AN ANALYSIS OF THE INVESTMENT APPRAISAL OF ENCLOSED REGIONAL SHOPPING CENTRES - AN AUSTRALIAN PERSPECTIVE

by

Spike Boydell

A thesis submitted for the degree of

Doctor of Philosophy

July 1998
Abstract

AN ANALYSIS OF THE INVESTMENT APPRAISAL OF ENCLOSED REGIONAL SHOPPING CENTRES - AN AUSTRALIAN PERSPECTIVE

by Spike Boydell

A thesis submitted for the degree of

Doctor of Philosophy

Chairperson of the Supervisory Committee: Professor Peter H. Morgan
School of the Built Environment

This doctoral thesis undertakes an analysis of the investment appraisal of enclosed regional (or larger) shopping centres from an Australian perspective. The aim of the thesis is to provide a deeper understanding of the valuation and investment analysis of this $14 billion sector of the Australian economy. The objective is to evolve conceptual frameworks to model the key influences and relationships that affect the players and the process. The outcome is a detailed and thorough investigation, initiated from an extensive literature review and thereafter grounded in the analysis of experiential qualitative data derived directly from the key participants in the Australian regional shopping centre sector. Whilst this investment sector is significant in terms of the capital value that it represents, no previous study of this type has been undertaken.

Through a thorough literature review that focuses on and around appraisal and depreciation, and subsequent pilot studies, a series of conceptual frameworks are derived to model the influences and processes related to owners, developers, managers, architects and valuers. Using a qualitative methodology grounded on the experience of the key players (‘experts’ in qualitative methodology) a significant empirical data set was derived. This data was analysed using QSR NUD IST™, a ‘Non-numerical Unstructured Data Indexing, Searching and Theorizing’ software. The analytical process allowed the evolution of the conceptual frameworks to facilitate, for the first time, the modelling of actual processes and relationships in the investment appraisal of enclosed regional shopping centres in Australia.

The outcome represents a significant advancement in understanding this area, in particular the relationship between the main ‘players’ of developer, property manager, architect and with particular reference to the valuer and the owner. This research has proven the following issues: shopping centres are an evolving asset (they gradually mature in contrast to their office investment counterparts); refurbishment and expansion mask depreciation; owners spend money to depreciate the competition, whilst benefiting their development, management and architectural subsidiaries; investments change hands between a few major players at low yields to maintain portfolio value in an oligopolistic market; there is general confusion over the investment terminology; and, the valuer is subject to intimidation and is expected to forecast with limited information. A new category of depreciation, competition depreciation, is identified.

This thesis strengthens existing academic literature on depreciation, investment appraisal and regional shopping centres, and as such provides an original and significant contribution to this field of knowledge.
TABLE OF CONTENTS

CHAPTER 1
INTRODUCTION .................................................................................................................. 1

1.1 Introduction .................................................................................................................. 1
1.2 Research problem and hypotheses .............................................................................. 3
1.3 Justification for the research ....................................................................................... 5
1.4 Methodology ............................................................................................................... 7
1.5 Outline of the thesis .................................................................................................... 9
1.6 Definitions .................................................................................................................. 10
1.7 Delimitations of scope and key assumptions ............................................................ 11
1.8 Conclusion ............................................................................................................... 12
References: Chapter 1 .................................................................................................... 13

CHAPTER 2
LITERATURE REVIEW ..................................................................................................... 16

2.1 Introduction ............................................................................................................... 16
2.2 Parent disciplines and classification models ............................................................. 18
  2.2.1 Enclosed Shopping Centre ................................................................. 18
  2.2.2 The Role of Shopping Centres in Strategic Property Portfolio Management ....... 20
  2.2.3 Forecasting (preamble) ......................................................................... 32
2.3 Appraisal .................................................................................................................... 36
  2.3.1 Concepts of Appraisal ........................................................................ 36
  2.3.2 Market Value ....................................................................................... 38
  2.3.3 The Three Approaches? .................................................................... 43
  2.3.4 Highest & Best Use Analysis ............................................................. 45
  2.3.5 The market (sales) comparison approach to value .................................. 47
  2.3.6 The cost approach to value ................................................................ 50
  2.3.7 The income or capitalisation approach .............................................. 52
  2.3.8 Discounted cash flow analysis .............................................................. 57
  2.3.9 Commentary and Critique of the AIVLE DCF Standard ....................... 58
    2.3.9.1 Application .................................................................................. 60
    2.3.9.2 Concepts .................................................................................... 61
    2.3.9.3 Industry Standards for Discounted Cash Flows ......................... 62
    2.3.9.4 Layout of Discounted Cash Flows ............................................ 65
    2.3.9.5 Reporting Requirements ............................................................ 68
    2.3.9.6 Responsibilities ......................................................................... 70
    2.3.9.7 International Perspective ............................................................ 70
    2.3.9.8 Review ....................................................................................... 70
  2.3.10 Depreciation ................................................................................................. 71
    2.3.10.1 The ‘American School’ ............................................................ 76
    2.3.10.2 ‘Lemons’ .................................................................................. 80
    2.3.10.3 Economic Life ......................................................................... 82
    2.3.10.4 UK Research .......................................................................... 82
    2.3.10.5 The shopping centre life-cycle .................................................. 86
    2.3.10.6 Physical obsolescence .............................................................. 93
    2.3.10.7 Functional obsolescence ........................................................... 94
  2.3.10.8 Economic obsolescence ............................................................... 95
    2.3.10.9 Other categories of depreciation/obsolescence ......................... 95
    2.3.10.10 Masking obsolescence ............................................................ 96
    2.3.10.11 The length of a property life cycle ......................................... 96
    2.3.10.12 Optimal time to renovate a shopping centre ............................ 101
2.4 Conclusion ............................................................................................................... 104
References: Chapter 2 .................................................................................................. 105
CHAPTER 3

METHODOLOGY............................................................................................................................................ 114

3.1 Introduction ............................................................................................................................................. 114
  3.1.1 Establishing a Philosophy ................................................................................................................. 115
  3.1.2 The Research Dilemma .................................................................................................................... 115
  3.1.3 Extension Frequency ......................................................................................................................... 118
  3.1.4 Art or Science? ................................................................................................................................. 119
  3.1.5 Grounded Theory ............................................................................................................................ 120
  3.1.6 Art or Science? ................................................................................................................................. 120
  3.1.7 Grounded Theory ............................................................................................................................ 121

3.2 Justification for the paradigm and methodology .................................................................................. 121
  3.2.1 Application to Property Investment Appraisal .................................................................................. 121
  3.2.2 Supporting Software ....................................................................................................................... 122

3.3 Research procedures .............................................................................................................................. 124
  3.3.1 Risk, Growth and Depreciation ....................................................................................................... 124
  3.3.2 EMPIRICAL WORK ......................................................................................................................... 125
    3.3.2.1 Conceptual Framework ............................................................................................................. 125
    3.3.2.2 Owners ..................................................................................................................................... 127
    3.3.2.3 Developers .............................................................................................................................. 131
    3.3.2.4 Managers ............................................................................................................................... 132
    3.3.2.5 Architect ............................................................................................................................... 133
    3.3.2.6 Valuers .................................................................................................................................... 134
    3.3.2.7 Analyst .................................................................................................................................... 137
    3.3.2.8 Expert Interviews ................................................................................................................... 137
  3.3.3 Ethical considerations ..................................................................................................................... 138

3.4 Analysis ................................................................................................................................................... 139

3.5 Conclusion ............................................................................................................................................. 140
  3.5.1 Conclusion to first year of study ....................................................................................................... 140

References: Chapter 3 .................................................................................................................................. 142

CHAPTER 4

ANALYSIS OF DATA..................................................................................................................................... 145

4.1 Introduction ............................................................................................................................................. 145

4.2 Subjects ................................................................................................................................................... 146

4.3 The Analytical Process .......................................................................................................................... 149
  4.3.1 The Valuer Analytical Detail: .......................................................................................................... 150
  4.3.2 Analysed Valuer Interviews ........................................................................................................... 166
  4.3.3 Analysed Owner Interviews .......................................................................................................... 219
  4.3.4 Patterns of data for the investment appraisal of enclosed shopping centres ................................... 249
  4.3.5 Conclusion ...................................................................................................................................... 250

References: Chapter 4 .................................................................................................................................. 251

CHAPTER 5

CONCLUSIONS AND IMPLICATIONS ......................................................................................................... 252

5.1 Introduction ............................................................................................................................................. 252

5.2 Conclusions about the research hypothesis: an analysis of the investment appraisal of enclosed regional
shopping centres – an Australian perspective ............................................................................................... 253
  5.2.1 Shopping centres are an evolving asset .......................................................................................... 254
  5.2.2 Owners will have to spend about 100% of what they pay for the asset within the first ten years to
maintain the yield and income .................................................................................................................. 254
  5.2.3 Refurbishment and expansion mask the depreciation ....................................................................... 255
  5.2.4 Owners spend money to depreciate the competition ....................................................................... 255
  5.2.5 Owners also have development, management and architectural subsidiaries that gain employment
and income from the continual expansion process .................................................................................... 256
  5.2.6 Acquire investments at low yields to maintain portfolio value ....................................................... 256
  5.2.7 Let the valuer struggle to find information ...................................................................................... 257
  5.2.8 The valuer is as confused as everybody else about the terminology ................................................ 258
  5.2.9 Intimidation ..................................................................................................................................... 258
  5.2.10 Who can forecast beyond 3 or 4 years? ......................................................................................... 259

5.3 Conclusions about the research problem .............................................................................................. 259

5.4 Implications for theory .......................................................................................................................... 261
5.4.1 Appraisal ................................ ................................ ................................ ................................ .... 261
5.4.2 Depreciation ................................ ................................ ................................ ................................ .... 262
5.4.3 Portfolio Strategy ................................ ................................ ................................ ................................ 262
5.4.4 Property Research ................................ ................................ ................................ ............................. 262
5.5 Implications for policy and practice ................................ ................................ ................................ 263
5.6 Limitations ................................ ................................ ................................ ........................................ 263
5.7 Further research ................................ ................................ ................................ ................................. 264
References: Chapter 5 ......................................................................................................................... 266

BIBLIOGRAPHY 267

APPENDICES 1

Appendix One: Meeting with AMP Property Investments ................................................................. II
Appendix Two: Overseas Travel Report ............................................................................................. VIII
Appendix Three: ‘Expert’ Interviewees ............................................................................................. XI
Appendix Four: Shopping Centre Classifications ............................................................................. XII
Appendix Five: Regional Centres Refurbishment/Extension Profile ................................................ XVI
Appendix Six: Shopping Centre ‘Players’ .......................................................................................... XVIII
Appendix Seven: Letter of Introduction to ‘Experts’ ........................................................................ XXII
Appendix Eight: Nodal References ................................................................................................. XXIII
Appendix Nine: Sample ‘original’ transcription of ‘Expert’ interview ................................................ XXXIX
LIST OF FIGURES & TABLES

FIGURE 2-1: LITERATURE REVIEW ................................................................. 17
FIGURE 2-2: TOTAL RETURN SINCE PURCHASE ....................................... 21
FIGURE 2-3: CAPITAL RETURN ................................................................. 22
FIGURE 2-4: TOTAL RETURN SINCE PURCHASE ....................................... 23
FIGURE 2-5: TOTAL RETURN ON YEAR ...................................................... 24
FIGURE 2-6: PORTFOLIO STRATEGY ............................................................ 30
FIGURE 2-7: MARKET VALUE ................................................................. 39
FIGURE 2-8: DEFINING YIELDS .................................................................. 55
FIGURE 2-9: AIVLE DCF STANDARD (1 OF 2) ........................................... 63
FIGURE 2-10: AIVLE DCF STANDARD (2 OF 2) ....................................... 65
FIGURE 2-11: DEPRECIATION ................................................................. 72
TABLE 2-1: DEPRECIATION AND RENTAL VALUE, YEARS 1 TO 20 .......... 83
TABLE 2-2: DEPRECIATION IN THE OFFICE SCENARIO .......................... 86
FIGURE 2-12: THE PROPERTY LIFE CYCLE .............................................. 87
FIGURE 2-13: REAL VALUE OVER TIME .................................................. 89
TABLE 2-3: PHYSICAL OBsolescence ....................................................... 94
TABLE 2-4: PROPERTY LIFE EXPECTANCY (IN YEARS) ........................... 97
TABLE 2-5: DEPRECIATING RETAILER PERFORMANCE OVER TIME ... 100
FIGURE 3-1: CONCEPTUAL FRAMEWORK: OVERVIEW ......................... 126
FIGURE 3-2: CONCEPTUAL FRAMEWORK: OWNER .................................. 128
TABLE 3-1: REGIONAL SHOPPING CENTRE OWNERSHIP ....................... 129
TABLE 3-2: OWNERSHIP OF CENTRES BY PARTIES INTERVIEWED ........ 130
TABLE 3-3: DEVELOPERS OF REGIONAL SHOPPING CENTRES ................. 131
FIGURE 3-3: CONCEPTUAL FRAMEWORK: DEVELOPER ......................... 131
FIGURE 3-4: CONCEPTUAL FRAMEWORK: MANAGER ............................. 133
TABLE 3-4: MANAGERS OF REGIONAL SHOPPING CENTRES .................... 132
FIGURE 3-5: CONCEPTUAL FRAMEWORK: ARCHITECT ........................... 134
TABLE 3-5: ARCHITECTS OF REGIONAL SHOPPING CENTRES .................. 134
FIGURE 3-6: CONCEPTUAL FRAMEWORK: VALUER ............................... 135
FIGURE 3-7: QSR NUD-IST™ PROCESSES ............................................. 140
FIGURE 4-1: EVOLVED CONCEPTUAL FRAMEWORK: VALUER ............... 147
FIGURE 4-1: EVOLVED CONCEPTUAL FRAMEWORK: VALUER (REPEATED) 167
FIGURE 4-2: EVOLVED CONCEPTUAL FRAMEWORK: OWNER .................. 219
Whilst all acronyms are defined before they are adopted in the thesis, the following is a reference summary of the main abbreviations adopted in thesis.

