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Market rent revisited

By Don E Gilbert

In 1995 Don Gilbert wrote an article in The Australian Property Institute's quarterly Journal entitled "Market rent: what is it?"[1]

In that article Don sought to define market rental value, the responsibility of the expert in asset valuations under the Corporations Act, and to differentiate and highlight the responsibilities of the professional from the wider industry.

This article seeks to update and review the status of the industry and the expert's role and responsibility, with knowledge and research gained since 1995 with regard to retail property.

> 'this article seeks to update and review the status of the industry'

Market rental value definition

Since 1995, the Australian Property Institute has sought to define Market Rental Value. Guidance Note "GN 34" (draft) entitled "Assessment of Market Rental Values – Retail" defines Market Rental Value as *"the estimated amount for which an asset should rent, as at the relevant date, between a willing Lessor and a willing Lessee in an arms' length transaction, wherein the parties has each acted knowledgeably, prudently and without compulsion, and having regard to the usual terms and condition for leases of similar assets"*, noting *"The market rental value of a particular asset or premises that is subject to a 'Lease' must reflect the terms and conditions of that Lease".* Derived from *Spencer v Commonwealth 5 C.L.R. 418*

In particular GN 34 considers the "permitted use" clause under a lease as a primary consideration. The concepts of vacant possession, face rents and the effective gross rental (being adjustments for incentives) are also to be taken into account.

Meaning of "market rent"[2]

"Market rent" describes the amount of rent that:

- *The market, notionally, is prepared to pay, Spencer v Commonwealth (1907) 5 CLR 418*
- *Is an objective calculation, and*
- *Requires the valuer to look at what a willing, but not anxious prospective tenant would be prepared to pay to a willing, but not anxious, landlord. Burns Philp Hardware Ltd v Howard Chia Pty Ltd (1987) 8 NSWLR 642.*

These elements will be affected by many factors, including the length of the lease, the use which the tenant may make of the premises, and the other obligations imposed on the tenant, including reimbursement of outgoings.

During a rent review, the new rent will be determined by the application of a protocol, the parameters of which are established by the intention of the parties. *Jenolin Pty Ltd v Joint Ownership Pty Ltd (1991) ANZ Conv R 359.* Common factors are:

- *comparable rents or premises, McCafferty v Queensland Treasury Corp (1991) Q Conv R II54-415) comparable rent review clauses; and*
- *the 'hypothetical test'.*

Consideration is usually restricted to the actual situation, though other factors which may influence the market, for example inflationary figures, may be relevant. *Woolworths Ltd v Merost Pty Ltd (1988) 14 NSWLR 300.*

Don Gilbert is a specialist retail valuer, an Associate of the API and a former South Australian Divisional Councillor. He specialises in retail valuations and arbitration and has provided advice to members of the Small Retailers Association of South Australia (now State Retailers Association), the Retailers Association of Queensland and Queensland Retailers and Shop Keepers Association.

For further information, please contact Don Gilbert on Tel 07 3342 1735 or email: qldleasecons1@optusnet.com.au

While the reviewed rentals of comparable premises constitute relevant evidence of "market rent", allowance should be made for non-market considerations that may have influenced the parties. *Edmund Barton Chambers (level 44) Co-op Ltd v MLC Assurance Co Ltd (1986) 6 NSWLR 322*

Hypothetical letting test

The *"hypothetical letting test"* is generally used only if expressly provided in the lease as a criterion on which the valuer ought base his/her valuation. The test is premised on the assumption of a willing landlord and a willing tenant, and is expressed as the sum which is high enough to be acceptable to a willing landlord and low enough to be acceptable to a willing tenant. Any circumstance which affects the actual landlord and the actual tenant, but which would not affect the hypothetical landlord and tenant is irrelevant. *FR Evans (Leeds) Ltd v English Electric Co Ltd (1977) 36 F&CR 185.*

Risks associated with a "market rent" review

There is a danger associated with the use of "market rent" review. It may unduly favour the landlord if insufficient attention is given to the drafting of the clause, or if the land-

lord is in a superior bargaining position during negotiations, which will often be the case in a rent review during a lease. There are three main issues:

