

## COMPARISON METHOD OF VALUING A RETAIL SHOP LEASE AKA FROM A TO B VIA Z

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### ABSTRACT

*This paper is a follow-up of my earlier paper about the Profits Method, relating to perceived benefits and limitations using that method to determine market rent.*

*Mr. Malcolm Macrae<sup>i</sup> used the Profits Method extensively in his determinations in Queensland, Australia. This method is used in our work, but to a lesser extent, and mainly as a back-up method. Our courts have tended to give the Comparison Method more weight.*

*Both methods are covered in articles on my LinkedIn site.*

*Using the Comparison Method to determine current market rent, the valuer, depending on his knowledge of contract, contract and tenancy law, business and shopping centre metrics (it could also be for a High Street shop), is seeking appropriate “evidence” to link rents for grocery stores, or supermarkets or pharmacies, etc. from Shops B, C, D and E to say Shop A to justify his determination.*

*There is a high degree of subjectivity in what evidence to use, how to choose it, is it available and how to apply it. By following the steps in this paper, my aim is to reduce the subjectivity of rental determinations, to improve their reliability, so that one can form **a deliberate and informed view about what the current market rent is using the Comparison Method** for a retail shop, subject to the limitations of that method.*

*This paper must be read in conjunction with “The Profits Method Exposed: The Benefits and Limitations”.*

Keywords: retail, rent, market rent, profits method, comparison method, valuing rent

### INTRODUCTION

After accepting a nomination by a court or tribunal (or joint appointment), a Specialist Retail Valuer (‘SRVs’) “*Must determine the rent ... on the basis of the rent that would be reasonably expected to be paid for the retail shop if it were unoccupied and offered for leasing for the use for which the shop may be used under the lease or a substantially similar use.....*”<sup>iii</sup>. This is a prescriptive guide for the determining valuer under State Tenancy Laws.

In this paper, the “target lease” or the “target store”, it is the store whose rent is to be determined. A follow up paper will be required, about why this important way of “re-evaluating” or “re-calibrating” the rent with store performance metrics, often does not result in satisfactory outcomes.

In this paper reference to a valuer, also means an appraiser, the N. American equivalent.

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As the title of this paper suggests, many Specialist Retail Valuers are not complying with the laws and using the Comparison Method can be very subjective.

From my evaluation of many determinations, SRVs are:

1. Incorrectly or improperly collecting analysing and processing lease rental data and using it is “evidence”; and
2. Deliberately “engineering” determinations, or worse, they are oblivious about why their determinations are the product of flawed use of evidence or application of same.

SRVs are also not:

1. Collecting sufficient evidence or it is not available;
2. Evaluating and or understanding the evidence collected and or how to apply it to the “target” store or lease being valued;
3. Using what is called “evidence” (often “untested”) and applying it, mostly, without adjusting the rent for the target site, and stating the reasons why;
4. Making determinations to “current market rent”, which the Law requires to be the “reasonable rent”.

Most valuers including Specialist Retail Valuers, using the Comparison Method carry out a basic evaluation of the data metrics. Price of house, flat, unit, office, warehouse divided by floor area = \$2,000 dollars a square metre or square foot.

Likewise they have adopted this basic form of comparison for valuing leases aka annual gross rent divided by floor area = \$2,000 per square metre per annum.

For many reasons this basic form of analysis does not satisfy the requirements under our State Tenancy Laws.

Say for example the “Target Stores” current market rent is \$100,000. The shop is a small supermarket trading at \$10,000 a square metre, or at \$3.3 million per annum. The equivalent occupancy cost is around an industry standard 3.0% of turnover (for a suburban store). in the country areas freight charges in Australia becomes a significant cost impost; it has a direct bearing on market rents.

