion of value.

6.2 GST Considerations

GST is a complex and detailed piece of legislation.

Valuers are not tax, accounting or legal experts and should recommend that the client conduct their own investigations relating to the treatment of GST in the event of a transfer of the *BTR property* development.

Notwithstanding the above, the report should clearly state the assumed treatment of GST and the GST status of the valuation assessment contained therein.

When the *Valuer* is provided with specific instructions or taxation/accounting advice relating to the treatment of GST, this should be followed by the *Valuer* and included in the report with appropriate referencing and qualifications of the source of information relied upon.

7.0 Valuation Reporting

Valuation reports of *BTR property* developments should have regard to the requirements contained with *IVS 103 Reporting*.

Reports should satisfy any requirements contained within the instructions agreed between the *Valuer* and the instructing party, as well as contain the following minimum information:

- Reference to the instructions received
- Details of the asset that is the subject of the valuation
- Purpose
- Client and any other parties who can use or rely on the valuation
- An appropriately worded third party disclaimer
- Valuation date, inspection date and date of issue of the report
- The valuation approach selected, and method or methods applied
- Supporting evidence for comparison purposes (e.g.: sales evidence)
- Details of any assumptions made
- The conclusion(s) of value and explanation for any conclusion(s) reached
- Details of any limitations, conditions, or qualifications on the valuation

In addition, the *Valuer* may receive specific instruction to provide a total gross realisation calculation, being the sum of the individual values of the units in the development. Note the total gross realisation is not a reflection of the value of the whole development and must not be reported as such. Where there is a difference between the sum of the individual values and the value for the whole development the *Valuer* should provide comments to explain the difference.

8.0 Effective Date

This *GP* is applicable from 1 January 2023. Earlier adoption is permitted and encouraged.