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABS</td>
<td>Australian Bureau of Statistics</td>
</tr>
<tr>
<td>ACSC</td>
<td>Australian Council of Shopping Centres</td>
</tr>
<tr>
<td>AIVLE</td>
<td>Australian Institute of Valuers and Land Economists</td>
</tr>
<tr>
<td>AMP</td>
<td>Australian Mutual Provident Fund</td>
</tr>
<tr>
<td>ARY</td>
<td>All Risks Yield</td>
</tr>
<tr>
<td>AUBEA</td>
<td>Australian Universities Building Educators Association</td>
</tr>
<tr>
<td>BCSC</td>
<td>British Council of Shopping Centres</td>
</tr>
<tr>
<td>BOMA</td>
<td>Building Owners and Managers Association</td>
</tr>
<tr>
<td>CALUS</td>
<td>Centre for Advanced Land Use Studies</td>
</tr>
<tr>
<td>Cap Rate</td>
<td>Capitalisation Rate</td>
</tr>
<tr>
<td>CBD</td>
<td>Central Business District</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
</tr>
<tr>
<td>CV</td>
<td>Capital Value</td>
</tr>
<tr>
<td>DCF</td>
<td>Discounted Cash Flow</td>
</tr>
<tr>
<td>DDS</td>
<td>Discount Department Store</td>
</tr>
<tr>
<td>EMS</td>
<td>Environmental Management Systems</td>
</tr>
<tr>
<td>FR &amp; I</td>
<td>Full Repairing and Insuring</td>
</tr>
<tr>
<td>GIM</td>
<td>Gross Income Multiplier</td>
</tr>
<tr>
<td>GLA</td>
<td>Gross Lettable (leasable) Area</td>
</tr>
<tr>
<td>HBU</td>
<td>Highest and Best Use</td>
</tr>
<tr>
<td>ICSC</td>
<td>International Council of Shopping Centers</td>
</tr>
<tr>
<td>IRR</td>
<td>Internal Rate of Return</td>
</tr>
<tr>
<td>ISVA</td>
<td>Incorporated Society of Valuers and Auctioneers</td>
</tr>
<tr>
<td>JLW</td>
<td>Jones Lang Wootton</td>
</tr>
<tr>
<td>MAI</td>
<td>Member of the Appraisal Institute</td>
</tr>
<tr>
<td>MIRR</td>
<td>Modified Internal Rate of Return</td>
</tr>
<tr>
<td>NOI</td>
<td>Net Operating Income</td>
</tr>
<tr>
<td>NPV</td>
<td>Net Present Value</td>
</tr>
<tr>
<td>NUD IST™</td>
<td>Non-numerical Unstructured Data Indexing, Searching and Theorizing</td>
</tr>
<tr>
<td>OAR</td>
<td>Overall Rate</td>
</tr>
<tr>
<td>PCA</td>
<td>Property Council of Australia</td>
</tr>
<tr>
<td>PV</td>
<td>Present Value</td>
</tr>
<tr>
<td>QIC</td>
<td>Queensland Investment Corporation</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
</tr>
<tr>
<td>--------------</td>
<td>-----------</td>
</tr>
<tr>
<td>QSR</td>
<td>Qualitative Solutions and Research Pty. Ltd.</td>
</tr>
<tr>
<td>REITs</td>
<td>Real Estate Investment Trusts</td>
</tr>
<tr>
<td>RICS</td>
<td>Royal Institution of Chartered Surveyors</td>
</tr>
<tr>
<td>SCD</td>
<td>Shopping Centre Database</td>
</tr>
<tr>
<td>TroY</td>
<td>Total Return on Year</td>
</tr>
<tr>
<td>TRsP</td>
<td>Total Return since Purchase</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>ULI</td>
<td>Urban Land Institute</td>
</tr>
<tr>
<td>US</td>
<td>United States of America</td>
</tr>
<tr>
<td>WACC</td>
<td>Weighted Average Cost of Capital</td>
</tr>
<tr>
<td>YP</td>
<td>Years Purchase</td>
</tr>
</tbody>
</table>
ACKNOWLEDGMENTS

A doctoral thesis is a long and often lonely path. What makes the journey worthwhile are the places you visit, and more importantly, the people that you meet along the way. Many have influenced me in my understanding of life. They know who they are, and I thank them with my heart and soul.

I formally acknowledge the financial support of Healey & Baker, Property Consultants, London for the initial ‘pump-priming’ afforded by a Healey & Baker Award in 1992. Also, the University of Queensland for awarding me two academic scholarships on full pay which enabled me to research full time and compile my qualitative data. The scholarships took place January – July 1995 and August – December 1996. I also thank my ‘experts’ who provided a basis for the empirical data; they are named in Appendix Three.

My two supervisors, Peter Morgan and Neil Crosby, have remained supportive in extension mode, despite the tyranny of distance and inevitable postal delays in pre-email times, since my move to Australia in 1993. They have been aided in the Antipodes by Brian Waghorn who, armed with trusty red pen, has voluntarily accepted the role of mentor in Australia.

My family remains with me despite the enormous challenges of completing a doctoral thesis whilst progressing an academic career which has spanned two hemispheres. It has been a long and truly educational journey for us all. My heartfelt thanks go to Marie, Edward and Eleanor. It is customary to thank the typist. That was me, word by word, figure by figure.

Spike Boydell
Chapter 1

INTRODUCTION

1.1 Introduction

It was Napoleon I (née Bonaparte) who first described England as a nation of shopkeepers.¹ However, the commentary in Wealth of Nations by his contemporary, Adam Smith², still holds true more than two centuries after it was scribed:

“To found a great empire for the sole purpose of raising up a people of customers, may at first sight appear a project fit only for a nation of shopkeepers. It is, however, a project altogether unfit for a nation of shopkeepers but extremely fit for a nation whose government is influenced by shopkeepers.”

In the intervening two centuries the quotation could be expanded to economies largely founded on consumerism. This is epitomised by the population eagerly seeking materialistic instant gratification within suburbia’s new cathedrals ³ - the regional shopping mall. These new “temples” to consumerism are now evident throughout the world - and there has been a proliferation of enclosed shopping centres over the last twenty years. Within Australia, in particular, the enclosed shopping centre has enjoyed recent success as an investment option. To quote David Lowy,⁴ Managing Director of the successful Westfield Holdings with extensive interests in Australia and the USA:

“...well managed, major regional shopping centres are now being recognised for what they are, the best form of real estate investment and in fact, probably the best form of any investment.”

This statement is common as an industry view, especially in its attempt to hype up the retail market sector. However, behind this facade lies an untold, or hushed, story that these new “cathedrals” are probably more depreciation prone than other property asset classes. Returning

---

¹ O’Meara (1985)
² Smith (ed. Todd) (1976)
³ Duffy (1994)
⁴ Lowy (1993)
to the theme of eighteenth century quotations, Samuel Adams\(^5\) added another truism that still has context:

“**A nation of shopkeepers are very seldom so disinterested.**”

The “disinterest” is a deliberately chosen attitude by the property industry to play down the inevitable need to account explicitly for depreciation within the investment appraisal of enclosed shopping centres. As Baum\(^6\) has correctly observed, the effects of depreciation and its cause, obsolescence, are often masked by inflation and rising property values, which were significant factors in the UK, US and Australia during the 1980s, before the collapse of the respective property markets. The falling value of money results in a rise in nominal values that hide the extent to which real values may be falling. This means that despite a decline in real value due to obsolescence, the property appears to be rising in value compared to historic cost, but the building will be under-performing. Inflation also makes the provision for replacement by means of amortisation more difficult as the sum required to renew the property asset is constantly rising.\(^7\) Indeed, within the Australian sector, given land availability, the norm is to undertake significant extension works at the same time as the inevitable refurbishment, which may be to (partially) mask the nature of cash injection when analysing the assets total return performance.

Consequently, this thesis investigates the background to the investment appraisal of enclosed shopping centres, drawing on the evolving valuation and appraisal philosophy emanating from the US, UK and paying particular attention to their hybrid, the Australian property market. The area of depreciation is isolated as the, hitherto, most significant unquantified aspect in discounted cash flow appraisal. The resulting depreciation index (or factor) will be incorporated within an evolved cash flow model. The independent and original contribution to knowledge which emerges is an enhanced market awareness of the life cycle of the enclosed shopping centre, and a far more considered appreciation of some of the key financial risk criteria in this multi-billion dollar sector of the Australian economy. This is achieved through a qualitative analysis, which builds on the literature to extract a contemporary understanding of the key ‘players’ in the regional shopping centre investment market. The qualitative analysis highlights the actual processes and challenges facing the players, identifying knowledge gaps and exposing unexpected realities. The outcomes also have a correspondingly significant benefit to the US and UK retail property sectors.

\(^5\) Adams (1776)  
\(^7\) Boydell & Clayton (1993)
1.2 Research problem and hypotheses

The purpose of this PhD research is to undertake an analysis of the investment appraisal of enclosed regional (or larger) shopping centres. Within that purpose, the research approach is to consider the application of contemporary appraisal theory to the regional shopping mall investment class, whilst identifying and qualifying the risk, growth and depreciation aspects with empirical Australian data. Through this approach a hypothesis contextualising the framework and forces surrounding the investment appraisal of enclosed shopping centres will be evolved.

The area of valuation and appraisal is extraordinarily wide as humankind has long since placed value on land and property. This pre-dates foundation economics, spans through Fisher’s Theory of Interest\(^8\) and leads to the contemporary approaches of the 1970s highlighted by the ‘Real Value’ work of Wood\(^9\) and developed in the 1980s by Baum & Crosby\(^10\) from the UK together with the US, or Wisconsin, school of Ratcliff\(^11\) and Graaskamp\(^12\). The prime text references that link shopping centres and valuation appraisal by Vernor & Rabianski\(^13\), Hines\(^14\), Jefferies\(^15\) and Garrett et al.\(^16\) all take a current practice approach. In so doing, they do not acknowledge real value approaches or rational models in the investment appraisal of enclosed shopping centres.

During the 1980s there was a growing awareness of the impact of obsolescence and depreciation on commercial property by Bowie\(^17\), Salway\(^18\), Trott\(^19\), and Baum\(^20\). This is separate from the tax write-off approach to commercial property depreciation that takes a whole life approach to regularised annual book value reduction. Baum further developed his

---

\(^8\) Fisher (1930)
\(^9\) Wood (1972; 1977)
\(^11\) Ratcliff (1979)
\(^12\) Graaskamp (1991)
\(^13\) Vernor & Rabianski (1993)
\(^14\) Hines (1988)
\(^15\) Jefferies (1990)
\(^16\) Garrett et al. (1976)
\(^17\) Bowie (1983)
\(^18\) Salway (1986)
\(^19\) Trott (1986)
\(^20\) Baum (1989)
work focusing primarily on the London office market and the industrial sector.\textsuperscript{21} Whilst many acknowledge the retail sector, and enclosed regional shopping centres in particular, as having a shorter life between refurbishment than the office or industrial sector (a notional fifteen years) there has been no empirical research to support the commonly agreed assertion.\textsuperscript{22} The reality of depreciation within shopping centres has been largely ignored by the valuation and appraisal professions in the UK, US and Australia despite the significant potential affect on investment returns, if not capital values.

The goal of this research project is to build theory through the analysis of qualitative data, which can then be applied to the wider property investment and appraisal market. Such a goal is a logical, achievable and worthwhile aim for a doctoral thesis.\textsuperscript{23} Hitherto the limited theory available in this area has taken a largely historical perspective. This thesis represents a new domain of enquiry, since it is the first study that specifically qualitatively examines and synthesises participants’ (who are the acknowledged ‘experts’ in qualitative research) perceptions under a conceptual framework of the investment appraisal of enclosed shopping centres. In so doing it generates and evolves new theory as the outcome of an analytical qualitative research methodology using an original data set. This new theory is grounded in the informed (‘expert’) opinion (which is factual evidence) and experience of the significant proportion of Australian experts in the regional shopping centre investment sector.

The use of grounded theory does not have to result in the building of a ‘total’ theory.\textsuperscript{24} It is a worthy aim of Doctoral Research to expose the relevant features of a corpus of data, whilst exploring certain key categories in more detail. Indeed, the qualitative approach results in a significant evolution and perceptual broadening of the initial conceptual frameworks which then need careful analysis to elicit the key components of the process.

\textsuperscript{21} Baum (1991; 1993)

\textsuperscript{22} including Kinnard (1990); Baum (1991); Vernor & Rabianski (1993)


\textsuperscript{24} Henwood & Pidgeon (1995)
1.3 Justification for the research

1. The importance of the research is inherent in the significance of the regional shopping mall as an asset class in cash dollar terms and within the context of asset class weighting within the institutional property and wider portfolio level. It is an area where performance measurement is only of recent (past decade) significance and property, which has seen recent decline for asset allocation by the superannuation and insurance funds, is very much under the spotlight as an asset class. Retail property has been cited as the best performing property asset class of the last five years, and has some support as the best overall investment class post 1990.25

2. Whilst current practitioner approaches based on a traditional methodology are documented, the application of contemporary theory and depreciation modelling has been ignored in the regional shopping centre area. Baum highlighted the need for such investigation into the shopping centre sector.26

3. The term depreciation has been long accounted for from a taxation viewpoint and there is support for a whole structure life of approximately thirty-five years based on annual write-off figures. Such a philosophy fails to account for the real nature of depreciation and obsolescence in regional shopping centres which incorporates the physical, functional, economic, legal, social and (specifically) competition depreciation factors rather than merely considering the shell structure’s operational life. The research method adopted (refer Chapter 3) for qualifying the depreciation issues incorporates a detailed survey of the “experts” involved in the majority of the 72 (super) (major) regional shopping centres within the Australian market.