What if the SRV using non-arms-length adopted \$400.00 a square metre aka 33.3% above current market rent, but the following metrics were different:

1. The size of the shop is 250.0 square metres, it is still achieving \$3.3 million in sales; no problem  $\$400.00 \times 250.0 = \$100,000$ . The one error cancelled the other out, the determining valuer has *accidentally determined current market rent* at the “reasonable rent”. SRVs can and do; some get it right or very wrong, and are oblivious why. Because why? They have never had the competence levels or have not taken their technical competence levels up to the right level to do the job;
2. The shop is 300.0 square metres. The SRV’s determined rent is \$120,000, the error is magnified by the incorrect evaluation and application of the \$400.00 per square

metre rate. Equally the opposite can apply, he adopts \$250.00 a square metre and applied it to the 300.0 square metre shop. He has undervalued the lease;

3. The shop in fact is 500.0 square metres, the catchment metrics competition profile only lets it trade at a maximum of \$3.3 million, sales are \$6,600 a square metre, he applies \$400.00 per square metre to 500.0 square metres. Both errors act as a multiplier and magnify the determining valuers errors and omissions. The determined rent is \$200,000 or 6.0% of turnover, they cannot compete against Aldi, Coles and Woolworths. They lose market share, the centre becomes less competitive and they close down. Other shops in the centre also close down as foot traffic falls;
4. Equally the opposite can apply, rent evaluated too low, small highly efficient shop and so on.

To correctly evaluate the evidence, its relevance, whether it is capable of being used and how, if the SRV had all the relevant performance metrics, he could test it, use it and state how he has used it giving his reasons why in order to comply with the law. Eg. \$100,000 per annum.

And that is the crux of this conundrum. From our research no-one has spelt it out.

### **WHAT THE SPECIALIST RETAIL VALUER MUST DO**

Section 29 of the Queensland Act sets out, “*Matters to be considered by specialist retail valuers.*”<sup>iii</sup> The reader should acquaint him or herself with these prescriptive requirements, before reading the rest of this paper in the end notes.

Section 33 covers the Effect of determination. It states:

*“The current market rent of the leased shop determined by the specialist retail valuer is the current market rent of the shop and the rent payable under the lease for the rental period under the review.”* My emphasis added.

As stated previously:

1. These are, essentially, prescriptive signposts for the valuer to follow;
2. He must not have regard for goodwill<sup>iv</sup> or the “*Tenant’s fixtures and fittings*” he does not ignore them, he must quantify their value, so that the rent does not adversely impact on the business’s goodwill or the fixtures and fittings;
3. Section 29 (c) (i) was previously in the Act, removed from the Act and re-inserted. Why? Because valuers failed to realise and needed to be reminded that they are not just valuing or evaluating the rent at a period of time; they are valuing it for the forthcoming term of the lease<sup>v</sup>;
4. The darkened portion of Section 33, above, reinforces this.

Essentially the valuer appraiser is forensically testing the key trigger points between willing, informed, hypothetical landlords and tenants in regard to the rent they would agree upon, under the terms of the lease for the shop that is vacant. In effect is an intense evaluation of the points of ‘offer and acceptance’ aka the “meeting of the minds”.

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This is a very challenging task, and many valuers do not grasp what is expected of them. Nor do the administrators and regulators.

Market Rent, as defined by the International Valuation Standards Committee (IVSC), is also set out in my first paper - Derived from Spencer v Commonwealth 5 C.L.R. 418 (Gilbert, D. 1995).

The problem with the definition is that it ignores the *highly specific permitted use* of a Retail Business Model being evaluated. State Tenancy Laws close any gaps.

To reiterate from my first paper, Prof. Millington, in his 1996 article, stated that comparisons “*may be helpful*” but only:

*“if comparable transactions are sufficient in number and sufficiently comparable to be acceptable evidence and to give a reliable indication of either general levels of value or trends in value”.*

In my paper covering the Profits Method, it is submitted that the Comparison Method suggests subjectivity. But how subjective? What is the degree of subjectivity?

The following was suggested:

1. Comparing houses with houses, industrial property, Grade-A offices with Grade-A offices, strata title (units, community title) and apartments, etc., in relative terms, is generic. It is fairly easy to obtain evidence and to see the links;
2. That there are variances and differences, and adjustments to be made;
3. Retail lease comparability is vastly different and far more challenging.