- Many market review clauses are drafted such that the rent review process is initiated by the landlord. This allows the landlord to begin the review in a rising market, while retaining the status quo where rents are stable or, as may sometimes happen, falling.
- Where the landlord is in a superior bargaining position, the landlord may be able to insist that market rent reviews are only applicable where the market has risen, and include a ratchet clause. (It should be noted, however, that where the *Retail Leases Act 1994 (NSW)* applies there may not be a provision that enables the landlord to prevent, or limit, the rent from decreasing (section 18(4)).
- Where a rent review occurs during the term of a lease, the landlord will generally start from a superior bargaining position simply because the tenant cannot walk away from the negotiations. The use of independent valuers attempts to circumvent this inequality."

Legislation applicable

Most state tenancy legislation follows the same format applicable to market rental valuations. S 29 of the *Queensland Retail Shop Leases Act* reads as follows:

'Matters to be considered by the Specialist Retail Valuer' under part (a)

(i) on the rent that would reasonably be expected to be paid for the 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 lessor's outgoings payable by the lessee under the lease; and

(iii) on an effective rent basis; and

(b) must not have regard for the value of the goodwill of the lessee's business or the lessee's fixtures and fittings in the retail shop; and

(c) must have regard to -

(i) submissions from the lessor and lessee about the market rent of the shop; and

(ii) the other matters prescribed in regulation.

S 51 AC of the *Trade Practices Act* calls for market outcomes and this becomes an added responsibility, for Lessors and Lessees negotiating leases.

In addition there is ample case law covering various aspects of market rental valuations.

An interesting trend may be emerging, and that is where a valuation appears not to have been carried out in accordance with the Act, definitions and convention, that valuers are being challenged for non-compliance.

'an interesting trend may be emerging'

Independent research on shopping centre rents since 1994 and specific trends

An extract from an industry article prepared by myself in August 2002 with regard to the review of the Queensland Retail Shop Leases Act reads as follows "*it was reported earlier this year that Westfield's average specialty shop occupancy costs were 16.1%. The ARA's 2001 average occupancy cost survey supported this and found specialty shops are paying 16% on average or $1145/M2 in regional centres nationally, up from 12.9% and $880 / M2 in 1994. The JHD[3] average excl GST was 16.5% or $1177/M2. As at September 1998, Indooroopilly's average specialty shop occupancy cost was 16.3%, with a range between categories of 6.3 to an astonishing 32.4%! Paramatta's average was 17.2% and Doncaster 18.1%. As at December last year, specialty shop occupancy costs at Bankstown Square were 17% and Sunshine Plaza 16.2% or $1240 / M2. Over the period 94/95 to 00/01 regional shopping centre's average size increased from 47,492 - 59,676 M2, and specialty shop sales fell from $7224 - $7127 / M2. Cost of goods and expenses would have been influenced by inflation of around 18%. In real terms regional shopping centre sales adjusted for inflation have fallen to $5915/M2 over the same period.*"

This evidence shows a strong correlation from different sources, as to the accuracy of the data.

In effect the outcome of the above points towards:

- Bigger centres and more retail space;
- Duplication of businesses, resulting in smaller critical mass with negative affect on viability/profitability, which reduces economies of scale;
- Lower sales and higher operating costs since 1994;
- Rent levels above "market value" (higher than the floor price), often incorrectly signaling more development[4] when it may not be warranted;
- Misallocation and waste of Lessors and Lessees capital (see point below);
- Higher business failure rates, technical insolvency of many other businesses;
- Increasing stress levels between stakeholders, with rising propensity for disputes;
- Potential for inflated asset valuations;
- Questions of Derogation of Grant, Quiet Use and Enjoyment (spelt out in some state legislation), Duty of Care, Breach of Duty of Care (customary or professional and statutory standards[5]), Damages[6] and possible claims of Unconscionable Conduct[7]; and
- The possible need for intervention by authorities.