4. The outcome of this research is the formulation of evolved conceptual frameworks, specifically for the valuer and the owner, which serve as detailed checklists to consider risk and return factors within the appraisal model (refer Chapter 4). This modelling (for the conceptual frameworks are ‘models’) synthesises those aspects of the literature review which whilst considered significant have hitherto been untested in appraisal modelling with original analysed qualitative ‘expert’ data. This allows workable hybrid conceptual frameworks (or models) to be evolved that facilitate a deeper, new understanding of the process involved in

25 Boydell (1995b)
the investment appraisal of enclosed regional shopping centres. This understanding is the new, evolved, theory. As a result, the importance and relevance of certain components can be much better understood and justified. The models also create a workable access system for the data.

5. The potential application of the data is not limited to the $14+ billion worth of assets which the Australian regional shopping centre sector represents. The resulting models (conceptual frameworks) have international relevance in the emerging global property market where institutional property investment is not restricted by national boundaries. The key purpose, irrespective of the workability or otherwise of the models, is to highlight the appraisal issues and to stimulate a greater awareness of the risk, growth and depreciation factors amongst the valuation/appraisal professions and their investment clients. Take a current example of an Australian shopping centre that was opened in 1991 after exceeding its construction cost targets of $550 million. In less than four years the prestige property has fallen in value to a current investment worth to the owners of $155 million and is about to be placed for sale on the open market at approximately $200 million. The fact that the investment, which was repossessed by the vendors, owes the owners more than $900 million in rolled over interest and capital outlay is public knowledge. What is not public knowledge is how so called ‘prime’ investments can diminish in value to such a degree, even accounting for the recessional environment of the last few years. It is clear in such a case, where political and financial factors also play an influential role, that the problems are not restricted to the valuation and forecasting approach. The original and subsequent valuation methodologies do come into question and in their own right serve as justification for the research and strive towards a more rational understanding of the process and the theory.

The research comes at a critical time for the Australian market as it slowly takes stock of evolving standards for discounted cash flow models by the Australian Institute of Valuers and Land Economists. Computer based models have been commercially available in the US for some years and have become the standard at institutional investment level. The UK and Australia have been slower to adopt such an approach and there is recalcitrance by many in their respective professions to properly accept and adopt the available tools in property investment decision-making.²⁷

14 Methodology

It has been said that knowledge is power. This adage still holds amidst the property profession and the investment community they serve. A catalyst to this research was the 1991 Healey & Baker Award granted to the author by the UK property consultants to ‘pump-prime’ the research. The initial availability of research capital and resources was not an issue. The opening of clients’ professional files was another issue altogether. Confidentiality, if not paranoia, was the order of the day. The availability of any real data remained a significant issue until Australia’s largest property fund, AMP, became aware and interested in the developing research in 1995. This resulted in the opening of files by the valuation team in their capacity as the client. A workshop was established in Sydney over two days with all AMP retail/shopping centre valuers flying in from interstate to review and rebuild their appraisal models (the agenda for that workshop can be found in Appendix 1). To facilitate this meeting, full files/case studies on three AMP regional shopping centres were made available – on the proviso that they were not for wider publication, which precludes their explicit use within this thesis. The meeting, and the subsequent contact with the AMP shopping centre valuation team, served to consolidate understanding of the literature, establish a focus for the detailed ‘expert’ interviews, and serve as a catalyst to obtain support from other market players.

The researcher’s involvement with AMP followed an overseas study tour in March and April 1995 which incorporated ‘pilot’ interviews with property owners, investors, appraisers and academics in 4 US cities, London and Singapore (the learning outcomes are summarised in the overseas travel report, which comprises Appendix 2). This built on the researcher’s earlier UK experience and related shopping centre study tours in Helsinki, Finland and Berlin, Germany together with valuation study tours of France, Belgium, the Netherlands and New Zealand.

The literature (Chapter 2) surrounding the investment in regional shopping centres is diverse. It includes traditional and contemporary appraisal theory, retail theory and urban geography, land and regional economics, finance, depreciation and replacement theory. The most significant gap in the literature is that it is not, in many cases, forward looking. Much of the appraisal literature, particularly that related to shopping centres, errs on the historical. There is little interplay between risk, growth and depreciation as specific aspects of shopping centre appraisal. It is that knowledge gap that this thesis attempts to fill through the analysis of
empirical data from current property market players (the ‘experts’ in the qualitative analysis) and the resultant evolved conceptual frameworks.

Given the concern of ‘knowledge’ expressed above, it was decided to overcome the paucity of ‘real’ (non-marketing) data by undertaking a qualitative methodology (Chapter 3). This is a move away from the perceptually ‘safe’ collection of, often subjectively selected, data and associated quantitative analysis. It is a new, but proven, methodology for application to property investment related research.\(^{28}\) Conceptual frameworks (models) of the regional shopping centre process were developed from the literature and overseas pilot studies. The key influences in the investment appraisal of enclosed regional shopping centres are the owners (investors/fund managers) and valuers/appraisers. Developers, managers and architects augmented these ‘experts’, who each had active involvement in at least 3 regional shopping centres. Such is the nature of the ownership of the 72 regional (or larger) shopping centres in Australia, that often the same party filled up to four of the roles. In addition, most participants had a valuation qualification in their background. In addition, following the spirit of qualitative research, an analyst was incorporated for balance at the behest of one of the other respondents. The assistance and supportive participation of the ‘expert’ property market players is acknowledged (Appendix 3).

Of critical importance to facilitate open and honest discourse with the participants, confidentiality in respect of source and specific detail was a key issue. It is only within a framework of mutual respect and trust that worthy interviews can be undertaken. Confidentiality is fundamental in all social science qualitative research to protect the interests of both the interviewer and interviewees. It allows sensitive information to be discussed, safe in the knowledge that no one other than the researcher will ever have access to the transcripts of the interview. The confidentiality aspect was ensured through the use of the QSR NUD•IST™ qualitative analysis software.\(^{29}\) Such a programme enables the original interview transcripts to be analysed and the data presented in coherent manner which ensures anonymity for the specialist (‘expert’) who was interviewed.\(^{30}\) The analysis allowed the conceptual frameworks to be developed from the perceptual (based on the researchers synthesis of the literature) to the evolved (based on first hand commentary by ‘experts’). The

\(^{28}\) Turner (1995) \\
\(^{29}\) Qualitative Solutions and Research Pty. (1996) \\
\(^{30}\) Note: in a break from accepted social science qualitative research practice, a fully anonymous transcript of an interview with a valuer ‘expert’ appears in Appendix 9. This transcript was only included after the viva-voce examination to satisfy the requirements of the external examiners. Written permission was obtained from the valuer in question prior to its inclusion.
interviews were (with one exception) recorded, transcribed, coded and then analysed. The coding and analysis, together with the evolved frameworks and full summaries of the ‘owner’ and ‘valuer’ respondents comprises Chapter 4.

Conclusions drawn from the analysis (Chapter 5) highlight the actual understanding of the aspects of risk, growth and depreciation within the investment appraisal of enclosed regional shopping centres in Australia. Several key themes evolve, most significantly the misunderstanding over risk and yield terminology (despite a recent industry Practice Standard\cite{AIVLE1996}), the challenges of forecasting and the availability of information from the valuation profession.

1.5 Outline of the thesis

This thesis follows the Perry ‘5 Chapter’ approach.\cite{Perry} That is, it follows the progression of:

- Chapter 1: Introduction
- Chapter 2: Literature Review
- Chapter 3: Methodology
- Chapter 4: Analysis of Data
- Chapter 5: Conclusions and Implications

For clarity and convenience these 5 Chapters have been adopted, although they could be well described as sections. Each Chapter has been further broken down into sub-sections to guide the reader through the thesis. This is particularly relevant in the Literature Review and Analysis Chapters, where a large amount of information is presented. Where appropriate, diagrammatic representations of the hypotheses and analysis process have been provided.

The detailed references referred to in the footnotes can be found at the end of each chapter. A full bibliography can be found at the end of the thesis, along with the appendices.

\cite{AIVLE1996} AIVLE (1996)
1.6 Definitions

Throughout this thesis, terminology is explained when first introduced, so far as is possible. In order to avoid any initial confusion, the following definitions are offered.

**Investment** is the process of using capital to acquire an asset (in this case a shopping centre) which will, hopefully, produce an acceptable flow of income by way of rental from tenants together with an appreciation in the capital value of the asset over time.

**Appraisal** can be taken to have two distinct meanings within this thesis, following the Baum and Crosby definition. The term appraisal is broken down into two specific applications:

- **Valuation** being a prediction of the most likely selling price, quantified in currency terms; and,
- **Analysis** being an estimation of investment worth, quantified in currency terms as a net present value (NPV) or percentage terms as the internal rate of return (IRR) of an investment decision.

**Enclosed Shopping Centre** is taken to mean a regional, major regional or super regional shopping centre as defined by latest Building Owners and Managers of Australia definition. A more detailed explanation is given within the literature review (2.2) with full classification details in the appendices.

The primary sources of literature in this thesis come from Australia, the UK and the US. As a result there are some noticeable variations between words like centre (Aus & UK) and center (US), but this is not constant, and for example program (Aus and US) and programme (UK). There may also be variations within countries. As this thesis has been prepared in Australia, it includes fieldwork in Australia, the US and the UK, and is being submitted for assessment to an UK University, there is by implication some overlap in the phraseology.

Wherever possible the Australian definitions have been taken in order to explain a concept or

---

32 Perry (1995)
34 BOMA (1995)
approach (as with the principle of market value and highest and best use) or type (as with the definition of an enclosed shopping centre) as is expanded in the literature review (2.2 & 2.3).

Valuer. The Australian definition is adopted. The Australian ‘Valuer and Land Economist’ is synonymous with the ‘Appraiser’ (US) and General Practice Chartered Surveyor (UK). The terms are interchangeable within the context of this thesis. By way of further clarification, Trimboli defines a ‘Valuer’ as:

‘One who estimates value. A competent valuer is one who possesses ability to discover, classify and rate the separate influences which combine to create, sustain or destroy value and is therefore skilled in the technique of valuation. A real estate valuer has to be qualified and registered under the appropriate statute before he undertakes the valuation of real property.’

Gender issues: within this thesis the terms he/she and male/female are interchangeable, and are not intended to be gender specific unless used in relation to a reference.

All dollar amounts are in Australian Dollars unless otherwise stated in the text.

1.7 Delimitation’s of scope and key assumptions

The title of this doctoral thesis is ‘an analysis of the investment appraisal of enclosed regional shopping centres – an Australian perspective’. It therefore focuses on the 72 regional (or larger) shopping centres in Australia and those involved in their role as an investment. It is the product of several years’ research, which has seen the author living originally in the UK and more recently in Australia. There is, understandably, a resultant synthesis of appraisal philosophies between those two countries in the presentation of the thesis. Moreover, the influence of the US on the Australian regional shopping centre scene cannot be understated. Much of the relevant appraisal literature also comes from the US, as does some of the commentary from the researchers own pilot studies and interviews there during 1995.

In order to obtain depth in the analysis, only those industry players who had involvement in 3 or more regional shopping centres were included. Qualified involvement in at least three centres ensured that those ‘experts’ interviewed represented a breadth of understanding of the detailed issues involved in the process. Thus they were not relying on isolated or limited experience.

---

35 Trimboli (1979) p. 98.
This thesis does not attempt to provide a definitive spreadsheet solution for the investment appraisal of enclosed regional shopping centres. There are already several proprietary models commercially available. Moreover, there is a requirement on valuers (within Australia) to qualify the authorship/developer of any such models within their reports. The investment appraisal of enclosed regional shopping centres is enough of a ‘minefield’ without adding another spreadsheet which may ensnare the unwitting. More importantly, this thesis serves to highlight the nature of those snares and traps, so that others may, hopefully, realise their existence and incorporate them in their own future appraisal models. This thesis analyses the deeper framework from the perception of valuers and their (owner) clients, the processes and the future directions for this market sector.

The impact of differences in demographic potential of a trade area and the uncertainty of infrastructure improvements has not been addressed in the professional (i.e. appraisal) literature. The issue of demographics and urban geography is a huge area of research on its own account – it is beyond the scope of the current study.

1.8 Conclusion

This introductory chapter laid the foundations for the thesis. It introduced the research problem, research questions and hypotheses. Then the research was justified, definitions were presented, the methodology briefly described and justified, the thesis was outlined, and the limitations were given. On these foundations, the thesis can proceed with a detailed description of the research.

References: Chapter 1

Adams, S. (1776) Oration said to have been delivered at Philadelphia, 1 August 1776, cited in Oxford Dictionary of Quotations (3e) (1985), Oxford University Press.


Graaskamp, J.A. (1991) (ed. Jarchow, S.P.) Graaskamp on Real Estate, the Urban Land Institute,
Washington.


Trimboli, F. (ed.) (1979) A Glossary of Terms used in Real Estate and Valuation Practice(2e), The Real Estate Institute of Australia, Canberra.


Wood, E. (1977) Property and Building Appraisal in Uncertainty, Liverpool Polytechnic, Faculty of
Chapter 2

LITERATURE REVIEW

2.1 Introduction

In considering a quantitative methodology, the literature review process enables the researcher to identify the previous research and identify gaps in understanding.\(^{37}\) It also highlights the conceptual and theoretical frameworks that will feed back into the research findings. This chapter can be called research issues rather than literature review with equal validity.\(^{38}\) The dichotomy with grounded theory research is that rather than testing relationships amongst variables, the purpose is to discover categories and the relationships between them, grouping them in new rather than standard ways. The inference (after having worked through much of the literature) is that the history may cloud, or at least obscure, the discovery. There is a dilemma here in that an accusation could fall on the researcher for having his head in the sand and so be running the risk of reinventing the wheel. This is overcome in this research by using the literature as a background for creating models (conceptual frameworks) of what appear to be the important issues in the investment appraisal of enclosed regional shopping centres (Chapter 3). These models are subsequently tested through the analysis of empirical data and the conceptual frameworks are evolved through the experience and understanding of the ‘expert’ market players (Chapter 4). Thus the issues are looked at in new, rather than standard, ways and new categories, relationships and groupings become apparent.