Extrapolating the problem further, here are a more few reasons:

1. Hardly ever are two retail leases or retail leasing situations the same; therefore their degree of comparability is less likely and this increases the subjectivity of how one uses each piece of “evidence”;
2. It is a highly segmented market, with around 200 or more retail business uses. So each business model changes, so most of the “evidence” cannot be used and or it cannot be directly linked to the Target Shop;
3. The behaviour of major landlords in Australia hardly produces leasing outcomes of an arms-length nature, therefore over time the data has become corrupted;
4. Who bids for High Street precincts, for example; how does the bidding change over time?
5. There might be a dearth of evidence, or it is not a product of arms-length negotiations;
6. There can be enormous differences between sites. Some stores are highly efficient, whilst others languish with surplus space. There might be basements, licensed areas, or mezzanine floors that distort the most well intended analysis and use of the evidence.

It follows: what is the impact on risk and the multipliers of that, namely market value? This is spelt out in an example of an individual lease, and then extrapolated out for a shopping centre

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that were hopelessly overvalued, if the value metrics had not been assessed, quantified and applied (Gilbert, D. 2014).

Prof. Millington says that comparable rents may be helpful, i.e. the data metrics, but they have to be sufficient in number.

Data metrics as stated are a product of gross rent for highly specific business use, analysed back to a dollar per square metre rate. A valuer/appraiser<sup>vi</sup> has at his disposal a wide range of “numbers”, e.g. \$500.00 to \$1,000 per square metre. He picks a number, real or imagined (which is sometimes “engineered” to suit the case), or is persuaded by some argument for or against the landlord’s or tenant’s case.

The number is multiplied by the floor area, efficient or inefficient, and it becomes the purported market rent.

But that valuer/appraiser must still satisfy the criteria called upon under our respective legislations, conventions, and definitions, eg. Sections 29 and 33 of the Act in Queensland – see below. If valuers continuously get this wrong, they create an enormous amount of dissatisfaction for those stakeholders who rely upon their expertise (sic).

This is not only a product of expert determination; it is also a product of non-arms-length negotiations, which valuers fail to evaluate properly.

As stated: the Profits Method can directly and accurately link store performance metrics to the site and the rent, if correctly analysed and applied. The Comparison method can be highly subjective, yet our Courts and Tribunals prefer this method.

Even worse, the retail Shopping Centre Industry, and particularly the A-REITs (‘Australian-Real Estate Investment Trusts’), is highly engineered, along with its tenants and its core investments. And many Directors believe if they quarantine themselves, via what are apparently Trusts “removed” from Management Companies, that they are not responsible!

The product of “engineered” rent is “engineered value”<sup>vii</sup> and that is a major problem for retail groups, large and small, local and international in Australia.

As an example of how the Profits Method links the shop’s performance to the site without trying to link B to E, to A without going via Z, let’s discuss the limited evidence for The Pub With No Beer in the Australian outback (this is an Australian song; but let us value a lease for an Australian outback pub which does not sell beer under a specific lease).

Say the Business Model (the permitted use) is standalone from other comparables eg. standard supermarkets, department stores, pharmacies, etc. with a unique business model attached to it, in a smaller regional town. If the business data metrics are thoroughly stress-tested and clearly presented, actual Annual Financial Statements must have the *closest data metrics* of a hypothetical letting than *any other comparable material*. It is as basic as that and no court or tribunal can argue in the alternative.

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The Profits Method links the “actual” with the “hypothetical” leasing if the actual data (business metrics) are substituted for the/a hypothetical leasing scenario.

There is a clear link between the business operated to reasonable standards and the lease being evaluated. One can then work one’s way through the requirements of the respective Retail Legislation, to pass the necessary tests, e.g. the permitted use is a direct link; a hypothetical leasing scenario can be tested; the gross rent can be quantified; one can quantify “super-profits,” i.e. genuine goodwill to exclude it from the rent, and the fixtures and fittings of the Tenant’s business. Yes they are real, they must be real, no lease would be valid or in place if there were *no actual fixtures and fittings*.

