# RURAL VALUATIONS COMPARED WITH URBAN VALUATIONS

## ANALYZING SALES

The non urban valuer has to look more closely behind the circumstances of non urban sale to find out the true relationship between the parties to the transaction. For example, the vendor and purchaser may have different surnames but are part of the local extended family which farms the area. Only local knowledge can ascertain this fact.

The non urban sale may have 2 contracts of sale; one for the real estate and another for livestock and plant. The valuer should peruse both contracts as often the value of livestock and plant is overloaded for stamp duty and income taxation reasons. The extra price is compensated by a lower price for the real estate component.

The stated area of the land sold may be wrong. It is common for the vendor to include the area of road permits and other crown occupations which he cannot. The relevance of adjoining owner sales in rural localities is less important compared to such sales in urban areas. The sale to the owner of a property "just up the road" may be the same as for an adjoining owner. In some rural localities the only possible sale may be to an adjoining owner.

The Notice of Transfer commonly has a misdescription of the legal description of the property and area sold. Therefore, the valuer has to check the parish or section portions on the parish or hundred map. The valuer requires a good knowledge of crown tenures. He needs to know about changing boundaries according to the law of riparian rights.

## IDENTIFICATION

Identification is required on both the parish map and air photos. The valuer needs a knowledge of air photo interpretation (api). Unlike urban properties the valuer is rarely able to see all the property. Therefore, he/she must make use of air photo interpretation to value those parts he/she has not inspected.

He/she needs to be able to identify and classify soils, topography, vegetation, weeds, pests, and timbers. He needs to be able to ascertain the most suitable pasture improvement program including aerial seed and super (ass).

He/she must be able to ascertain the functional value of improvements such as fencing and water. Unlike urban valuations the value of the cottage or homestead is not very important. The valuer must be able ascertain the optimum development for the subject land. The is particularly relevant to the clearing of timber.

## THE EFFECT OF TECHNOLOGICAL CHANGE

This applies particularly to the value of development, improvements, and plant. Grazing is much more economical because of the high efficiency of the poisons, sprays, and drenches being used. This allows a much higher stocking rate, raises the productivity of the land and therefore, the land value. Technological change is important when valuing woolsheds, shearing gear, fencing, and dips. The new poisons and rabbit control methods have reduced the rabbit population so much that it may have lowered the value of rabbit proof fencing.

## VALUATION FACTORS

Unlike urban valuations the typical rural property (about 1000-2000 ha) will have at least 90% of total value as land, pasture, and clearing. The value of improvements such as fencing, sheds, and water is really a question of utility. For example, is the fence stock proof? If it is it does not matter a great deal if it has been repaired numerous times in the past and looks very untidy. Because physical improvements are such a small part of the value of the property it is not necessary for the valuer to spend too much time on their valuation. A verbal description of the homestead is enough and there is probably no need to measure it up.

The main method of valuation is the cleared hectare method. The most common check method is the carrying capacity or units of production method. These two methods can be used to value most rural lands except for specialist uses such as dairies.

The capitalization method is not a good primary method because of the problem of:

1. Determining typical or average management. This is almost impossible because of the numerous farm management programs the typical farmer can choose from.

2. Forecasting future income and outgoings. Australia's inclement weather and overseas competition for primary produce makes it most difficult to forecast future farm incomes. They are subject to much larger error than the forecasts for an urban land use.

The capitalization of expected net annual income (expected gross income - fixed costs) is a useful check method for intensive land uses or "agribusinesses". However, there are particular dangers in including goodwill, short life plant and equipment and stock. Do not forget that generally, the valuer's task is to value the real estate. DCF is not acceptable as a method of valuation as it is not accepted by the courts or clients. It is a predictive model and therefore, cannot give a single answer but a range (eg at 95% probability). DCF can be used as ancillary evidence or data (with proper disclaimer clauses) for example, using three scenarios; expected, pessimistic and optimistic scenarios.

Statistical methods such as MRA cannot be used for valuation purposes as it is not recognised by the court or the market. There are large errors in using predictive models and if the valuer does use MRA the final answer cannot be a single amount must be a range of value (eg at 95% probability). Such an answer is unacceptable for valuation clients.