The risk that history may ‘cloud the discovery’ is not perceived as a problem in the route adopted, given that the related literature identifies the gap in knowledge whilst painting an essential backdrop. What is important is not to be constrained by having to adhere to a previously developed theory that may or may not apply to the investment appraisal of enclosed shopping centres and, as will evolve, the relevance or otherwise of depreciation as the ‘gap’. Strauss and Corbin further contend that there is no need to review all the literature beforehand, because if the process works, new categories or theories will emerge that neither the researcher,


\(^{38}\) Perry (1995)
nor anyone else, will have thought about previously. Therefore, by way of introduction, this
literature review is now approached with the caveat that it will not constrain what follows it, and
thus will not be allowed to stifle further contribution to knowledge. The flow of the literature
review is presented diagrammatically in Figure 2.1

![Diagram of Literature Review](image)

**Figure 2-1: Literature Review**

Source: Boydell, developed for this research

The literature review broadly follows the headings outlined above, then flows into the
Depreciation Model (Figure 2.11).
2.2 Parent disciplines and classification models

In considering the literature review for ‘an analysis of the investment appraisal of enclosed shopping centres – an Australian perspective’ it is necessary to define and set a format for the aspects of investment, appraisal and enclosed shopping centres. The latter is addressed first to set the framework and context of enclosed shopping centres for all that follows.

2.2.1 Enclosed Shopping Centre

With the exception of Robina Town Centre\textsuperscript{39}, all Australian regional shopping centres have evolved through time. From humble beginnings as a supermarket and possibly a discount department store (DDS) certain centres have expanded, slowly maturing as an investment and providing a vehicle for asset allocation by the property trusts and superannuation funds who now own them. Regional shopping centres now represent multi-million dollar assets of financial, political and economic significance. They are familiar to all in the western world, but what sets them apart from the other prime property investment classes of office and industrial, is that they are evolving assets. They evolve over time and are a source for continued institutional investment, unlike offices, which are fully mature assets on the first day they open. This is a critical aspect that sets this research apart from previous work, particularly in the area of depreciation of office buildings.

The Urban Land Institute provides the accepted definition of the term shopping center as:

“A group of architecturally unified commercial establishments built on a site which is planned, developed, owned, and managed as an operating unit related in its location, size, and type of shops to the trade area that it serves. The unit provides on site parking in definite relationship to the types and total size of the stores.” \textsuperscript{40}

Given that this thesis was prepared in Australia (and as a result that is where the qualitative interviews are focussed), the Australian definition is taken. The main industry bodies which provide a business/professional forum for “shopping centres” are, within English speaking western society, The International Council of Shopping Centers (ICSC) based in New York, US, the British Council of Shopping Centres (BCSC) in Reading, UK and the Australian Council of Shopping Centres (ACSC) a subsidiary of the Building Owners and Managers Association of Australia (BOMA, now Property Council of Australia - PCA) based in Sydney, Australia.

\textsuperscript{39} Robina Town Centre located in the Gold Coast Hinterland of Queensland, on the eastern seaboard of Australia opened in 1996. It was conceived as a finished regional centre, albeit that it has inbuilt design to allow evolving peripheral expansion over time.

\textsuperscript{40} ULI – The Urban Land Institute (1977), p. 1.
The definitions for what actually comprises a regional, super regional or neighbourhood centre vary from country to country and hitherto in Australia from state to state. In order to establish a form of comparison, the most recent BOMA/PCA Shopping Centre Directories Classifications have been adopted.\textsuperscript{41} These definitions are employed in all BOMA Shopping Centre Directories’ post 1994. The revised system (1995) comprises six (6) core and three (3) specialist classifications. Core classifications appear in all BOMA directories. Specialist classifications are included in directories at the discretion of BOMA's local state or territory ACSC committee. ‘Core classifications’ comprise City Centres, Super Regional Centres, Major Regional Centres, Regional Centres, Sub-Regional Centres and Neighbourhood Centres. The ‘specialist classification’ includes Showroom-Warehouse Centres, Themed Centres and Markets. The classifications are set out in full in Appendix 4.

This thesis concentrates on centres classified as Regional or larger, i.e. it also embraces Major Regional and Super Regional Centres. As a base point, the Regional Centre definition is adopted:

\textbf{A.4. Regional Centres}

\textbf{Definition:}

A shopping centre typically incorporating one full line department store, a full line discount department store, one or more supermarkets and around 100 or more specialty shops. Total gross lettable area retail typically ranges between 30,000 and 50,000 square metres.

\textbf{Key features:}

\begin{itemize}
  \item extensive coverage of a broad range of retail needs (including specialised retail), however, not as exhaustive as major regional centres;
  \item contains a combination of full line department stores, full line discount department stores, supermarkets, banks, chain and other specialty retailers; and,
  \item provide a broad range of shopper facilities and amenities.
\end{itemize}

There is no database currently available which catalogues all centres in Australia, as membership of BOMA is voluntary and the data is owner provided. Additionally the information rapidly dates - a summary of the current BOMA data for regional, major regional and super regional shopping centres is included in Appendix 5. The situation is compounded in the US where there are currently 40,368 centres \textsuperscript{42}. The analysis of the BOMA data presented in Appendix 5 demonstrates significant inconsistencies in the timing of

\textsuperscript{41} BOMA Australia (1995)

\textsuperscript{42} National Research Bureau Shopping Center Database and Statistical Model (1995)
refurbishment and extensions to the 72 centres analysed. The researcher has to adopt a qualitative approach to investigate the rationale for such inconsistencies.

The research limits itself in the title to enclosed shopping centres, but a tighter focus is necessary for the purposes of progressing the research. The enclosed shopping centres in question can be limited to the BOMA Australia definition of Super-Regional, Major-Regional and Regional. This broadly falls in line with the US definitions of Regional Center and Superregional Center\textsuperscript{43} \textsuperscript{44} that are also detailed in Appendix 4.

What really differentiates the two markets (Australia cf. US) is the relative population density (17 million cf. 256 million, 1995) and the resultant number of traders in the market. It has been observed that in Australia, because of the relatively small size of the economy most industries only have one or two players and that holds true in department store retailing where there is only Myer/Grace and David Jones.\textsuperscript{45} There are only four shopping centres in Australia with more than one full-line department store whereas from the ICSC definitions, a Regional Center in the US must have at least two (a full line and a junior). In any given US market there can be up to six major players: Nordstrom, May Co., Federated, Macys, Sears, J.C. Penny.

As stated this research limits itself to the Australian BOMA definitions for Regional, Major Regional and Super Regional Shopping Centres. Within Australia, all such Regional (plus) centres are "enclosed" (i.e. sheltered from the weather) and air conditioned, with the exception of Pacific Fair and Robina Town Centre on the Gold Coast, and Penrith Plaza in New South Wales which have an open “high street” concept.

2.2.2 The Role of Shopping Centres in Strategic Property Portfolio Management

Within Australia, there is considerable hype of the retail markets by some of its leading proponents. To quote David Lowy, Managing Director of Westfield Holdings with extensive interests in Australia and the USA,

‘...well managed, major regional shopping centres are now being recognised for what they are, the best form of real estate investment and in fact, probably the best form of any investment.’

\begin{itemize}
\item \textsuperscript{43} ICSC (undated)
\item \textsuperscript{44} Note: this is the US spelling.
\item \textsuperscript{45} Lowy (1993), p. 7.
\end{itemize}
Indeed, while self interest is evident in such statements, for the market must promote the market, current statistical information supports it. The graphs (Figures 2-2, 2-3, 2-4 & 2-5) based on the BOMA database display how, based on their data, the retail sector has excelled in Australia over the last decade. It is challenging to attempt to draw trends in the Australian market from what has occurred in the UK and US over the past few years. From an investment viewpoint, the longer term forecast for the retail sector is critical.

If property is looked at in isolation, and the three indicators of Australian CBD Office, Australian Retail and the generic Composite Property are compared, Retail success is evident (Figure 2-2). Retail success was most evident in the post 1990 period.

![Total Return since Purchase (TRsP)](image)

**Figure 2-2: Total Return since Purchase**

Source: adapted from BOMA (1994)

Obviously, total return is dependent on the security of property yields coupled with increasing rents. Annual percentage growth in the retail sector has not been as volatile as the CBD
Office market, with associated impact on Composite Property (Figure 2-3).

### Capital Return

**Annual Percentage Growth**

![Graph showing annual percentage growth](source: BOMA)

**Figure 2-3: Capital Return**

Source: adapted from BOMA (1994)

It is important not to contrast property in isolation. If retail property (or the slice of the market in the BOMA statistics) is contrasted against the constantly revalued, and thus more volatile, Bond and All Ordinaries markets, the strength and smoothing of retail is evident (Figure 2-4). Retail property has performed well against these key indicators and excelled against Listed Property Trusts.

When the returns are annualised into percentage growth (TRoY), there is a noticeable lack of volatility in the retail market compared to the other sectors (Figure 2-5). Indeed, in the late 1980s, the retail property sector growth per annum was at its strongest, with the Australian All Ordinaries Index showing negative growth in 1987, 1990 and 1992.

Historically property (as a broad investment class, rather than shopping centres specifically) has justified its role as an investment medium.\(^{46}\) The institutional investment market is a

---

\(^{46}\) Boydell (1995b)
relatively small and homogeneous one, and has also become an industry where individual fund performance is widely monitored. The 1980s property boom and the subsequent collapse in the market which has seen the capital value of many property investments more than halve in real terms in the space of four years has caused a greater questioning of the traditional merits of property, namely:

- Property offers the potential for diversification against gilts and equities.
- Property is considered a long-term asset. This makes it a good long-term liabilities match, which is especially attractive for immature funds and long-term life funds.
- Property is believed to be an inflation ‘hedge’.
- Property forms a significant class of asset. As such, it requires serious consideration as part of a well-diversified portfolio.

![Total Return since Purchase (TRsP)](chart)

Figure 2-4: Total Return since Purchase

Source: adapted from BOMA (1994)
That property is perceived to be a long-term, low-risk investment with potential for portfolio diversification has been confirmed. In that research 86% of respondents considered the lack of short-term property volatility to be an advantage. The short-term volatility of property is in question however due to the nature of the asset and the infrequency of market sales, with the confusion that is often concealed behind annual asset valuations. Herein lies a potential dilemma and source of confusion when using statistical information based on BOMA data given that it is based on bonafide appraisals of investment worth prepared by valuers for their investment owner clients.

The situation remains that the weighted average proportion of assets in property has declined,
taking the UK example, from 23% in 1979 to an average of around 7% in 1992. The Australian market is currently considered to have, depending on the source adopted, around a 10% asset allocation in property. Many suggestions have been proffered as to the changing attitudes to property as an investment that have served to fuel this proportional asset class reduction. Several large pension (superannuation) funds - traditionally big investors in property - have had to make earlier than anticipated payouts because of workers being offered and accepting early retirement. Furthermore, many funds have become increasingly ‘mature’; that is, they have shown a greater inter-temporal balance between cash inflows and outflows because of changing population age structures. For these newly matured funds, short-term liquidity, rather than long-term liability matching has become an increasingly important consideration. Simultaneously, smaller pension funds have gained a greater share of the pension’s market. These smaller funds are less likely to invest directly in property because of high management costs and the difficulties of creating a sufficiently diversified property portfolio. This is supported by evidence that pension funds with assets greater than $2bn hold approximately 13.5% of their assets in property compared to a 5.5% proportion for funds with assets less than $500m.

It is relevant to dwell on these statistics. Taking the shopping centre example from above, if a fund was to have a modest level of diversity within Australia, to add a $200 million centre to five others in its portfolio (one in each state capital), and accounting for a 30% retail asset allocation within a 10% property allocation in the portfolio, the total fund would need to have assets over $40 billion (US definition). It is for this reason, given the scarcity of national investors with those resources, that shopping centres are commonly held in joint venture, or as is becoming more common, as Real Estate Investment Trusts (REITs) or Listed/Unlisted Property Trusts. Furthermore, funds with multi-billion assets cannot accept the rigidity of single nation investment, and would clearly seek to invest internationally, being global players.

Other factors contributing to the decline include:

- **Research and performance measurement.** A greater understanding of the performance characteristics of property leading to a heightened awareness of the implications of its relative illiquidity, in turn leading to increased caution and selectivity.

- **Market fluctuations.** Increased adoption of performance indicators has proved property

---

48 Sieracki (1992)
49 Debenham, Tewson & Chinnocks (1988)
to be less attractive in the short-term than equities, particularly as comparisons to equities exaggerated property’s poorer returns during the mid 1980s equities boom. While property outpaced equities in 1987 and 1988 many funds were still disinvesting because of their early 1980s performance. Those funds missed the benefits of the two years of the property boom, but being underweight, missed the problems that followed the collapse of the property market in 1990. Furthermore, after the equities market crash of 1987, pension funds were still reluctant to invest in property as the proportion of property by value had already risen in their shrunken portfolios. The astute fund managers are now addressing this situation - vulture funds can currently acquire prime investment property at less than replacement cost.50

- **Alternate opportunities.** Institutions can today choose from a far wider range of domestic and overseas investment vehicles than was the case 15 years ago.

- **Short-termism.** Increased emphasis on short-term measures of asset performance by institutional investors gives less weight to the long-term stability of returns which property has shown. Direct property holding is perceived as having a more limited role to play in meeting short-term targets due to its relative illiquidity, which is currently reinforced by an international oversupply of investment property.

- **International economic factors.** Coupled with the property market crash has been a world recession; the major international investors in property during the 1980s, North America, Japan and Scandinavia, have all faced major internal difficulties. This has led to new investors, such as China, picking up the potential winning of acquiring property while it is at a low. Similarly, within Australia, Hong Kong investors are particularly active given the post-1997 uncertainty of the Hong Kong market. Furthermore, in forecasting for any investment class, who could realistically have foreseen the ramifications that the 1990-91 Gulf War and the impact on a falling UK and US property market?