(There are some valuers/appraisers who believe that if they ignore the fixtures and fittings they will go away and the Tenant’s assets can then be quantified and valued into the lease! How foolish is this?)

Now, contrast the direct ability to link the performance metrics to the site; there is virtually a direct correlation. This was the Specialist Retail Valuer Malcolm Macrae’s preferred option; and he was never faulted in Queensland. He knew how to do it.

One is then left with the task of making adjustments for the lease, is it a 5.0 or 8.0 or 10.0 year lease; CPI increments, CPI + 2.0%, 3.0% or 5.0% increments, or a complete lack of tenure, etc.

My opinion is that as one is valuing a lease going forwards, more work has to be done for acceptance of this as a valid methodology.

My other opinion is that by using the Comparison Method, subject to all its imperfections, and the Profits Method (and several related methods), one can “lock-on” to a more definite opinion.

## **COMPARISON METHOD UNDRESSED**

Millington says comparisons:

*“may be helpful... if transactions are sufficient in number and sufficiently comparable ... to give a reliable indication of either general levels of value or trends in value”*,

yet the courts and tribunals in Australia are giving weight to this far more subjective methodology.

Why? In my opinion, there are no good reasons.

### **The requirement to have sufficient number of comparables and why?**

Clearly, anyone who has studied *and understands* Financial Mathematics and Statistics will understand the importance of what Prof. Millington “locked-on” to with regard to having a sufficient number of comparables. What one is seeking to do is to eliminate variances and variables by having a broader or wider *body of evidence*.

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This, however, poses many challenges. Every retail business model is different; there are even sub-models within one model, e.g. a sub-newsagency versus a full line newsagent, which the valuer/appraiser cannot do anything about. One *must compare like with like*, but this reduces the availability of evidence, e.g. some 200 permitted uses. Furthermore, the centre, catchment, geographic and/or demographic characteristics should be similar. But are they? Hardly ever, so one therefore cannot simply transfer “evidence” and notionally impute it, without making adjustments and stating one’s reasons why.

So, unlike a residential, office or industrial precinct, where comparables are usually concentrated and *relatively generic*, the retail precinct is sliced and diced by up to 1/200<sup>th</sup> via:

1. Permitted uses; and
2. Further, sometimes, via significant differences in each retail site, i.e. the comparable, and
3. The structure of the leases.

What about that single retail outlet, say, the branded supermarket in a regional town that can only support one store? Where does the “evidence” come from; is there a place for the Profits Method? One can use comparable evidence between towns and regional towns where the metrics are similar, as long as the permitted use is the same. Why? We are measuring and comparing the performance metrics of the *same retail dollar*, with the parties in different places! One can still take arms-length evidence from Townsville and link it to Mackay or Gladstone, but make adjustments and state one’s reasons why.

In larger metropolitan centres, one can segment the market demographically by considering evidence in precincts with similar characteristics, but one still needs a body of evidence to support one’s determination. One is trying to obtain a body of evidence about ‘like’ residences with like or similar residences, or ‘like’ strata-title or community title flats and apartments, or offices or industrial premises.

One is challenged with seeking out a *sufficient body of fairly recent evidence, of the same or similar permitted use (under the lease), which might or might not have similar demographic characteristics, pedestrian traffic, and, perhaps, a similar competition profile.*

In short, this is a big ask. The valuer/appraiser/Specialist Retail Valuer is challenged with a difficult task. He/she has to be focused and disciplined to gather the evidence, process and analyse same and decide whether or how one can use it. (See below, flawed use of data metrics and or assumptions by valuers/appraisers in actual determinations).

### **The nature and type of comparables**

Some of the points made below have been covered above.

Firstly, one is seeking a critical mass of like comparables, but what about the nature and type of the comparables? What about the comparables, the frontage, depth, exposure, traffic, size, etc. Are there other physical differences, e.g. basements, mezzanines, parking, or proximate area of anchor tenants?