The rural valuer must be able to convert different stock units into dry sheep equivalents (dse). This can be most difficult. This will be covered later.

The valuer often has to adjust crown tenures such as conditional leases to freehold equivalents ("present title basis" (PTB)). This requires a knowledge of compound financial formulae.

The problem of cost versus value is most important in the rural context because of the allowable income tax deductions. Although less important today compared with the early 1970s the use of tax advantages by "Pitt St farmers" 'has tended to raise the value of poor and marginal rural lands.

The urban influence is most important. The urban influence or potential for future subdivision often dominates land values in the coastal and central regions of NSW and south and south areas of South Australia. This applies particularly when the property is near a large town or city.

## PRESENT TITLE BASIS (PTB)

The methods of valuation for rural properties assume that the property is fee simple in possession or unencumbered freehold. However, most rural properties have some part lease or licence from the crown. Therefore, to find the market value a final adjustment to the unencumbered value is required converting to a lesser amount which takes into account the extra cost of occupying less than freehold lands.

## LICENSES

Licenses from the crown are only an annual right to occupy and therefore, the occupier has no economic interest in them. Because the owner has no interest in the licenses they are not valued directly as part of the property. However, some licenses (exclusive licenses) can only be used by the owner of the freehold land and therefore, that owner has "de facto" ownership over such licenses. If the annual rent being paid is less than market rent (as it usually is), the adjoining or surrounded licences will add value to the main freehold lands.

Those lands in which the owner has an interest for example, freeholds and leaseholds have a higher value which reflects the potentiality and probability that the Department of Lands will allow transfer to the an intending purchaser.

## EXCLUSIVE LICENSES AND LEASES

Some crown licenses and leases can only be occupied by the adjoining or surrounding owner, for example, internal road permits and permissive occupancies with no external access. In such cases the added value to the main part is the value of those lands less the capitalized annual rent. On the other hand, lands which have a number of potential occupiers such as licenses on nearby stock routes or on common reserves will add little or no 'value to the main as there is less certainty that the new owner will be allowed to occupy those lands. A fraction only of the value is added the value of the main property. For example, 10 - 20 % of freehold value less the capitalized rents.

The valuer should determine the allowable land use on the licensed land. If that use is the highest and best use then the starting value is fee simple in possession. If the allowable use is less than the highest and best use then its value is a proportion of the FSIP value. The discount will depend on whether or not a potential purchaser would want to use the land for the allowable use.

## LEASEHOLDS

Leaseholds on the other hand provide the owner with an interest in the property and should be valued with the main part of the property. Most crown leaseholds are for a term of years and unless there are facts to the contrary such as a statement by the Lands Department it should be assumed that the owner will be allowed to lease those lands in perpetuity. Once this assumption is accepted the only difference between leasehold lands and freehold lands are the rent and conditions of use. If the allowable use is the highest and best use of the land then the only disadvantage for the owner compared to freehold lands is the payment of rent to the Department of Lands.

On the other hand if the allowable use is less than the highest and best use then the FSIP value will have to be discounted. Normally leased and licensed lands are the more marginal lands and the allowable use will be the highest and best use.

## CAPITALIZATION OF CROWN RENTS

The value deducted from the fee simple in possession value is the capitalized value of the rents being paid. The valuer ascertains the annual rents from either the owner or the Department of Lands and this amount is capitalized in perpetuity using a conservative capitalization rate. A conservative rate is adopted because of the low returns received from rural properties and the conservative nature of the total investment. For example, 6-8% per annum.

**EXAMPLE:** The fee simple in possession value of a rural property is 850 000 including certain road permits and crown leases. The valuer determines that the rents being paid for all road permits, a short term crown lease for years, and a long term crown lease for years is 5 400 per annum. A suitable interest rate is 8% per annum.

CAPITALIZED VALUE OF RENTS: 5400 * 100/8 = **67 500**

**PRESENT TITLE VALUE:** 850000 - 67500 = **782500**

The valuer should stress in the valuation report that the final value is on a present title basis. For example, the final statement in the valuation report should be as follows:

"The present title value of the subject property as at 06.10.1994 is **$ 782 500 say 783 000**

David Hornby 201093