There is another fundamental area yet to be extensively addressed, or accepted, by the property investment industry - property wears out and depreciates which is in contrast to traditionally applied valuation methodology. The ‘wear’ is usually termed obsolescence and can be attributable to many factors. With this obsolescence comes a deterioration in rental values, or a lower proportional increase at rent review, coupled with an increasing yield as the lease covenant or tenant security deteriorate. These two factors produce a comparatively

---

50 Boydell (1995b)
lower capital value and a reducing total return figure, which is a fall in real value. In other words, property is prone to depreciation. Little, if anything, is done in practice to take explicit account of obsolescence and depreciation issues in the investment advice market. There are at least three reasons why this is so. First, there is a general confusion over the relationship of the terms depreciation and obsolescence (as is developed later). Secondly, most of the practitioners (be they appraisers, chartered surveyors or valuers) tendering property advice have been taught to capitalise an income flow in perpetuity. While arguably a naive practice, this is straightforward and well understood by the market. Thirdly, and perhaps what is most important, there is the fear of the market.

This ‘fear’ of the market is the paranoia, and isolation, that practitioners expose themselves to in stepping apart from the prevailing flock mentality. There are limited players in the market place, particularly for regional shopping centres, and there is a short-term risk in upsetting the players and the market in highlighting issues hitherto left unspoken. That risk manifests in potential lost fee income as professional work (annual portfolio valuation) is directed to competing practices in the short-term. There is also the risk of exposing that such issues have not previously been explicit in professional advice – thus opening the way to litigation for professional negligence.

Looking at the single asset life cycle is only a small, but important, part of the property strategy in a portfolio context. The portfolio context offers the key to the future of property as an investment class. It has been argued that the construction of hypothetical portfolios shows that a minimum of 20% allocation to property is necessary to maintain adequate diversification.\(^\text{51}\) \(^\text{52}\) The variety of risks attached to property within the framework of conventional investment theory were not necessarily sufficient explanations of its low weighting. Property is seen as a relatively low-risk investment that can help to diversify a portfolio to reduce total variability of returns without adversely affecting average returns.\(^\text{53}\) It has been suggested that a reasonably diversified portfolio would require a minimum of 20 to 30 properties but even this allocation is beyond the reach of all but the largest funds.\(^\text{54}\) Indeed as most funds hold less than 30 properties, they must, by implication, be poorly diversified. The result is that property-specific factors rather than merely market-wide factors influence

---

\(^\text{51}\) Sweeney (1988)
\(^\text{52}\) Richard Ellis (1990)
\(^\text{53}\) Howells & Rydin (1991)
\(^\text{54}\) MacGregor (1990)
the performance of the average ‘real’ portfolio. To diversify away specific (non-market) risk, a portfolio of some 200 properties would be required. This would mean that the portfolio would show systematic (market) risk only and it would be possible to track the market.

At a time when investing in property is being called into question, it is important to look for some means of measuring risk associated with property in an understandable and unambiguous way if any confidence in property investment is to be restored. Risk may be defined as ‘the chance of financial loss’ or more formally, ‘the variability of returns associated with a given asset’. By contrast, many property investors seem to think about risk in terms of the various sources of specific property risk, for example, tenant default, or the likelihood and possible duration of ‘voids’ between lettings.

The idea of Modern Portfolio Theory is not new, but it is relatively new in its application to property. The theory offers a valuable strategic tool as it tests the efficiency of investments in achieving the highest returns for each level of risk. Risk here is a measure of what is expected to happen in the future rather than what is happening now; thus, quantifiable risk is a measure of the expected return not being received. A model for portfolio strategy is set out in Figure 2-6.

In addressing shopping centres in particular, several merits become apparent. There is a strong sense of physical identity, as shopping centres are a significant landmark within urban environments. They afford a periodic cashflow, potentially tax-free proceeds from refinancing, equity build up through mortgage repayment, overall capital appreciation and potential inflation hedge. Their merit as a tax shelter is questionable. In US markets shopping centres have to be depreciated over a 31½ year life so unless an investor pays too much for a centre, the options for tax shelter are limited. In Australia, where centres are depreciated over 40 years, the opportunities are even more limited. Where the average life is likely to be 15 - 20 years, such depreciation allowances, founded on longer lasting office blocks are seemingly inconsistent.

55 Brown (1991)
56 Gitman (1987)
57 Markowitz (1952)
The risk of an individual centre is minimised by the anchor department store/s. Department store owners undertake extensive market research, and know which markets will support their stores. Indeed, because lending is rarely forthcoming without pre-commitment from anchor tenants, the unwarranted construction of shopping centres is substantially reduced. The ‘componentisation’ of anchors taking ‘pads’ to build their stores, be it as a lease, joint venture or sale and leaseback, is an ideal risk spread/reduction vehicle.

The risks in shopping centre investment can be separated into three stages of the life cycle: Planning and Construction, Operational and Termination/Sale. Attending to risk variables at the planning stage is fundamental to the long term future and success of the investment. Componentisation is fundamental. Location is critical, although ‘location, convenience and tenant mix’ now supersede ‘location, location, location’. Evaluating the demographic profile of the consumer, based on census and other forecasting tools allows centre growth to be targeted accurately. Inherent in that is market competition. This varies between say the US and Australia - in Australia there are only four shopping centres with more than one department store – as was highlighted above. In Australia you have Myer/Grace or David Jones. Obviously they are not likely to participate in schemes which would adversely prejudice their other stores. The US situation is more competitive with six major players: Nordstrom, May Co., Macys, Federated, J.C. Penny and Sears. Identifying correct capitalisation of the centre is essential as is establishing advantageous financing. During the ‘on-site’ construction period, the time frame, weather and labour variables must be accounted for. Due time must also be set aside for the obtaining of any statutory permits or licences and undertaking environmental impact studies.

At the operational stage, the correct estimation on time to lease up to 75%, then 90%, of the retail space is critical on the cash flow to offset debt funding. The lead-time before the overage element of the percentage rent is achieved has similar implications, but in that instance, for the tenants as well as the investor. Net leases minimise management risk as they ensure a relatively stable operating income stream for the owner/investor. Opportunities for refurbishment are a risk minimiser if properly addressed with due diligence over the reality of the centre’s life cycle. As mentioned elsewhere, such factors are sometimes overlooked in the appraisal and feasibility. Pro-active on site management and marketing should serve to minimise cash flow variances.

\[60\] Vernor & Rabianski (1993)

\[61\] Hines (1988)
At the termination/sale stage, timing is again the critical factor. This is the stage of yield optimisation that can be prejudiced by overlong marketing or seeking too much by way of sale price. The semantics are in question with the terminology. Graaskamp suggests that yield is the arithmetic relationship of outlays and receipts, and has nothing to do with risk.\textsuperscript{62} Purchaser finance is another risk - and disposal benefits may be lost or enhanced by the vendor offering finance options. The tax merits are also dependent on the position of the centre within its overall life cycle.

\begin{figure}
\centering
\includegraphics[width=\linewidth]{figure2-6.png}
\caption{Portfolio Strategy}
\end{figure}

Source: Boydell, in Boydell & Clayton (1993)

\textsuperscript{62} As cited by Graaskamp in Jarchow (1991) p. 352.
What can be observed from the returns outlined earlier, shopping centres are high risk investments which are therefore high yielding (albeit that this statement is in conflict with Graaskamp’s comments). In some circles this may misguidedly be construed as a high yielding advantage and abnormally high (above sector) returns are evidently currently achievable. Given their nature, few investors would hold a shopping centre in isolation as an investment. Their counter cyclicality or negative correlation is currently working to the advantage of the shopping centre. Within Australia, whilst many centres are currently valued at under replacement cost, there are prospects for capital growth as they operate in a market which is not overbuilt.\textsuperscript{63}

There remains an unduly large gap between theory and practice. The quantification of risk is still unrefined if not largely ignored by practitioners. In empirical research by Waldy, 77\% of fund managers questioned did not measure the risk attaching to either individual property or a property portfolio, and of the sample over 90\% did not measure risk specifically.\textsuperscript{64}

In considering macro (portfolio of holistic) risk, the function of modern portfolio theory is supported and gives a strategic guide regarding the properties to include within the portfolio - properties with low positive or high negative degrees of association. This supposition helps support the ‘role of property as an investment medium’ as property is negatively correlated to equities and gilts, so the inclusion of property within the general (total asset) portfolio will enhance returns while reducing risk.

However, it is not the purpose of this thesis to explain the inner workings of modern portfolio theory but rather to draw attention to it at a strategic level. Modern portfolio theory and the other areas of current thinking being applied to property - such as the capital asset pricing model and arbitrage pricing theory - all have their place in strategic property portfolio management. Regrettably, there remains practitioner discomfort of the available techniques, as with valuation and appraisal advancements towards a rational model, and this is not likely to impress outsiders as the decisions for regional shopping centres relate to assets worth tens, if not hundreds, of millions of dollars. Admittedly there is still a need to close the gap between theory and practice, and the value of intuition in property investment decision-making cannot be ignored. Chartered surveyors, valuers/land economists and appraisers continue to maintain an advantage over equity managers in building property portfolios. While the equity

\textsuperscript{63} Kelleher & Armytage (1993)
\textsuperscript{64} Waldy (1991)
manager could build a property portfolio concentrating on structure, the chartered surveyor or valuer could probably build the right structure, negotiate to find the ‘right’ properties, and then manage the investments on both macro and micro levels.

2.2.3 Forecasting (preamble)

Appraisers are in the business of forecasting or predicting the economic rent, hypothetical sale and probable selling price of a property. Ratcliff argues that this is not measurement, but rather economic forecasting under uncertainty. He goes on to suggest:

“It is an interesting scientific generalization that no prediction can be made in any field of knowledge, except on the basis of observations of past relevant behaviour.”

Within his analysis of contemporary regional shopping centre valuation in Australia, Gothard agrees that “the marketplace is, and always has been, the true source of the valuation solution”. The area of forecasting is fundamental to the advancement of valuation methodology and portfolio theory with respect to property and must be mentioned. As with indexation, forecasting relates to the collection and application of data. Clearly mere rental forecasting is not the only - nor the most important - goal of the analysis. Rather, it is total returns that are important to investor performance. Regional property markets do not exist as coherent entities and there is a need for forecasting at the local area level. This focus is fundamental to market knowledge and is the reason a local surveyor’s or valuer’s advice can result in positive abnormal returns.

Forecasting has received little formalised attention from Property Researchers. It is accepted, however, that all those involved in the investment world are engaged in forecasting in one form or another. The mere process of ‘discounting’ future income streams at a target or required rate of return is forecasting future performance. The move towards replacing conventional implicit all risks yield (cap rate) models with what some would see as “dangerously subjective explicit cash flow models” forces the valuer into what Baum and Crosby refer to as the hazardous science of forecasting. MacLeary and Nanthakumaran suggest that the paucity of research can be attributed to the traditional background of the

---

65 Ratcliff (1972a)
66 Gothard (1994) p. 236
67 McNamara (1991)
68 McNamara (1991) p. 64 & 75.
valuer/surveyor, which does not include knowledge of econometric modelling essential to the development of forecasting models. As a result, property professionals rely on forecasting advice from other sources – namely the analysts whose training is in econometrics, statistics and mathematics. The relative numeracy of the average valuer is open to question. Whilst much of the shopping centre related forecasting is based on Census information, such as the demographic projection based on Australian Bureau of Statistics (ABS) data by Jebb Holland Dimasi, Syntech, Ibecon, Econtec and others, there remains a lack of property specific data both in terms of quality and quantity.

If an investor has no forecasts, he or she will be completely ignorant of future movements in investment markets and will supposedly be unable to make any meaningful investment decisions. This may not be the case, as the investment strategy for an investor with no forecasting ability is relatively straightforward – follow the herd and construct a diversified portfolio which hopefully tracks the index. Hetherington argues that it is not necessary to predict exact levels when forecasting, but rather to identify turning points in the market. He cites the five basic indicators/variables of property performance measurement as:

- Yield;
- Rent;
- Rental Value;
- Capital Return; and
- Rate of Return.

However, Yield and Rental Value are taken as the most important as once they have been forecast the others can be calculated. There is a complex synergy between forecasts of market variables and forecasts of portfolio variables. Rental values and yields are supply and demand driven, in the truest sense of simple economics. However primarily the tenant influences the economics relating to the supply and demand of rental values, whereas the yields are investor driven with greater portfolio influence. It is acknowledged that rental values and yields can be forecast in the short-term (12 months) with a reasonable degree of accuracy but the margin of error (standard deviation) will be considerably higher thereafter. Reliable mid-term, or longer, forecasts do not exist and there is a tendency in property for valuers to rely on the past, or history, in order to make their projections.

---

The critical forecasts in the valuation models are those of rental growth, capital expenditure and reversionary capitalisation (which may, or may not, reflect a depreciation component dependent on the extent of capital expenditure accounted for). In simplistic terms, it is common for the valuer to adopt a simple straight line or variable rental growth. As suggested above this figure may be derived from census and planning data. As part of the due diligence process of undertaking local economic analysis in shopping centre appraisal, Vernor and Rabianski highlight the need to analyse forecasted population, employment and income data as well as marketability (sales) and property specific market data.73 Mitchell reinforces the need for the inclusion of a serious market study component in every major appraisal.74

Whilst not mentioned in much of the literature, retail sales data is essential to forecasting and is at the heart of all the income from a regional shopping centre. As Ramsey puts it:

“The economic situation of a major retail center is like a ship afloat in a sea of retail sales. As the sea rises and falls, so the ship of value floats up and down. Accordingly, an appraiser or analyst who navigates the ship without knowing the currents and eddies of the retail seas risks running aground on the shoals of weak analyses.”75

Contractual lease rentals are often out of date as a form of comparison and merely offer an historical perspective from which to build income forecasts. In contrast, retail sales are the most current measure of tenant performance, providing the valuer with advance warning of possible lease renewal or fluctuations in rental rates. This data is closely linked to tenant occupancy costs. An acceptable occupancy cost (rental income, plus overage, plus outgoings) is acknowledged in the range 10% - 12% of retail turnover.76 Occupancy costs above this level imply that the tenants return and thus landlords’ income stream, in the long-term, cannot be sustained. There is anecdotal market evidence which leaves this open to debate with occupancy costs for major Australian regional shopping centres cited in the range of 13% - 15% (mean 14½%) by retail commentators.77 Within the Australian market, such knowledge is (presumably) perceived as power and public published retail sales data is only available in abbreviated form within trust fund prospectus’. In contrast, within the US, such information is commercially available from the Urban Land Institute’s Dollars and Cents of Shopping Centers.