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There might be minor or major differences in the permitted uses. The list is endless.

Yes, the permitted use is the same or similar, but radical elements in one or several of the above cause the actual comparable rent to be above or below that which contributes to the “range” of evidence; which becomes the body of evidence eg. non-arms-length transactions. You cannot transfer untested “sitting tenant” evidence from one site to the other. Evidence must be “tested”, it must be adjusted for the perceived differences of the site being evaluated.

In a recent matter our firm was jointly appointed via the parties’ lawyers. By segmenting the market of standalone beachside restaurant cafes (from upmarket precincts, food courts, small shopping centres, etc.), all with different challenging licensed areas, seating, seating configurations, exposure, parking, exposure to weather, it meant we had a far higher chance of comparing ‘like’ with ‘like’. This is obviously common sense, and obviously the data also fell into a narrower range.

The determination used a body of good quite recent “evidence” of other beachside restaurant cafes, backed up by a solid Profits Method evaluation, which cross-referenced and supported my key “evidence”. The Profits Method modelling was weighted slightly in favour of the landlord. And we stated our reasons why.

Behind the scenes, the landlord wanted us to do a nudge nudge, wink wink determination; outcome unchanged. That is not our role; but there is a court tribunal system that can overturn one’s determination if they do not agree with it.

The relevance of this example:

1. Each determination of market rent poses different challenges;
2. One sometimes has to think outside the square;
3. There are effective ways of “slicing and dicing” the market’s comparable evidence. eg. a marketing major helps, by compared like beachside cafes and restaurants with like narrows the market hence the range down;
4. We have ongoing interference, even from our own Regulators; how does one handle them?
5. One is often dealing with parties who are polarised, angry, uninformed or even want us to be partial;
6. We have Registration Boards and Divisional Councils who may be skewed with advocates;
7. The paying public often has millions of dollars tied up in the mix. They may have been sold property or bought into businesses or taken up leases which are above or below market rent, and have a right to have their rents properly determined via the best independent, impartial and objective valuers who can do the job with authority;
8. Not only is it difficult getting evidence; often, those making appointments or investigating “complaints” lack the expertise to do so.

The nature and type of comparables can be extremely important. In one matter two or three bits of highly relevant recent evidence were withheld from me, which was contrary to my terms of engagement with the landlord and tenant, and one should not miss an opportunity to obtain the data. The landlord, as well as the tenant, have the right to the knowledge of their

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expert whose services they engage, and the determining valuer has the responsibility to use that evidence if it was relevant. It is our knowledge, skill and judgement that is being relied upon; and not the tenant or landlord advocate. There is a line in the sand between persuading the Expert and or telling him or her what to do.

And in instances such as this, Courts and Tribunals *must support their Experts*.

### **The usability of the comparables, non-market transactions**

Once evidence is obtained, one might not be able to give it appropriate “weight” without store performance metrics of the comparable evidence of the store itself and of the centre (if relevant).

Some valuers should never be given store performance metrics: they do not know how to use them, and agency based valuers posing as experts can, and do, use them to the detriment of the one party!

Based on our work experience the following assumptions can be made in regard to 10 pieces of “evidence” (if available/obtainable):

1. Only one or two will be pivotal;
2. Three/four including one and two above are useful;
3. Sometimes, five to seven will be usable, including the data evidence from above; however, one gives it less/limited weight;
4. It will take 60 to 90 minutes to gather, obtain, discuss, collate, process, weight and analyse one bit of evidence.

We use the LIS Data Base (‘Lease Information Systems’) and discover leases that are registered in the State Registry. LIS can do searches as well.

Sometimes a pattern emerges as one gathers and processes the evidence. On other occasions, using the evidence alone to form one’s opinions is sufficient, using modelling we have developed over the years eg regression analysis of the “tested” evidence.

It often involves several processes and, again, a pattern emerges. It then needs to be written up and presented in a report.