Considering that regional shopping centres are more often than not the flag-ships of many superannuation funds, this form of investment vehicle may be getting increasingly risky. The onus and responsibility falls back on the profession in all the circumstances, to bring this to the attention of all stakeholders.

Occupancy costs - what they should be and what they are

Over many years it has been possible to obtain from various sources and collate into categories, what occupancy costs should be

Table 1: Schedule of appropriate rent costs (rent:sales %) Collated December 2002

©	Suggested rental rate to business volume – (occupancy costs: sales[8])				Actuals rents being charged (occupancy costs)		
Category	Internat council of shop centres	Property Council of Aust (BOMA)[9]	Pracdev (Hartley Aust) 02/2003[10]	CCH B/marking prev FMRC	JHD regional surveys Mar 2002	A regional Centre, Brisbane 1998	A manag group 1999
Bakery/cake		4 – 6	9	8.99	14.7	21.9	
Beauty	6 – 10			13.61	15.8		23.8
Books	5 – 8	3 – 6	5	6.13	17.6	15	13.6
Butchers		2 – 4	4	5.79	9.3	14.8	
Car access	2 – 5	4 – 6	5	4.63			12.3
Coffee shop			8	12.75	17.7		16.7
Confectionery			4			22.6	
Convenience			3	6.36			
Dentist			6	5.59			
Dep stores	2 – 3	2 – 3					
Dry cleaning			6	14.63	28.1	23.8	22.4
Electrical	3 – 6	2 – 4	3	2.32	8.6	6.3	
Fabric/textile		6 – 7	5	7.7			
Fashion access			6		18	24	14.6
Footwear – retail	5 – 8	7 – 8	7	7.33	18.2	16.1	12
Footwear – repair	8 – 10				27.6	17.6	21.9
Florists	7 – 10	7 – 8	7	9.95		14	13.9
Furniture	4 – 6	5 – 7	4 / 5	6.03	21		
Fruit & veg		3 – 5	4	5.26	8.5	10.6	
Gifts			6	12.65	21.3	21.8	17.2
Hair	8 – 10	5 – 7	10 M				
12 W	12.61	19.7	20.7	19.2			
Hardware	3 – 6	3 – 4	4	3.98	21		8.7
Health shop			6	8.91		17.5	11.1
Jeanery			8		20.3	15.5	14
Jeweller	6 – 10	7 – 10	9	5.86	14.2	16.4	12.6
Kitchenware			9			17.1	
Ladies wear	4 – 8	6 – 7	9	8.9	19.1	19	14
Liquor	3 – 6	3 – 4	4	3.05			4.8
Locksmith			5				
Manchester			5			19.8	14.2
Medical GP			7	5.96			
Menswear	4 – 8	6 – 7	7	9.14		15	12.5
N/agency		3 – 6	5	4.86	13.1	16.1	10.2
Nursery		7 – 8	5	4.95			14.8
Optometrist			9		16.5	16.5	13.7
Pawn			9				11.3
Pets		7 – 8	8			32.4	17.5
Pharmacy	4 – 6	6 – 7	5	3.51	11.4	12.9	8.2
Restaurant[11]	5 – 10		8 & 11	11.44	19.7	17.7	16.7
Sports shop	5 – 8		6	6.7		9.3	14.2
Stationery	5 – 8	3 – 6	5	3.01	17.6		
Supermarket	2 – 3	1 – 2	2	4			2.5
Takeaway		7 – 10	8	9.84	17.7	20.2	16.7
Toys			7				
Travel agent			5 comm	11.41			1.7 total
Vet			6	7.72			
Video			9	12.38			22.8

and what they are. Interestingly there is a strong correlation from two leading accountancy/business based sources and two from the property industry itself, one source being from overseas.

I have conducted many case studies using actual trading accounts from individual categories and outcomes are very consistent, if one applies customary business logic. In other words, business logic, which is entrenched in the capitalist system and case law – the considerations the average hypothetical Lessee may take into account, when committing to a lease.

When sales or gross profit margins are lower, capacity to apportion operating cost with rent as a residual declines, with the opposite also true when business efficiencies are higher.