---

77 Unpublished market commentary by retail consultant for major Queensland regional shopping centre.
This section set out to consider the role of the shopping centre as an investment medium. It was done by considering some factors relating to the decline in property asset allocation, life cycle, introducing the concept of depreciation and obsolescence (which will be developed further) and appraisal issues, together with modern portfolio theories at the strategic level. In summarising this section, it had been established that property as an investment sector and regional shopping centres as an asset class have a continuing part to play in the institutional investor's portfolio. Property has strategic, tactical and portfolio diversification roles. New ‘global’ and ‘futures’ opportunities are available. Within this it is important to qualify how the property asset allocation should be split. Taking again the BOMA statistics, the optimal (property) portfolio mix between 1985 and 1990 would be CBD Offices, whereas, if one were to continue through from 1985 - 1994 the optimal would be weighted towards the retail sector.

Perhaps it is fair to say that it is not property that has problems as an asset class, but the problem lies with our expectations of an asset, be it property or gilts or equities. Over the last decade our society has changed significantly because of advancing technology and shifting philosophies. Consumerism and short-termism are very much at odds with the savings mentality of our forebears. Property is a commodity that is currently out of step with today’s short-term investment aspirations. All investors are confronted with confusing indexation results and relative performance indicators. There is a human need to invest shrewdly, with heavy emphasis on current investment returns. However, for many, the cashing in of an investment or benefit from a pension may be many years in the future, and the knowledge of the investment’s long-term security must implicitly be more important than last year’s returns.

Property, and the shopping centre market in particular, is likely to be in for a difficult few years. Greater awareness of depreciation, obsolescence and sick buildings syndrome will undoubtedly cause a tremor to run through the market until valuers come to terms with the valuation and management tools available to deal with the issues. Property research and forecasting are still in their infancy and will, no doubt, develop rapidly over the coming decade; the resultant knowledge base will serve to restore investor confidence in the asset.

The current world recession, low cyclical level and over-supply offer potential opportunities for the risk-takers to achieve abnormal positive returns in the short-term. By their nature, pension funds are not high-risk opportunists; moreover, they are more concerned with tracking the market. Once the importance of last year’s returns or relative fund performance
is exposed and the investor acknowledges the greater importance of funds being available in the future when they are needed to pay an individual’s insurance or pension, the case for property will be restored.

Property remains a long-term investment and that endurance is fundamental to its role as an investment medium. Whether ‘Well managed major regional shopping centres are and will continue to be the best form of long-term estate investment’ to again cite David Lowy, is not, perhaps, as certain.

2.3 Appraisal

2.3.1 Concepts of Appraisal

The thesis centres around relative understanding of the term appraisal and, indeed, the term is discussed more fully as the literature review progresses for it is a source of much confusion in the market.

Whilst appraisal has been defined as “the answer to a question about a real property interest – where the number of possible questions is myriad”, appraisal can be taken to have two distinct meanings within this thesis.\(^7\) The term appraisal is broken down into two specific applications:

**Valuation** being a prediction of the most likely selling price, quantified in currency terms; and,

**Analysis** being an estimation of investment worth, quantified in currency terms as a net present value (NPV) or percentage terms as the internal rate of return (IRR) of an investment decision.

Having thus determined the parameters of the title to focus on the valuation and analysis of regional and super regional enclosed shopping centres, primarily within Australia, the areas can be explored in more detail. There has been much written on valuation/appraisal, investment, and shopping centres in isolation, but little has been done to draw the issues together and apply contemporary thinking on appraisal, investment, ownership and life-cycle

---


issues. The prime text references which link shopping centres and valuation appraisal (Vernor & Rabianski (1993); Hines (1988); Jefferies (1990); and Garrett et al. (1976)) all take a current practice approach. Notably, the text by Vernor and Rabianski was prepared for and published by the Appraisal Institute (as was Garrett albeit to an earlier audience) and similarly Jefferies by the New Zealand Institute of Valuers. Within this is an interesting consideration on the role of a valuer/appraiser. The valuer/appraiser has to operate within a clear set of practitioner guidelines determined by their overseeing professional body in the country of practice. Within Australia it is the Australian Institute of Valuers and Land Economists (AIVLE) whose members carry the designation AVLE (Val) or fellowship FVLE (Val) determining them as valuers as opposed to economists AVLE (Econ)/FVLE (Econ). Some share joint designation e.g. FVLE (Val & Econ) for both streams. In the US, the Appraisal Institute members carry the designation MAI (member of the Appraisal Institute). In the UK, the major overseeing professional body is the Royal Institution of Chartered Surveyors (RICS) whose members carry the designation FRICS for fellow or ARICS for associate membership. Within the UK there is also the recognised Incorporated Society of Valuers and Auctioneers (ISVA) whose members carry the designation FSVA or ASVA for fellow or associate respectively. The situation is further complicated in the UK because the Chartered Surveyor undertaking valuations/appraisals of shopping centres in the context of this thesis would be a member of the general practice (GP) division, and a GP Chartered Surveyor has a far wider advisory role than his American or Australian counterparts. Within Australia it is the norm in the shopping centre arena for lessors to prohibit, or actively discourage, lessees from seeking independent professional advice and negotiating assistance at lease renewal, for example. As such, Australian tenants are largely under-represented. The narrow definition of the Australian AIVLE member is recognised by the institute by the proposal to change the name to the Australian Property Institute (API) in 1998.

It is contended that the Australian valuer and the American appraiser are by the constitutions of their professional associations forced to take somewhat of an historical approach to valuation, to generalise, basing their advice on past transactions or historical ‘comparable’ data. This is further compounded by the descriptive and/or demonstrative approach to real estate/property education imposed on the university system by the Appraisal Institute, AIVLE and RICS in their respective countries. It is left to their investment/analyst colleagues to undertake the ‘futures’ approach based on forecasting and forecasting.

econometric/statistical demographic data and the position of the investment within the portfolio.\textsuperscript{82} Their UK counterparts, whilst having greater flexibility as to the nature of their professional advice, tend also to fall very much into two camps, dependent on their role (albeit within the same company) as valuer or investment property portfolio adviser. It will be argued that this separation should not exist, for as has been defined above, the term appraisal in the title serves to incorporate both valuation and analysis. Vernor and Rabianski define real estate appraisal as applied urban land economics, which serves to reinforce this view.\textsuperscript{83} As the assets in question, regional and super regional enclosed shopping centres, are often worth several hundred million dollars, an historical perspective cannot be taken in isolation. There is a need to combine the practice/historical approach of the valuer and link it to the futures role of the analyst within a framework of rational approaches as purported by, for example, Baum & Crosby.\textsuperscript{84}

2.3.2 Market Value

In considering the need for the investment appraisal of enclosed shopping centres, Hines\textsuperscript{85} seemingly overlooks the annual (or periodic) ‘book valuation’ required by superannuation funds and summarises the most frequent reasons for shopping centre valuation as

- centre financing or refinancing
- property tax assessment or reassessment
- distribution of the assets of an estate
- condemnation\textsuperscript{86} of property and payment of fair market value
- leases subject to periodic appraisal
- hazard insurance coverage
- purchase or sale of a centre

contending that the valuation approach tends to be different for each of these appraisal purposes. This list is more concise than other definitions for value as the present worth of future benefits arising out of ownership to typical users and investors, defining value in up to forty-one categories.\textsuperscript{87} The Australian Institute of Valuers and Land Economists has adopted

\begin{itemize}
  \item This view was reinforced in discussions with Perry Sudduth, Director of JLR New York.
  \item American terminology meaning ‘compulsory acquisition in UK parlance.
  \item Trimboli (1979) pp. 95 – 97.
\end{itemize}
The International Assets Valuation Standards Committee definition\(^88\) of *Market Value*: Market value is the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arms’ length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

This will be taken as the benchmark definition of market value and is close in principle to the US Appraisal Institute's definition.\(^89\) Ratcliff’s\(^90\) consideration of market value is summarised in Figure 2-7. Ratcliff argues that no single price is a certainty given that the market is in a state of constant flux. For this reason appraisals should include a range of values together with a qualification of probability.

![Figure 2-7: Market Value](image)

Source: adapted for this research from Ratcliff (1972)

Placing a ‘neat’ definition on market value is a trap of a totally linear appraisal worldview that needs to be broken.\(^91\) The use of a single ‘market value’ estimate is to ignore market risk, or moreover, relative risks. Kinnard raises the question “*Market Value of What?*” and draws out the need to separate ‘business value’ from ‘real estate value’. He argues that the market value

---


\(^90\) Ratcliff (1972) pp. 10 – 14.

definitions are satisfactory in a ‘typical’ situation where the purchaser is a passive investor who retains a good manager. However, where the purchaser is an unusually successful and credible business entity, some value other than ‘market value’ should be the focus of the appraisal.\textsuperscript{92}

This introduces some of the forty-one concepts referred above, but focuses particularly on \textit{use value} (business value or going concern value) and importantly \textit{investment value}. Investment value in this context is defined as:

\textbf{The specific value of an investment to a particular investor or class of investors based on individual investment requirements, as distinguished from market value, which is impersonal and detached.}

This investment value is the asset value that is significant to insurance companies and superannuation funds for three main reasons:\textsuperscript{93}

- the ability of the company to declare a bonus for long term policy holders;
- shareholder impact by influencing net asset value and share value for non-mutual funds; and,
- they affect the solvency of the insurance company.

This leads into the actuarial area and the actuarial valuation methodology of discounted cash flow, discontinuance and smoothed market value (an average over the last five years adjusted for inflation).

An area that is patently unclear for appraisers/valuers, is how to discriminate the added entrepreneurial value in their determination on market value. Whilst the terminology ‘entrepreneurial’ can be confrontational\textsuperscript{94} it is an important issue to which Kinnard\textsuperscript{95} repeatedly refers. How is a valuer to discriminate the business value (or entrepreneurial value) resulting from the cachet of ownership/operation where market leaders generate above-market sales, revenues and rentals (and thus higher ‘value’) because the owner/operator is who they are? The argument follows that any above-market dollar return or rate of return to an operating property should be capitalised into business value rather than real estate value. It is accepted that shopping centres require intensive management and high levels of operational entrepreneurial input to maintain business viability as well as maintaining/enhancing the market value of the real estate. Without this ongoing ‘effort’ the total ‘property’ will be worth significantly less. From a taxation view, Beebe quotes case law that concludes that should the

\textsuperscript{92} Kinnard (1990)

\textsuperscript{93} Crosby et al (1993) pp. 54 – 58.

\textsuperscript{94} Boydell & Shortt (1993)

\textsuperscript{95} Kinnard (1990)
owner prove higher rents resulting from business skill, then the excess income above the economic rent could be discounted as an expense.⁹⁶

The debate concerning economic versus contractual (as determined by the lease) rent is challenging. It is not uncommon for below market rents to be paid (for business or entrepreneurial reasons) by flagship or anchor tenants. This is contentious from a taxation point of view where propensity to produce income at market level may be the basis. However, an owner might rightly suggest that the contractual (below market) rent is the source of income. There are precedents in the US literature,⁹⁷ which support tax assessors to upwardly adjust rentals to ‘market level’ on the basis that the value of a property is determined on its propensity to produce income without regard to the owner’s business acumen. Implicitly, once the ‘market’ is understood from a synthesis of the data and statistics the value could be determined without regard to actual facts. The reality is that the contract rent cannot be totally disregarded. Additional US case law is cited by Gossett⁹⁸ suggesting that actual (contractual) rents should be utilised when the income approach is adopted unless there is evidence of bad management in the subject shopping centre.

Cotterell touches on the same theme, but focuses on the overage component of a turnover lease as opposed to the entrepreneurial aspect.⁹⁹ Ability to produce overage, or percentage, rent is attributable to the business skills of the landlord and/or the tenant. Whilst it is acknowledged that successful shopping centre appraisal depends on an understanding of the inner workings of the retail industry,¹⁰⁰ the appraisal literature, in general, overlooks this aspect.

Macrae considers the determination of ‘market’ rental values under Australian legislation.¹⁰¹ State Acts have been established to deal with the contentious retail lease issue. Taking the Queensland example (Retail Shop Leases Act, Queensland, 1994) section 29 directs Specialist Retail Valuers to determine the rent assuming the shop is unoccupied and available for existing (or similar) use, on a gross rent (less lessor’s outgoings) basis, and on an effective rent

---

⁹⁸ Gossett (1984)
⁹⁹ Cotterell (1991)
¹⁰⁰ Gelbutch (1989)
¹⁰¹ Macrae (1996)
basis. Confidentiality clauses are commonplace in such leases.