If one speaks directly to the parties about lease transactions, it can be established how the evidence came into being. Was it an arms-length transaction? Was it under duress, or worse, misrepresentation? Were incentives involved?

One can then form an opinion as to what “weight” one can apply; but still he *must comply* with the law.

In my opinion, valuers using this methodology fail if they do not establish the veracity of the evidence and the use of it, irrespective of the *number of comparables and/or that they are sufficiently comparable*.

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The bureaucrats administering the processes and arm-chair valuers/appraisers do not understand the challenges facing the independent valuer/appraiser doing a proper job, or are happy to goose the metrics!

As mentioned, we draw from a *limited body of usable evidence* (as stated, we do not have a large body of relatively generic evidence, e.g. houses, flats, condominiums, offices, etc. from which to draw our evidence).

Retail leases are highly specific and the valuer/appraiser/Specialist Retail Valuer should not circumnavigate this process or invent “evidence” (although we have some who do). The valuer will produce a *range of evidence*, some of it relevant and some not. This method and the range of data *on its own*, does not enable the objective valuer/appraiser to “lock-on” to a value, i.e. the annual rent. Why not? Because it is a subjective methodology – see Robinson Bross.

One must then establish what evidence is both relevant usable, and how.

### **Lack of comparable evidence**

Surprisingly or perhaps not, it appears that Conservative Governments in Australia are in the hands of our minority developers and development lobby.

We have all the processes in place, from legislation to registration (storage and retrieval). With some fine-tuning, the governments could make it compulsory to register all leases in, say, three months from lease commencement, and could even force disclosure of incentives.

Any informed market with fair legislation *must be good for all stakeholders* and unfortunately (and surprisingly) State Governments seem to be swayed by minorities and not by where the majority of their votes come from!

### **Usefulness of store and centre performance metrics**

The value of actual store performance metrics, and those of as many comparable leases as possible, plus of course centre and precinct metrics, is that they assist one to measure the veracity of each bit of evidence. They provide the key to avoiding and preventing one bit of “evidence” effectively being a “number” so that, in effect, one is only comparing the evidence that one can give proper weighting to.

There are ways and means of using evidence which “*may be helpful ... if ... sufficient in number and .... comparable .... to give a reliable indication of either general levels of value or trends in value*”, however a full analysis of *all the data metrics*, including future minimum, maintainable sales; trend analysis; and projecting store Key Performance Indicators will enable a valuer appraiser, to link the evidence to the store and the lease metrics for the best outcomes.

### **THE PROFITS METHOD: NO GOODWILL AT LEASE END**

Professor Millington suggests that a major determinant of retail rental values is the perceived potential profitability of various retail activities. He states:

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*“...it is the present and future trading potential of a property which determines its present rental value, and in the same way it is the anticipation of future rental returns which determines the present capital value of a property.”*

These points were covered in “The Profits Method exposed: the benefits and limitations”.

It is patently obvious that the measuring of “goodwill” or super profit, aka “rentalising the business” (Macrae, M.) off the back of a retail business’s superior performance is not intended, either at common law or by the legislators. For example, what if an average operator were to purchase the business operated by someone who is above “average”?

Well this falls into “unjust enrichment” territory, and this is where a valuer/appraiser with above average forensic skills comes into play.

Leases with no tenure, generally have no “goodwill”. It is Australian Shopping Centre terminology. From a valuer/accountant’s point of view, “goodwill” or “super profit” of an above average operator, must not be quantified into the lease and rent.

## **CONCLUSION**

The Comparison Method is *not a product* of readily available and reliable data or evidence.

The evidence is not easy to come by, nor is it reliable, nor can one take it and use it at face value.

When used to value other types of properties, evidence for the Comparison Method is far more readily available, even from similar geographic locations. It is often far more generic, whereas in the retail arena and when valuing leases, i.e. the rent, there are enormous differences.

How one uses the “evidence” when there is often no direct correlation between retail sites, is challenging and will be problematic, even for very experienced retail valuers and appraisers.