For example, longer trading hours may result in higher sales, but in the process expenses in achieving higher turnover levels, could cause a significant reduction in profitability and even trading losses, leading to business failure. Lessor risk and the overall risk on the investment increases. The increase in sales alone does not mean higher rents are affordable.

The principle of rent being determined by usage after business operating costs for a particular industry type is not new; it dates to the famous English economist Ricardo some 200 years ago.

Overall in a managed shopping centre, the mix and match of competing permitted uses, enables owners and managers to maximise rental returns, with sales figures submitted by retailers. But then the vexed question must be asked, to what extent have sales figures been used to maximise rent levels, which may be to the overall detriment of an investment property and the industry itself?

Table 1 shows numerous retail categories. The first four columns show the suggested rental rate to business volume (sales) by % age; determined by industry cost of doing business, profit margins and stock turns viz occupancy costs and what they should be, the next three columns represent the actual rate they are in major shopping centres across the country.

The real health of the retail investment property not only depends on the average occupancy costs of each category, but the actual range within each category itself.

There is a strong correlation from various sources showing that regional shopping centre occupancy costs are between 16 – 17% on average, with a range say from 6 – 35%. This independent research suggests a healthy centre with good management of tenancy mix, trading at high rates/M2 should have a maximum specialty shop rent ratio of 11 – 12%, with a range of 6 – 15% depending on the category in question, assuming the centre trades above average levels, with businesses enjoying good economies of scale.

The information Lessors have on each business derived from sales data collected alone, suggests an imbalance in knowledge the one party has over the other's "business". This raises the possibility that S 51 AC of the Trade Practices Act will be tested at some stage in the courts, if there is or has been a perception of harsh and unconscionable dealings between contracting parties.

The implications of disproportionate occupancy costs are far more severe; a two-tier retail investment market and a significant breach of fiduciary responsibility to the investing public, and Breach of Duty of Care by the Lessor as they have full knowledge of what the position is. In the end it falls back on the industry professionals, the experts to take responsibility or face the courts[12], not if, but when this investment sector collapses.

Analysis of risk on rental income stream of neighbourhood centres

Figure 1 shows the risk of income streams of primary anchor tenants in neighbourhood centres in Brisbane, Queensland, is important to understand.

The graph shows occupancy costs to sales and corresponding rent/M2 of convenience stores.

In the first instance, while both graphs are trending upwards, when one analyses rents/M2, it is far more difficult or even impossible to assess the risk factor. The business potential cannot be linked to the gross occupancy cost factor.

Analysis of occupancy costs on the other hand immediately enables one to see whether there are "warning signs" or signals, pointing towards potential weaknesses. GST reporting has also forced Lessees to improve record keeping, thus making better analysis possible. Lessees are also more willing to part with confidential business data to an independent third party valuer.

Secondly, there is no direct correlation between occupancy costs and rent/M2. Therefore analysis of rent/M2, is likely to result in more random outcomes.

‘the implications of disproportionate occupancy costs are far more severe’

Obviously a difference in floor space between two stores with similar trading potential, but with a 20 – 30% difference in floor area could have a significant affect on the rent/M2 if used as the primary evidence, to establish the risk level on income streams.

Conversely a store trading highly efficiently (it may have no competition in a given catchment area for example), paying a high rent/M2, could possibly be trading quite profitably, yet is may be assessed as being over-rented.

The opposite may also hold true, if the floor area is excessive for trading volumes.

It follows analysis of occupancy costs as primary evidence, is more useful in assessing risk on income streams.

The data used in the graph has been collated over the past year. Some of it would have been affected by the introduction of Sunday Trade in South-East Queensland in August 2002, however, for the purpose of this exercise is suffice.

