STATUTORY VALUATION PROCEDURES AND PRACTICES under the LAND VALUATION ACT 2010

FEEDBACK TO VALUER GENERAL - AGREEMENTS FOR LEASE

Issues for Consideration

- ***While agreements for lease are considered an 'encumbrance' in the Land Valuation Act 2010, they are not a registerable instrument for the purposes of the Land Title Act 1994. Do members think this affects certainty of the agreement and therefore the added value?***

  As discussed in our response to the question in dot point three there is a varying degree of certainty in agreements for lease. It is our understanding that in some instances there is a caveatable interest that could be registered. There are certainly contractual obligations contained in well drafted Agreements for Lease. Those obligations give the certainty contained in the agreement. Prudent purchasers will always consider the degree of certainty. In any event the *Land Title Act 1994* plays no part in the mind of the purchaser or the financial institution lending on the sale. It is irrelevant as to the added value of an agreement for lease.

  If a sale transaction occurs with an agreement for lease as part of the contractual arrangement, it provides certainty in relation to the development to be undertaken on the land.

  There are various forms of risk in relation to the development of land. One significant risk is securing tenants to occupy the proposed development. An agreement for lease to a major occupant adds substantial certainty to the proposed development and mitigates considerable leasing risk.

  An agreement for lease is a separate legal instrument which assists the future development of the land, much like a development approval facilitates and provides a level of certainty for future development.

  In the mind of the purchaser there is certainty that the amount they have paid for the site is contingent on agreements for lease. The valuer should be analysing the sale and what was considered as relevant or, assumed as relevant as a matter of common sense, in the mind of the purchaser as per *BWP Management Limited v Valuer-General* [2019] QLAC 4 at [68]. In *Eumundi Group Hotels Pty Ltd v Valuer-General* [2021] QLAC 2 at [148] the Court accepted the purchaser's assessment of the added value of the agreement of leases and the development approval.

- ***Agreements for lease obtained and provided within a sale by a 'vendor' may just be an indication of a sites 'ripeness for development', potentially be perceived as having some value or may not even be utilised or wanted by a purchaser. This may be fully separate to agreements obtained by a 'purchaser' before or after settling the sale, which might be considered as 'standard market buying practice' and a standard component of market value. How do you consider and account for these different and highly varying scenarios in a simplified and transparent mass valuation system?***

  Every instance must be considered based on the specific circumstances of the information available. Even in the mass appraisal system, there is still an obligation to properly analyse evidence on which the mass appraisal is based. Specific consideration must be given to any actual agreement for lease. There is no generic application that is appropriate in all cases.

  It is not appropriate to speculate on the various scenarios that may apply to an agreement for lease. The market will determine the value of a pre-commitment of a major occupant and pay accordingly as this is reflected in process negotiated by market participants.

  Discussions with purchasers, vendors and agents are integral to the proper analysis of sales to properly inform the mass appraisal valuation modelling.

- ***There are a range of items that are stated as 'agreements for lease', From simple 'letters of interest' prior even to building design or development approval, through to fully signed leasing agreements in place after a development is fully completed. These different items would likely provide vastly differing levels of security and hence potential benefit to any prospective purchaser. How would you consider and account for these different and highly varying scenarios in a simplified and transparent mass valuation system?***

  This question appears to overlook the obligation to properly investigate and analyse sales evidence on which reliance is to be placed when applying the derived metrics to other properties or even the application to the sale property as part of the mass appraisal process. To not do so is to risk applying what may be significant added value of an agreement for lease for one property to other land that does not have that benefit.

  It is incumbent on valuers to carefully analyse each circumstance to determine what, if any, impact an agreement for lease, or some other undertaking, have on influencing the sale price. A mass appraisal process is not an excuse for a valuer to overlook or not undertake careful analysis, as this would cause a widespread problem if applied on a mass basis to other assessments.

- ***Agreements for lease will not always add value to the sale of a property. In what circumstances do members consider agreements for lease will add value?***

  Whilst it is possible that an agreement for lease does not add value this is considered to be a rare occurrence. The only circumstance where we suggest this could apply is when the purchaser categorically states that the agreement for lease does not add value and intends to break or re-negotiate the agreement. If that is the case then the further question then needs to be asked : why did the purchaser proceed to purchase the property?

  The answer to the question would be best derived by careful analysis of market evidence. If a site sold with an agreement for lease reflects no variation from a site which sold without a similar agreement of lease, this would be market evidence of the added value, if any, of the agreement for lease.

- ***Other than assessing a similar property without an agreement for lease, how would members look to assess the added value?***

  See detailed commentary below.

We welcome the Valuer General using some or all of the following discussion.

Context

Essentially the site value of land is its *expected realisation* under a bona fide sale assuming all non-site improvements on the land had not been made.

Section 17(1) LVA outlines what is the *expected realisation*.