Introducing other data metrics into the mix, even reasonable approximates of one’s comparables eg. the occupancy cost, can substantially minimise potential variances, alter one’s weighting of evidence or cause the valuer to eliminate or disregard other evidence.

In order to comply with the requirements of making a determination of the market rent for a retail shop under the Act(s), it’s essential to have a thorough understanding and holistic working knowledge of:

1. Business data metrics generally;
2. The ability to calculate, evaluate and measure the business’s goodwill or assets of the business, in order to quantify and exclude the value of tenant’s assets from the mix<sup>viii</sup>. If one does not quantify same; how can one measure their relevance in the mix for exclusion purposes? The alternative, as some valuers do, is to pretend that, say, \$4 million worth of fitout and \$4 million worth of stock can or ought to be valued into the rent. This is bizarre thinking;

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3. This is what Prof. Millington is saying about the reliability or lack of comparable retail rents and the usability thereof for use in the Comparison Method.

Ironically, to quantify and comply with the Act, *and* to comply with the “reasonableness” tests under S 29, a thorough working knowledge of the data metrics of a specific business in question is *highly desirable*, and comes from the Annual Financial Statements. In addition, one must extrapolate projected metrics of the business itself to do this reasonably successfully<sup>ix</sup>.

The valuer’s responsibility is summarised in the decision as follows:

*“The valuation of the Current Market Rent was made in a valuation report prepared by Mr Don Gilbert, dated 13 November 2013. Mr Gilbert discussed the history of the shopping centre, and summarised his task as:*

*In sum: what is the current market rent for a pharmacy shop in a 431 square metre equivalent store without outside access, located in a DFO-format centre which appears not to have been fully accepted by the Cairns market, post GFC, facing stiff competition in its immediate catchment (including discount pharmacies), all when quite enormous changes are taking place both within the centre and the pharmacy industry, and the current Tenant business has been on rent relief but has just recently completed a refit? This is a complex task.”*

The determining valuer was confident to determine current market rent at \$171,000, which was a reduction from \$374,000 per annum. Three months later a pharmacy’s lease rent was renewed at \$165,000, 600 metres down the road. It had far better site attributes and offered better tenure.

To do this task, to have been able to satisfy the performance criteria of the comparison data, the store performance metrics, the centre performance metrics and the projected store metrics, a thorough and holistic working knowledge of these elements is required of the Specialist Retail Valuer. To do the job properly, there are no short cuts.

The Profits Method links the business to the site’s metrics, attributes, flaws, etc.; there is a direct correlation. The business must be operated to reasonable “average” standards, i.e. the standards of an “average hypothetical operator”.

The Comparison Method can be like going from A to B via Z.

Without actual site performance data (even reasonable estimates to test the veracity of the evidence), this may result in the possibility of the determination being more subjective.

If our duty is to the courts and tribunals and, of course, to the parties in rental disputes, then we need to rise to the occasion as independent, impartial, objective Specialist Retail Valuers with authority.

In turn, we require the support and backing of our sometimes hostile court tribunal systems; but they are not the experts. We are.

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In Queensland our Regulatory Authority was stacked with Real Estate Agents. The wider public, commerce and economic sectors need to rely upon our State Government Agencies, but not one that is fatally flawed. This appears to have been stopped for now.

If RICS<sup>x</sup> and API<sup>xi</sup> are the bodies that represent both Professional and Industry Members as they do, and the role of the Professional is toward the wider public (for the public benefit), then their job is precisely to back their Professional Members in a different capacity.

A failure to evaluate, estimate, negotiate or determine market rent simply extrapolates into supposed market value. If the rents are *not market rent* they are a Ponzi. If it is Ponzi, it is not a market operating according to supply and demand. The chance of “winners” and “losers” in the mix gets bigger.

By avoiding these pitfalls, and following process in a disciplined way, using evidence for the Comparison Method properly, and if used in conjunction with the Profits Method one can determine current market rent with a high degree of accuracy. And that is our Duty.