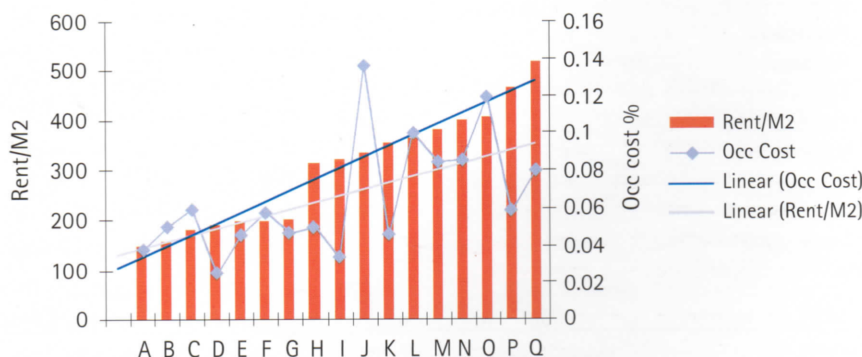
The principles of analysis of these convenience stores apply to all investment properties, and apply to the specialty shops in assessing risk.

Analysis of primary evidence shows an occupancy cost range of 2.47% to a massive 13.69% of sales, and a rental range/M2 from $148 - $518/M2. The recommended occupancy costs for convenience stores (mixed business) suggested by PRACDEV Key Indicators is 3% of sales, with an efficiency factor of sales per FTE (full time employee) of $190,000 PA working 38 hrs/week. The profile for a convenience store (or any other specialty shop whether in a centre or not) suggests a gross profit margin of 27%. Clearly from the analysis, it shows some businesses are in serous trouble, one paying almost 50% of its gross margin in rent charges.

While the range is quite significant, more important is the quality of that income stream. Depending on the critical mass of each business, location, socio-economic area, proximity to competition, convenience stores operate best on an occupancy cost of around 3 – 5% of sales. From the sample, sales range from $480,000 to $2 Million PA.

For full analysis, understanding gross profit margin details is also useful, and often high franchise advertising fee percentages, may significantly reduce effective gross profit margins of businesses. Big and small businesses by volume also have varying capacities to pay franchise fees.

Figure 1: Analysis of risk on rental income stream of primary anchor tenant: neighbourhood centres Brisbane



The centres where businesses J and O are located, with occupancy costs of over 13 and 11% were bought by a developer and medical professional respectively. While it is in a selling and or managing agent's interest to keep rentals as high as possible with fees often linked to price achieved or rents collected, to the dismay of the new owners, they discovered their investments are worth far less than what they have outlayed – a two tier market in operation.

Generally businesses A – I have reasonable occupancy cost to sales, with most from J – Q in serious trouble. Business A has a significant stock holding to generate its sales (high fixed cost), C's business has no critical mass and is simply too small, while G & H are reaching a threshold as far as occupancy costs go.

With the exception of businesses K and P, serious consideration must be given to lowering rental charges of all the stores in the J – Q segment, otherwise loss of traffic associated with the anchor tenants, could have a significant negative impact on the investment properties[13].

It follows, low gross profit margin high sales volume businesses can only sustain small differences in a fixed cost such as rent. That is because a small variation of say 1 – 2% will have a greater negative (or positive) affect on business viability, owing to negative (or positive) leverage.

Higher gross profit lower sales businesses, where the "leverage" affect has less impact, can withstand higher occupancy cost to sales ratios, and may also not be "evidence" of market rental value.

The leverage affect also operates in reverse for particular permitted uses, where margins or sales are higher or lower as the case maybe, due to socio economic factors, competition and so on. This will have a negative or positive affect on the profit of those businesses as the case maybe.

Smaller businesses also have less capacity to pay a disproportionate occupancy cost and the risk of business failure gets higher. This could occur where tenancy mixes are not well managed, or simply that a centre is too big for a catchment area or there is too much retail floor space for a given population.

A small down-turn in the economy, will increase the potential for business failure, where capital has been progressively eroded through high occupancy costs over time, where businesses have become smaller and so on.

The assumptions made above is that proprietors fit the description of the "average hypothetical Lessee" operating to reasonable standards.