Tenants ability to pay is, ultimately, the critical determinant of market rental. Ramsey’s comments on occupancy cost ratios were introduced earlier. Millington develops the concept of economic rent as a business surplus. This concords with the view that a mall must be run as a business rather than a passive real estate investment. The basis is the amount that a retailer anticipates that it can afford to pay using the following formula:

\[
\text{Anticipated gross takings from the business} - \text{Cost of purchasing stock} - \text{Trading expenses} - \text{Allowances for:} \\
\quad \text{interest on capital employed;} \\
\quad \text{labour and experience of the retailer; and,} \\
\quad \text{risk attached to the business} - \text{Equals} \\
\text{Balance available to pay the costs of property occupation} (\text{Rent plus outgoings i.e. Occupancy Costs})
\]

Value perceptions of investors are influenced by the initial value perceptions of the retailers – the potential users of retail property. Percentage (or turnover) rents add to this influence given that the landlords obtain ‘insider information’ (to use Millington’s phrase) of the retailer’s business. Such information allows the landlord to press the tenant for the maximum possible rental within the accepted model of occupancy cost ratios. Landlords do, however, expect rentals to increase annually in order to reach performance return targets, irrespective of the economic trading conditions. Fisher and Lentz studied 3 regional malls over a three-year period and from that compared 42 lease renewals with 59 new tenancies. They found that sitting tenants paid 13.6% higher rents than new tenants and from that, argue that this substantially supports the concept of business value in regional shopping centres. As a result,

---

103 Nunnink (1993) p. 27.
104 Kenney (1991)
105 Adapted from Millington (1996)
it is easy for the appraiser to naively include business value into the valuation of regional shopping centres by (possibly) incorrectly capitalising the ‘business’ element.\textsuperscript{107}

Concerns are also raised by Beebe\textsuperscript{108} and Gossett\textsuperscript{109} over the issues of: onsale of services (e.g. electricity\textsuperscript{110}) to the tenants by the landlord; handling of tenant finishes if the lease has them revert to the landlord on expiry; offsite improvements such as access roads, bridges, drainage and headworks which may be a condition of planning consent; and, collateral estoppel relating to benevolent (or otherwise) financing arrangements. On the issue of tenant finishes, Macrae\textsuperscript{111} argues that most tenants will end up paying substantial premium rentals to reflect the special value of their fittings, rather than face the costs inherent in non-renewal of the lease. Most landlords will succumb to exercising this ‘market’ power over their tenants to enhance the cash flow projections and then utilise the evidence as reflective of the market in other tenancies.

It is worthy of note that individual stores (e.g. specialties) are not zoned for rent in Australia for valuation purposes (in contrast to the U.K. practice).\textsuperscript{112}\textsuperscript{113}

2.3.3 The Three Approaches?

Meanwhile, Hines\textsuperscript{114} cites the use of ‘the three approaches to appraised value’ that is:

- (1) the cost approach,
- (2) the market (or sales) comparison approach, and
- (3) the income (capitalization) approach.

Vernor and Rabianski reaffirm these approaches as the US norm.\textsuperscript{115} Some (Jefferies\textsuperscript{116}; Fraser

\textsuperscript{107}Kinnard (1990)
\textsuperscript{108}Beebe (1988)
\textsuperscript{109}Gossett (1984)
\textsuperscript{110}Note: some Australian States, e.g. South Australia and Victoria, forbid the onsale of electricity.
\textsuperscript{111}Macrae (1996) p. 334.
\textsuperscript{112}see Hopper (1987)
\textsuperscript{113}Note: the concept of rental ‘zoning’ is a differentiation in rental value between retail space at the front (street end) of a shop and that towards the rear. A notional ‘halving’ of rental value every 6 metres (or similar) back from street line is adopted.
\textsuperscript{114}Hines (1988) p. 255.
\textsuperscript{115}Vernor & Rabianski (1993)
& Worzala\textsuperscript{117} dispel the first two as inappropriate concentrating on an income capitalisation approach as the only appropriate method. Hines\textsuperscript{118} considers the valuation of a property for investment purposes (the annual/half or quarter yearly analysis undertaken by superannuation and insurance companies of their portfolio assets) separately in order to introduce the concept of due diligence which is developed into an introduction to,

- (4) the ten year discounted cash flow (DCF) model.

However, this is only an explicit advancement of (3) the income (capitalization) approach. The due diligence process (according to Hines) is the investment valuation of property for either its impending purchase or sale.

The UK reader may find this perhaps a little confusing as introductory valuation texts in the UK (Enever\textsuperscript{119}, Richmond\textsuperscript{120}, Millington\textsuperscript{121}, and Britton et al.\textsuperscript{122}) all make reference to the five standard recognised methods of valuation:

- the comparative (or direct capital comparison) method;
- the investment method;
- the profits (or accounts) method;\textsuperscript{123}
- the residual method; and,
- the contractor's (or depreciated reinstatement cost) method.

Indeed, Millington also advocates a sixth as the mortgage equity approach. Within Australia, the UK residual method is incorporated in the In-Globo (or En-Globo) hypothetical development value approach. The Australian (and thus US) approach will be adopted where applicable in the hope of minimising any confusion that global comparisons may cause.

\textsuperscript{117} Fraser & Worzala (1993) p. 240.
\textsuperscript{119} Enever (1989) Ch. 5, pp. 61 - 64.
\textsuperscript{120} Richmond (1985) Ch. 7, pp. 123 – 132.
\textsuperscript{121} Millington (1988) Ch. 13, pp. 71 – 84.
\textsuperscript{122} Britton et al. (1989) Ch. 2, pp. 13 – 19.
\textsuperscript{123} Millington (1996) puts a case for the adoption of the “Profits Method” for shopping centres on the basis of their monopoly position and general lack of worthy comparable rental evidence.
2.3.4 Highest & Best Use Analysis

A critical aspect within the market value approach in Australia and the US is the principle of Highest and Best Use (HBU), an axiom that views land as a commodity and assumes the best use to be the one which maximises returns to the private sector.\(^{124}\)\(^{125}\) It was first expressed in the now famous regional and spatial economics writings of Johann von Thünen.\(^{126}\) Within Australia, the principle first gained notoriety and thus became established practice through the *Spencer Case*\(^{127}\) (*Spencer v. The Commonwealth of Australia (1907)*)\(^{128}\) which also set out the principle of market value until the AIVLE definition was accepted. Highest and best use is clearly defined by Trimboli\(^{129}\) as:

"The most profitable likely use to which a property can be put. The opinion of such use may be based on the highest and most profitable continuous use to which the property is adapted and needed, or likely to be in demand in the reasonably near future having taken into consideration zoning regulations. However, elements affecting value which depend upon events or a combination of circumstances which, while within the realm of possibility are not fairly shown to be reasonably probable should be excluded from consideration. Also, if the intended use is dependent on an uncertain act of another person, the intention cannot be considered. The use of land which may reasonably be expected to produce the greatest net return to land over a given period of time. That legal use which will yield to land the highest present value. Sometimes called optimum use. The use of, or programme of utilisation of, a site which will produce the maximum net land returns in the future, although such returns need not be in dollar amounts, eg social welfare buildings, schools etc. The optimum use for a site."

Within the US, alternate models emphasising different constraints to HBU have been proffered as whilst it is touted as the central concept of valuation, it has been an ambiguously defined concept premised on an appraiser's judgement.\(^{130}\) It is also considered to be a market-driven concept.\(^{131}\) This is further developed into concerns over the appropriateness of considering HBU from a macro or micro viewpoint, or from an urban land economics or appraisal consideration of land use problems.\(^{132}\) The dichotomy between appraisers and land economists is notably found in the valuation approach adopted by superannuation/insurance funds compared to that of their fee appraisers. In criticising HBU, Graaskamp observed that

\(^{124}\) Graaskamp (1978) p. 6.

\(^{125}\) Dotzour et al. (1990)


\(^{128}\) Rost & Collins (1984) p. 36.

\(^{129}\) Trimboli (1987) p. 46.

\(^{130}\) Grissom & Liu (1993) p. 86.


the term ‘highest’ implies a range of price conclusions from low to high to higher to highest, but has a conclusion presented in a single number.\footnote{Graaskamp (1978) p. 5.} The implication from this is that if the assumptions are irrelevant to the typical objective of analysis, a conclusion based on these assumptions will be relatively useless for the purpose intended. Graaskamps ‘most fitting use’ (MFU) macro-level model and Kinnards ‘most probable use’ (MPU) site-specific micro-level model whose concepts were summarised by Ratcliff proffered the main advancements into HBU.\footnote{Ratcliff (1972) p. 69.}

There seems to be little doubt that most investors optimise or satisfy and that few of them rely on the single classical criteria of maximising net income. To the extent that this is true, the ‘highest and best use’ determined by a maximisation of net income is an unrealistic concept because it does not reflect actual human behaviour. Actual decisions are complex, but the primary skill of the appraiser is to predict human behaviour in terms of the probable outcome. The ‘highest and best use’ thus becomes the ‘most probable use’ and the prediction of market behaviour in general, for whatever purpose, must be founded on the manner in which real people arrive at decisions rather than the unreal assumption of the single minimisation test.

Graaskamp defined MFU and MPU as follows:\footnote{Graaskamp (1978) p. 7.}

The most fitting use is the use that is the optimal reconciliation of effective consumer demand, the cost of production, and the fiscal environmental impact on third parties within physical capabilities of the land. Reconciliation involves financial impact analysis of ‘who pays’ and ‘who benefits’.

The most probable use is something less than the most fitting use depending upon topical constraints imposed by current political factors, the state of real estate technology, and the short term solvency pressures on consumer, producer or public agency.

In considering a potential regional shopping centre site, the analyst can eliminate the clearly inappropriate alternative uses to focus on the two or three which merit further scrutiny.\footnote{Vernor & Rabianski (1993) pp. 162 – 163.}

Input is required from each of the ‘three approaches to value’ in order to undertake highest and best use analysis, just as each approach requires some information from the others. Vernor and Rabianski argue this as a source of confusion for the inexperienced appraiser in that the HBU analysis is traditionally found before the discourse on valuation approaches within MAI format reports. They identify the problem within shopping centre valuation as many of the estimates required to undertake HBU analysis will be beyond the ‘typical’ appraiser’s expertise such as the situation where an office building is being considered as a possible alternative to a shopping centre development. To undertake such an HBU, a full appreciation of office markets, demands and values would be a pre-requisite. The need to test...
the range of alternate uses and alternate buyers throughout the appraisal process allowing a
compative study of functional risk (property dysfunction) is reinforced.\textsuperscript{137} Supporting this,
cost approaches are considered especially helpful in identifying returns to the capital
vestment of buildings and land with the residual representing the developer's return for
entrepreneurial risk; the income approach identifies the residual income from alternate uses;
and, market reward for site assembly and construction will be clarified by the sales comparison
approach. The 'three approaches' are all interrelated as each involves the gathering and
alysis of sales, cost, and income data that pertain to the property being appraised.\textsuperscript{138} It is
recognised that one or more of the approaches may have greater significance in a specific
assignment.

Within regional shopping centres the highest and best use may often be realised by
merchandising the centre – changing the tenant mix. The analysis can only undertaken
where retail sales data is available.\textsuperscript{139}

2.3.5 The market (sales) comparison approach to value

Comparison is the cornerstone of valuation and is the basis of all value judgements.\textsuperscript{140} The
need to make comparisons is the essential ingredient in arriving at a market view.\textsuperscript{141} A
systematic, five-step procedure\textsuperscript{142} for applying the sales comparison approach involves:

- 1) researching the market for data on comparable properties;
- 2) verifying the accuracy of the transactions and confirming them to be at 'arm's
  length';
- 3) determining relevant units of comparison;
- 4) comparing the subject with the comparables and varying the comparables for
differences; and,
- 5) reconciling the multiple value indications if not a single value or range of values.

\textsuperscript{137} Rams (1976) p. 382.
\textsuperscript{138} American Institute of Real Estate Appraisers (1987) p. 62.
\textsuperscript{139} Ramsey (1994) p. 501.
\textsuperscript{140} Enever (1989) p. 64.
\textsuperscript{141} Britton et al. (1989) p. 13.
\textsuperscript{142} American Institute of Real Estate Appraisers (1989) p. 340.
The sales comparison approach is an accepted methodology for single residential properties for owner occupation, but its limited application to enclosed shopping centres is realised.  

Beebe argues that market sales remain extremely persuasive evidence of value. Macrae argues that no two centres are in real terms comparable given age differentials, design, location, access, demographics, competition, growth, anchor tenants, leasing expertise and management issues. This view is supported by Millington who refers to the valuer’s ‘love affair with the comparable’, arguing that a valuation made today should represent the value based on income expectations of the immediate and more distant future whereas ‘comparables’ are indicative of what has happened in the past. In considering comparable investment sales of enclosed shopping centres, the market is not geographically limited to the local retail trade area, but instead relates to comparable centres regionally or more likely nationally, as investors in this asset class operate at a national and global level. Major retail centres are, in effect, quasi-monopolies. It is impractical to obtain comparable sales data within the same locale. This view serves to contradict McNamara’s opinion, raised earlier, that regional property markets do not exist as coherent entities. In considering operating expenses, averages from a national cross section are the essential unit of comparison rather than from a limited collection of successful or unsuccessful schemes.

It is usual to compare sales price per square foot (US) or square metre (Australia) against net operating income (NOI) of the gross lettable (leaseable) area (GLA) and infer the results based on the comparables to the subject property. These are considered in conjunction with comparative age, size, condition, refurbishment/extensions, catchment, percentage anchored, percentage vacant, sale price and date of sale, competition, parking, expense ratio, unimproved value, financing terms, upside potential and any other relevant characteristics which come to light from the evidence or special situation of the comparables or subject centre. This process of comparison is adopted within all ‘three approaches’ but the way the evidence is used in each does differ.

148 McNamara (1991)
149 The term ‘unimproved value’ is not known in the UK. Unimproved Capital Value of land is defined as ‘the capital sum which the land, if it were held in an estate in fee simple unencumbered by any lease, mortgage or other charge thereto might in ordinary circumstances be expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a bona fide seller might be expected to require and assuming that the improvements (if any) had not been made’ Trimboli (1979) p. 94.
The sales comparison approach is viewed by many as the most important for general (or rather residential) appraisal, but also the most difficult and subjective as no two properties are the same.\textsuperscript{150} Shopping centres, particularly, rarely have sufficient comparability without considerable adjustment.\textsuperscript{151, 152} For this reason it is dispelled by Jefferies as impractical because of the differences in physical attributes, lease terms and trading potential - even if a sufficient number of shopping centre sales were available.\textsuperscript{153} Hines advocates the method’s suitability as a land value comparison and also to determine a suitable gross income multiplier (GIM) for the subject property.\textsuperscript{154} To overcome the subjectivity of the appraisers "gut feeling" and the dissimilarities of schemes, Quality Pointscore (a form of price-quality regression) has been advocated together with other commercial computer regression models, although these have not been applied to shopping centres.