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Reference to useful document prepared by Victorian Small Business Commissioner's office: <http://www.vsbv.vic.gov.au/wp-content/uploads/2014/09/vsbv-srv-guidelines-September-2014.pdf> which backs up some of the issues about rental determinations. It is, a useful document.

**Editor K Murphy**

**Dedicated to Mr Malcolm Macrae, FAPI, CPA**

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#### **Footnotes**

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<sup>i</sup> M. Macrae, Specialist Retail Valuer and Member of Queensland Retail Shop Leases Tribunal

<sup>ii</sup> Section 29, Retail Shop Leases Act, Queensland. Most States and Territories have similar legislation.

<sup>iii</sup> *In making an opinion of the current market rent, the specialist retail Valuer:*

(a) *Must determine the rent—*

(i) *On the basis of the rent that would be reasonably expected to be paid for the retail shop if it were unoccupied and offered for leasing for the use for which the shop may be used under the lease or a substantially similar use; and*

(ii) *On the basis of gross rent less the Landlord's outgoings, payable by the Tenant under the lease; and*

(iii) *On an effective rent basis; and*

(b) *Must not have regard to the value of the goodwill of the Tenant's business or the Tenant's fixtures and fittings in the retail shop; and*

(c) *Must have regard to—*

(i) *the terms and conditions of the lease; and*

(ii) *submissions from the Landlord and Tenant about the market rent of the shop; and*

(iii) *The other matters prescribed by regulation."*

<sup>iv</sup> Special mention is required about Goodwill, courtesy M. Macrae

1. Considered principles of the Retail Shop Leases Act where they prescribe what a Specialist Retail Valuer must do and where they overlap in regard to this lease:

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2. For example, to avoid confusing what belongs to the Landlord and Tenant and to avoid attaching or adding the value of the Tenant's accumulated goodwill to the rent, we assume it is a bare shell;
  3. The permitted use of the shop (or a substantially similar use) is compulsory because a 'generic' permitted use in the retail arena is problematic;
  4. With an "average hypothetical" operator, the lease being evaluated does not comprise the actual parties but is simply an "average" landlord and tenant;
  5. To avoid any confusion, Goodwill is:
    - a. Site Goodwill = rent which is what we are seeking to value;
    - b. Business Goodwill = an amount that any hypothetical business investor would or ought to expect to justify when considering taking on business risk. Many valuers do see this as an opportunity to convert business risk reward into rent;
    - c. Personal Goodwill = the owner's wage;
    - d. True Goodwill = Super Profit. Super Profit cannot be measured into the lease under the Act;

<sup>v</sup> In Robinson Brothers (Brewers) Ltd v Houghton and Cheser-Le-Street Assessment Committee [1937] 2 KB 445 at 468 – 471, Scott LJ stated "This kind of estimating is a skilled business and it is here, especially, that the role of the skilled valuer comes in". Wise words considering they were used in 1937.

<sup>vi</sup> Specialist Retail Valuer in some states in Australia

<sup>vii</sup> International Valuation White Paper ('IVSC' – see below) entitled 'The Valuation of Real Estate Serving As Collateral for Securitised, Instruments' issued in July 2006 at <http://ivp.com.ve/docs/Normas%20de%20Valuacion/IVS%2001%20International/060616securit.pdf> which reads in part: "*The Valuer should investigate .... about prospective contractual rent, .... that the data is indeed accurate. Estimates .... which are unrealisable, are engineered rents; valuations based on engineered rents will not result in Market Value*".

<sup>viii</sup> S 29 (b) Must not have regard to the value of the goodwill of the Tenant's business or the Tenant's fixtures and fittings in the retail shop

<sup>ix</sup> Devery's Pharmacy Services Pty Ltd t/a Westcourt Plaza Pharmacy v Direct Factory Outlets Cairns Pty Ltd [2015] QCAT 275

The "decision" in the end was not about the determination; it was about matters of law. I am reliably informed that the landlord and tenant subsequently cobbled together some form of agreement to continue the lease.

<sup>x</sup> Royal Institution of Chartered Surveyors

<sup>xi</sup> Australian Property Institute