The business economics of the "average" retail business[14]

In order to amortise the set-up costs of the "average" retail business in five years, to justify one's outlays, the following model is submitted. After meeting cost of sales outlays of 60%, this leaves a gross profit margin of 40% depending on business type or whether it is franchised or not, (but may vary from around 16 – 75% or more). Wages on average, including a working proprietor for a 40% GP margin business, could equate to 11%, advertising say 2%, other operating costs 7%, depreciation 4% and net profit 8% (or amortisation viz 12%), which would leave 8% for occupancy costs. It cannot exceed 100%. This scenario ignores whether the type of operation is capital or labour intensive or both.

> ‘the leverage effect also operates in reverse for particular permitted uses’

Failure to properly apportion these costs to fixed and variable cost components, means one section of the business may be "stealing" from another portion of the business. The only way to stay in business may require the one party to subsidise its investment from outside sources. The outcome means the one party is "subsidising" the other party's investment and would fall outside reasonable commercial logic and possibly natural justice and fairness. It may raise questions of law.

In addition, where lease incentives include fit-out contributions, the Lessor in fact has taken "ownership" of portion of the Lessee's business. It becomes questionable whether the Lessor or Lessee's risk factors (business rate of return) should be used to "capitalise" the rental income stream to determine asset values?

This model also suggests sufficient business momentum and volumes to cover costs, failing that, by lease renewal there is no equity left to continue or the business must borrow more money, if it cannot fund it from within.

At higher business volumes, there may be economies of scale to justify paying higher occupancy costs and vice versa. Different gross profit margins, business volumes, capital profiles and whether that business is labour or capital intensive or not. Franchise fees and their quantum, also have a profound affect on assessment of market rental value, even within exactly the same category – say two seemingly similar food court businesses for reasons previously mentioned.

Given average gross occupancy costs are well above what are apparently economically prudent levels over a long period (even allowing for some "fat"), this points to an industry in trouble.

Some commonly observed flaws in market rental valuations

Over the years, I have observed some interesting practice within the profession, which includes that of senior practitioners carrying out rental valuations. Comments are less complimentary by those who have become victims of determinations. And it is not good for our reputation for being independent, impartial or objective.

The implications are that they may not produce outcomes that satisfy the *Spencer v Commonwealth* tests or the terms of the contract the valuer has entered into with both Lessor and Lessee, to determine the rent as their appointed "expert".

The following practices have been observed in some rental valuations and in some cases are compared to asset valuation principles:

- Use of dated evidence, subject to ratchet clauses for 5 – 10 years or more, likened to using dated sales evidence, without making adjustments;
- Use of evidence, which contributed to business failure within two weeks of the valuation report being issued – suggesting

the valuer who accepted the appointment was not au fait with this type of work or the evidence may have been accepted at face value or was not adequately tested;

- Widespread use of averages being occupancy cost to sales ratios or rent / M2, or the choice of the "averages" and picking a figure to "fit" a required answer, akin to using aged data, data that comes from numerous residential areas for example, from different styles, sizes and ages of comparables and using that figure averaged out - see above;
- Using quite different permitted uses and applying the "evidence". This might be compared to using evidence from the industrial warehouse space and applying it to commercial office space for example - as above;
- Splitting the difference between a Lessors "ask" and a Lessees suggested "market rental". This could mean a valuer has not fulfilled the terms of his or her contract - as above;
- Where a valuer has all logical avenues closed to it in submissions, and has created "additional" floor area by way of space used under license, applied a rental rate to quite clearly defined "common space" to get to public toilets, to come up with a rental that did not satisfy *Spencer v Commonwealth* criteria under state retail legislation, definitions, convention and so on;
- Where valuers ignore that outgoings is another form of rent, and state laws require that outgoings be included as "rent";
- Where "specialist retail valuers[15]" are not au fait with ordinary business terminology or how it impacts on a business, or centre and category performance data, or the impact of leases on a business;
- Where valuers not only give the perception of being biased, their demeanour and behaviour, shows a disregard for natural justice and fairness for the parties whom it is contracted to[16] for example by giving the one party less than five minutes of their time; and
- A combination of more than one of the above.

The outcome in Queensland has seen the list of specialist retail valuers having decreased from over 80 across the state to just over 40, with around two thirds willing to take on work, as rental valuations have been challenged since 2000 - see Going forward and Conclusions below.