The *expected realisation* of land under a bona fide sale is the capital sum that its unencumbered estate in fee simple might be expected to realise if that estate were negotiated for sale as a bona fide sale.

Unencumbered is explained in Section 17(2) LVA. It means "unencumbered by any lease, agreement for lease, mortgage or other charge."

Agreements for lease may occur for both developed property and where the added value is in conjunction with a development approval for land that is otherwise not improved other than potentially non site improvements.

The assessment of the added value of development approval and the added value of agreements for lease is inherently the added value of such agreements in the mind of the purchaser. What premium was that purchaser willing to pay for the benefit of a development approval and/or an agreement for lease. A difficulty that must be recognised and considered is that most purchasers only consider the value of the property with those agreements/benefits in place not the added value of such agreements.

The added value of a development approval includes the hard costs, time savings and the reduction of risk in obtaining that approval. This is particularly so where the approval was impact assessable. The assessment of the added value as a result of a development approval is relatively straight forward in comparison to the assessment the added value of an agreement for lease as the only subjective item that must be treated objectively is the reduction of risk due to the agreement for lease.

Method of Analysis

The added value of an agreement for lease includes the same components, albeit subject to the degree of certainty, of an agreement for lease, plus also a potential of the added value for the actual agreement for lease and the covenant of the Lessee.

Rather than the traditional method of envisaging the land as vacant, the best method to assess the added value of an agreement for lease is to envisage the improvements on the land "as if complete" but assume the improvements do not have the benefit of the tenant.

It is not unusual for a valuer to be faced with two different scenarios:

i. An improved property that is subject to a specific lease, the terms and conditions of which and the tenant are fully identified.
ii. That same improved property that is subject to vacant possession.

The question is; what is the difference in value between these two scenarios? That is, what is the added value of the agreement to lease as if it was, in fact, an actual lease. When considering this, there are a number of factors to be taken into account:

1. How long be allowed for a letting up period for the tenancy.
2. What is the estimated marketing/advertising cost to achieve the tenant.
3. What are the terms and conditions of the lease and how does that impact value.

4. What is the identity of the tenant and how does that impact value.

Items 1 and 2 are relatively straight forward.

The terms and conditions of the lease are critical. Market Rent is defined in the International Valuation Standards as:

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

Appropriate lease provisions assumed for vacant premises are the usual terms and conditions of leases of similar premises having regard to the most likely use to which the subject premises will be put.

Assumed lease terms to be considered include, for example, but are not exhaustive, where appropriate, the following elements:

a) permitted use;
b) the premises, including full identification of all physical components;
c) date of commencement;
d) expiry date;
e) option(s) for renewal;
f) adopted rent;
g) period to which the rent applies, which may be different from the term of the lease, which may be:
    i. a period equivalent to the term of the lease; or
    ii. a period equivalent to the unexpired term of the lease; or
    iii. a period equivalent to the interval between rent review; or
    iv. another period;
h) method and frequency of rent reviews
i) lessor's and lessee's liability for outgoings;
j) assignment clause and subleasing rights;
k) treatment of incentives; and
l) make-good provisions.

Other considerations include; how do the terms and conditions of the agreement for lease compare to usual terms and conditions of leases for similar premises, and what is the impact on value? In the case of an investment property the capitalisation rate varies according to the terms and conditions of the lease. The same applies to determining a capitalisation rate for an agreement for lease, at least to the extent it has the same level of certainty.

The final element to consider is the covenant provided by the tenant. Capitalisation rates vary between tenants. All other things being equal, the capitalisation rate for a large public corporation tenant may be firmer than the capitalisation rate for an individual.

This can also lead into any value attributable to goodwill as was considered in *Kent St Pty Ltd & Ors v Department of Natural Resources and Mines [2008] QLAC 221* and *Lilac Pty Ltd v Department of Natural Resources and Water [2008] QLC 220.* We note that these cases were specifically included in the last amendment to the *Valuation of Land Act 1944* and then removed from the *Land Valuation Act 2010. Kent St* was a catalyst for the legislation that exists today and provides guidance for all valuers on how to assess the value for leases or agreements for lease. The API recommends that reference to the guidance provided in the *Kent St* case should be included in the *Procedures and Practices* manual to assist all in the understanding of these concepts.

The API considers that the subject of agreements for lease deserves to immediately follow paragraph 8.3.3 of the May 2020 version of the document *Statutory Procedures and Practices under the Land Valuation Act 2010*. As discussed above, there are similarities between the added value of a tenancy and the added value of an agreement for lease.

The reference to agreements for lease in paragraph 3.2 on page 12 of the *Procedures and Policy* manual should be reviewed and updated to ensure consistency and the intention of the LVA is clear to all.

The following cases will assist in understanding the overarching principles:

Kent St Pty Ltd & Ors v Department of Natural Resources and Mines [2008] QLAC 221

Lilac Pty Ltd v Department of Natural resources and Water [2008] QLC 220