It has also been costly on valuers Professional Indemnity cover when they have had to notify their insurers that their work may be challenged.

‘the leverage effect also operates in reverse for particular permitted uses’

Going forward

There are over fifty retail categories and many sub-categories within that. For example, newsagents have up to four sub-categories. A business that is franchised often has quite different viability/profitability outcomes, than those that are not.

Valuers that apply "averages", average rents / M2 or average "occupancy costs", even from some very dated evidence without testing the "average" against the specific or without understanding the impact of applying that average to the operation of a business, bring not only themselves, but the whole profession into disrepute.

Either the profession will have to upgrade the skills of valuers to be able to do market rental valuations, or a whole breed of valuers will have to come from the teaching institutions.

The interpretation of "market value" is a product of the net positive cash-flows from an income producing property, not only the quantity of the income but the quality of the income stream in years to come, as a long-term investment vehicle.

It is naturally the aim of the wider industry, to maximise income within the prevailing law in order to maximise shareholder returns.

From Table 1 which shows the disparity between suggested occupancy costs and what they should be versus what they are, indicate increasing stresses, strains and potential for disputes between Lessors and Lessees. A negative multiplier affect if there is a downturn in consumer spending, will drive specialty shops (many of whom are already technically insolvent) out of business.

It is up to the profession to interpret long-term asset value for all stakeholders including unit trust holders, syndicates, superannuants, lenders, Lessors, Lessees, developers, potential investors and the like, despite allegations of the "insider trading" nature of the industry.

From the stresses and strains between Lessors and Lessees, industry experts will be instructed to prepare market rental valuations, which will withstand the "tests" under relevant Retail Shop Lease Legislation, definitions, case law and other convention for the purposes of apportioning damages:

- Where lease renewals have been carried out where there are allegations of misrepresentation, misleading and deceptive conduct, economic duress or even unconscionable conduct (S 51 AC Trade Practices Legislation) where rent levels do not satisfy "market rent value" criteria to quantify damages; and as a consequence
- Where investors have supposedly paid inflated prices for property, where there are instances of misrepresentation or misleading and deceptive conduct.

As an economy, which is becoming more sophisticated beyond just building shopping centres, it must consider the consequence of wasting capital on this asset class by considering the businesses which tenant them. This includes the function of each business, the costs of starting up, closing down, the employment opportunity created, the intellectual property harnessed within each one, which can be summarily destroyed by unacceptable industry practices. In other words, where the real money comes from to justify the outlay in the first place.

The "industry experts" will not be accountants, they will be from the valuation profession. In my view many/most accountants may understand the profit and loss of a business concerned and some appreciate the critical nature of business benchmarking and business investment convention and analysis, however very

few have knowledge of property economics, economics, valuation convention and methodology and so on.

The valuer able to carry out market rental valuations will have a sound knowledge of those areas mentioned in the paragraphs above including:

- The changing nature of retail, what a category killer or discount retailer may do to a retailer or a retail precinct;
- To be able to conduct competitor analyses and to be able to comprehend and understand when a specific category has reached saturation level within a "captive market" - a shopping centre;
- An ability to be able to assess and analyse whether a subject Lessee's business operation would subscribe to that of the "average hypothetical Lessee", and equally measure whether the Lessor's performance subscribes to that of the "average hypothetical Lessor" operating to best practice;
- Shopping centre industry principles and practice, including leasing practice and management practice including taking full "responsibility" for the management function, management of tenancy mix, terminology such as derogation of grant, quiet use and enjoyment etc;
- The length of leases, security of tenure (or lack of compared to the United Kingdom for example), the impact of major fitout on business investment principles, factors such as effective rent and leasing incentives;
- To be able to call for appropriate centre performance, specialty and category performance levels or precinct performance levels, in order to carry out the work at hand;
- The impact of random development approvals by Councils on existing developments during current lease terms, in the absence of increased trading potential;
- Local - , regional - , national - and international economics and the affects on consumer confidence and spending; and
- Tenancy Legislation within that state or territory in which they are working.

There should be an ability to "condition" both Lessor and Lessee of what the market rental "process" involves, to minimise unrealistic expectations and to be able to deal with either party who may seek to manipulate the process.

Conclusion

Market rental valuations are an exciting and challenging area to be involved in. The dynamics are exciting and challenging. Roller coaster outcomes of asset acquisition and valuations, would be far more in check if market rental outcomes were appropriate for business potential.

Lastly, the principle of management fees being a function of all revenue collected, and being the primary driver of rent increases and cost plus mentality of outgoings, promotion and some utility charges should be outlawed. Managing agents who derive fees on a percentage of revenue collected adds to an unhealthy cost plus mentality, vs quality of income stream and healthy investment attitude.

Fixed three yearly tendering may be a reasonable alternative.

It is also a massive conflict of interest for some stakeholders, whose interest is the net income of an investment - the share or unit trusts holders.

Our PI and professionalism comes under scrutiny in the process.

In turn the pressure falls back on the professionals in the industry to punish perceived value, rather than real value.

The experts role in determining market rental value is to do just that. That is why both parties have sought to appoint, or have gone to an independent body to have an expert appointed. By trying to appease either one of both parties, could result in the valuer failing to determine the rent according to legislation, definitions, convention and failing to carry out its professional duty to both parties, to whom it is contracted to.

Given overseas economic pressures are pointing towards deflation "falling prices", means the industry could be in for an interesting time ahead.

Notice of appreciation

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- Ian Brown CCH Benchmarking (formerly FMRC Benchmarking), Dr Keith Cleland (PRACDEV), Prof Alan Millington and Trevor Watters (PRACDEV) - NSW.

Footnotes

1. Gilbert - "Marlet Rent: What is It?"- The Valuer and Land Economist 1998
2. Corrs - "An overview of rent reviews"
3. JHD Retail Averages - March 2002
4. See article "Market rent: what is it?" The Valuer and Land Economist Nov 1995
5. Well known test cases: Mercer v Commissioner for Road Transport; Rogers v Whitaker; Sibley v Kias
6. Cork v Kirby McLean Ltd
7. Commercial Bank of Australia -v- Amadio (1983) 151 CLR 447,
8. Suggested occupancy costs (rent + outgoings) can vary due to different sales volumes, GP margins, trading longer hours, socio economic trading area, the affect and amount of franchise fees and so on.
9. "Determining Suburban Shopping Centre Rentals" by Philip Willington, The Valuer, October 1987
10. CCH Benchmarking (previously FMRC Benchmarking) Version 15, June 2003
11. Restaurant & Catering Operations Report April 2001 - Occupancy Costs 9.2% of ave sales $1 mill all respondents
12. "The Emperor's New Clothes - the truth about shopping centres" Brisbane, Australia 20th July 2001 by Assoc Professor Spike Boydell Ph.D FRICS pg 12 who says "It is only a matter of time before there is major litigation, which will expose the 'insider trading' nature of this investment sector."
13. "The Impact of Pedestrian Counts on Property Values" by GM Dowse, Dept of Finance and Property Studies, Massey University, Palmerston North, New Zealand
14. "Issues Affecting Shopping Centre Market Rental Values" by Malcolm Macrae - The Valuer & Land Economist, Vol 34 Nov 4 1996
15. A category of valuers in Queensland under the Valuers Registration Act 1992, that are able to do rental determinations in the state
16. API Information Paper "Rental Determinations" - Alan Hyam LFAPI March 2000 refers to Handbook of Rent Review by Bernstein and Renolds which states "it is the expert's duty to satisfy himself as to the facts of the relevant evidence" and with regard to the legal responsibility of the expert valuer "he is liable in negligence to both parties as he has a professional duty to both". McHugh JA in Legal & General Life of Australia Ltd v A Hudson Pty Ltd (1985) I NSWLR 314 states "By referring the decision to a valuer, the parties agree to accept his honest and impartial decision as to the amount of the valuation. They rely on his skill and judgement and agree to be bound by his decision".