The position of the centre within its life cycle (developed in the consideration of depreciation below) is seen by some as significant.\textsuperscript{155} Problems have arisen when adjustments have erroneously been made on an assumed life cycle of 40 - 50 years when 10 - 15 years is more realistic.

Although the comparative, or market data approach, is usually not attempted the market data from shopping centre sales remains vital and it is not possible to undertake a good appraisal without this data.\textsuperscript{156} The overall rate (dollar sales capital per square metre or per square foot) is considered one of the most important items of comparison, the accuracy of which is dependent on the depth of market information known of the sale, such as the mortgage interest rate in US examples where traditionally in smaller schemes the mortgage is often assumed by the purchaser. In this case, an old mortgage may be fixed to a beneficial low interest allowing for a correspondingly lower overall rate to achieve a comparable yield.

\textsuperscript{150} Fraser & Worzala (1993) p. 241.
\textsuperscript{151} Garrett et al. (1976) p. 16.
\textsuperscript{152} Butcher (1994) p. 331.
\textsuperscript{154} Hines (1988) p. 262.
\textsuperscript{155} Kinnard (1990); Boydell (1995a)
\textsuperscript{156} Garrett et al. (1976)
2.3.6 The cost approach to value

The cost approach to value is based on comparison, like the sales comparison (or market data) and income capitalisation approaches.\(^{157}\) Trimboli\(^{158}\) defines it as:

That approach in valuation analysis which is based on the proposition that the prudent purchaser would pay us more than the cost of producing a substitute property with the same utility as the subject property. It is particularly applicable when the property being valued involves relatively new improvements which represent the highest and best use for the land or when unique or specialised improvements are erected on the site and for which there exists no comparable properties on the market.

Within Australia this approach is often known as \textit{summation}\(^{159}\) meaning an addition of the values of the constituent parts of a property to arrive at its total value. A clearer explanation\(^{160}\) is that the cost approach to value states the value of a property to be roughly equal to (1) the cost of reproducing the improvements plus (2) the cost of the land, minus (3) a figure that approximates the amount of value of those improvements that has been used up in the course of its life. Or more concisely, the value is the market value of the land plus reproduction costs of the improvements thereon less accrued depreciation. Whilst this definition is relatively straightforward its application can be very controversial in that it raises many questions (and perhaps subjectivity) over anticipation, substitution, change, varying returns, life expectancy and highest and best use. Wurtzebach & Miles proffer a five-step methodology to the cost approach to value:

- 1) estimate cost to reproduce the existing improvements using today’s materials and construction techniques;
- 2) estimate the dollar amount of accrued depreciation during the life of the existing improvements;
- 3) accrued depreciation is deducted from the reproduction costs (1) to indicate the depreciated replacement value of the improvements;
- 4) the estimated value of the land (site value) is deducted from the sales comparison method (unless sales data is unavailable and alternative methods must be used); and,
- 5) an opinion of value is derived from adding the site value (4) to the depreciated value of the improvements (3).


\(^{158}\) Trimboli (1979) p. 20.


It is the area of depreciation that is fundamental in the accurate analysis and valuation of enclosed shopping centres and runs through all three approaches. In the case of the cost approach, depreciation plays a big part in tax shelter and as a result, separate values must be attributed to the land and improvements. The cost approach may establish an effective upper market value limit for a shopping centre and the cost approach is often the primary basis for tax assessor estimates in the US.\textsuperscript{161}

Whist the application of the cost approach is no different for a shopping center than for other properties, it plays a minor role in shopping centre appraisal, primarily because the land value element is difficult to estimate.\textsuperscript{162, 163} The obverse view is that it is probably the most certain method of estimating a value of the regional shopping centre in terms of the availability and use of factual information.\textsuperscript{164} The benefit is in estimating a replacement cost for insurance purposes and for tax depreciation of the improvements. There is disagreement over the inclusion of entrepreneurial risk with Garrett et al. arguing for its inclusion and Kinnard advocating its exclusion. Kinnard supports this by arguing that cost to produce space is not the same as cost to produce income.

The land value estimate is difficult because shopping centre sites are usually large and located strategically and thus little market sales evidence is likely to be available in the area. Most centres are built on land that may previously have been in multiple ownership or a large tranche set-aside as a Greenfield site in a developer’s land bank. Comparable land sales may be for smaller sites where the use such as a petrol service station has been established with an oil company paying a high premium for the site because of its proximity to the strategic location of the shopping centre.\textsuperscript{165} There is an evident marriage value element, for without the shopping centre, it is unlikely that such a petrol station would have been constructed and the land would be worth only a fraction of the price. Furthermore, due to the strategic size of the shopping centre site, a size allowance is fundamental in making any land value estimate comparisons. Considering the site value is relevant in highest and best use analysis by way of calculating the optimum price for the site or to qualify the viability of a competitor establishing a rival scheme.

\textsuperscript{161} Vernor & Rabianski (1993) p. 170
\textsuperscript{162} Garrett et al. (1976) p. 18.
\textsuperscript{163} Butcher (1994) p. 331.
\textsuperscript{165} Garrett et al. (1976)
Timing of any sales evidence must be considered in relation to date of grant of planning approval, full site acquisition, and contract with anchor tenant and leasing progress. If land value evidence is found for comparable sites, the stage in the development cycle must be considered and an adjustment attempted.\(^{166}\) Site value growth can thus be charted through the development process.

The highest court in the US, the Court of Appeals has stated that the cost approach and the income approach are flawed theories when used exclusively by assessors when considering regional shopping centres.\(^ {167}\) In considering regional shopping centres, the blending of two basic valuation theories provides recognition of their essential nature as both income producing and unusual enough to justify a heavy reliance on the cost approach.

2.3.7 The income or capitalisation approach

There are two methods adopted for the income approach. The first is to capitalise the current, or stabilised, net operating income (NOI) into perpetuity. This is a hybrid of the present value of a dollar per annum formula:

\[
PVS_{\text{p.a.}} = \frac{I - PV}{i}
\]

where \(I\) is the capitalisation rate selected from comparable evidence and \(PV\) is the present value of the right to receive a dollar in \(n\) years and is written:

\[
PV$1 = \frac{1}{(1+i)^n}
\]

Thus the full formula for present value of the right to receive a dollar per annum (or Years Purchase - Y.P) becomes:

\[\text{\textsuperscript{166}}\text{ Vernor & Rabianski (1993) p. 176.}\]

In the case of a perpetual income such as a freehold interest, the present value of the right to receive a dollar at some point in perpetuity is zero. Thus, the present value of the right to receive a dollar per annum in perpetuity (or \textit{Y.P. perpetuity}) which is known as the "cap rate" $R$ in Australia and the US becomes:

$$Y. P. \text{ perpetuity.} = \frac{1}{i} = R$$

This is then used to calculate the capital value ($CV$) of the investment:

$$CV = \frac{\text{Stabilised Net Operating Income}}{\text{Capitalisation Rate}} = \frac{1}{R}$$

In this approach, the cap rate is ideally found from comparable sales evidence where information about the net operating income (NOI) is available at the time of sale. This adjusted overall rate can then be applied to the stabilised net income of the subject shopping centre to derive the capital (market) value from the income or capitalisation approach to value.\textsuperscript{168} Hines develops this approach to account for a recapture rate to be added to the client's/investor's required or target yield. This may relate to a straight-line rate relating to the remaining economic life of the building, which is a form of acknowledgement of the wasting nature of the asset, and may include a sinking fund for reinvestment option.

Investor’s criteria for including property within their portfolio at the most basic level is that property hopefully provides rental growth of the regular lease income together with capital appreciation of the market value of the property. Therefore, the value of a property estimated by capitalisation of the income flow is of prime importance to the investor.\textsuperscript{169} Indeed in examples of shopping centre valuation it is often offered as the only method, with no

\textsuperscript{168} Hines (1988) p. 257.

\textsuperscript{169} Garrett et al. (1976) p. 19.
reference to IRR analysis. This approach considers the shopping centre’s propensity to produce an income from the leases in relation to the net income from the entire property - both land and improvements.

In capitalising an income flow estimate based on current, historic and projected future rental estimates, at least three options are available to the appraiser/valuer:

- direct capitalisation;
- discounted cashflow (DCF) spreadsheet analysis; and
- packaged simulation (commercial computer models).

Each method has its advantages and disadvantages and the ‘market’ approach for an appraiser is to mimic the market. This contention is in accordance with the earlier discussion that the valuer follows historical approaches.

In direct capitalisation, as shown from the formulae above, the net operating income (NOI) from a one year "snap-shot" of the income flow is divided by an overall or all risks yield. There is an implicit expectation for rental growth and capital appreciation built into the adopted yield, as that expectation is implicit in the sales price of sales evidence used. The income flow adopted is normally prospective, that is the expected income stream for the coming year.

It is an accepted view that capitalisation rates and their application is one of the least understood subjects in the appraisal process. These include overall capitalisation rate, building capitalisation rate, equity rate, yield rate, internal rate of return, interest rate and mortgage rate, to name some of those cited. (Figure 2-8 adapted from Isaac & Steley has been adopted in order to overcome some of the confusion). Within the US texts there is a tendency to include mortgage elements within the yield or capitalisation rate structure which can cause some confusion in analysis of sales data because investor finance elements and mortgage rates of comparable sales are rarely open knowledge.

---

170 Deane (1994)
172 Garrett et al. (1976)
Figure 2-8: Defining Yields

Source: adapted for this research from Isaac & Steley (1991)

This ‘definition’ of yields requires further explanation. It is an area of considerable confusion for practitioners. For example, Butcher suggests ‘either the initial or equivalent yield may be chosen as the capitalisation rate’.174 A simplistic explanation is offered by Tessier using the formula:

\[ \text{Overall Rate (OAR)} = \text{Y} - \text{GR} \]

Where \( \text{OAR} \)\(^{175} \) is the capitalisation rate for the current Net Operating Income (NOI), \( \text{Y} \) is the required total return (target rate, hurdle rate or IRR), and \( \text{GR} \) is the annual growth rate.

Where the capitalisation rate is 4% and the IRR is 11%, this would suggest an annual rental (NOI) growth of 7% (assuming an annual rent review to market pattern). Following on from this Tessier suggests:

“By way of summation, capitalizing NOI at 4 percent is entirely consistent with a total return (IRR) to the investor of 11 percent per annum. Fortunately, the appraiser need only concentrate on finding the proper capitalization rate (or multiplier) to apply to NOI. Discounted cash flow techniques and IRR analysis are just

---

175 Note: OAR is the overall rate. Vernor & Rabianski (1993) p. 231.
tools for explaining the underlying rationale of the capitalization rate found in market transactions.” 176

This is a definite case of ‘chicken and egg’ in respect of how yield (or risk) is derived. It is in line with the confusion emanating from the Professional Bodies as outlined in the commentary on the AIVLE DCF Practice Standard,177 below.

Within the context of the thesis, where regional through super regional centres are under consideration, the straightforward income capitalisation approach is considered by some (Jefferies178; Vernor & Rabianski179) as too limiting, lending itself to smaller well established centres with a stable trading pattern where there are few tenant changes contemplated or refurbishment or adaptations due. This does not, however, decry the approach as a valid check or to estimate some forms of depreciation. Problems occur where percentage or overage rents have to be considered and questions arise over the applicability of interest rates. Just as there is a case for differential risk rates between anchors (large space users, long leases and secure blue chip companies) over ‘ordinary’ mall tenants to reflect the relative security, so there is between secure ‘base rentals’ and volatile ‘overage’ or turnover income. 180 So far as the ownership of major centres in Australia by superannuation or insurance companies is concerned, the mortgage equity aspects are commonly ignored.181

The danger in adopting a straight capitalisation of prospective income flow approach is that the comparables may differ from the subject in some significant way that will not be replicated in the capitalisation rate adjustments. This includes such aspects as:

• stronger demographic profiles (which would justify a lower capitalisation rate to allow for higher potential income growth);
• differences in infrastructure, design, tenant mix;
• different anchor tenant agreements;
• investor motivation;
• loan financing agreements;
• building ratios and potential for expansion or redevelopment; and,
• the economic life of the centre.

176 Tessier (1991) p. 10
177 AIVLE (1996)
181 per preliminary interviews with Australian property fund managers.
The convention has become the application of a discounted cash flow (DCF) model that allows for fluctuations in income experienced by an overextended absorption period before achieving a stabilised NOI.

2.3.8 Discounted cash flow analysis

The advent of fast computing and the personal computer has made spreadsheets such as Lotus 1-2-3™, Corel Quattro Pro™ and Microsoft Excel™ readily available to the valuation/appraisal profession. Vernor & Rabianski argue this to be a “limited discounted cash flow analysis” given the US tendency towards proprietary dedicated simulation packages such as ProJect™. There is an inference, however, that the profusion of proprietary packages in the US results in the process becoming ‘mechanical rather than thoughtful’. ¹⁸³ This is not a new view, and represents a concern earlier expressed by Ratcliff some 25 years ago that:

“We are neglecting the task of developing a better understanding of the operations of the real estate market, measuring basic relationships which are essential to economic prediction in our field, and in general conducting a fundamental research which will improve the reliability of the inputs into the equations and the mechanical monsters, without which they are misleading or impotent.” ¹⁸⁴

In contrast, an important clarification of the terminology and reinforcement of the use of spreadsheet modelling is offered by Mitchell:

“Spreadsheet modelling, often incorrectly referred to as discounted cash flow (DCF) analysis by appraisers, is the most versatile and powerful tool in an appraiser’s toolkit... and should be utilized in the valuation of any proposed income-producing real estate project.” ¹⁸⁵

The usefulness is the same whether the spreadsheet model is used to derive the discounted cash flow (in other words the NPV), the internal rate of return (IRR) or the modified internal rate of return (MIRR) where funding is incorporated.

¹⁸⁴ Ratcliff (1972a)
2.3.9 Commentary and Critique of the AIVLE DCF Standard

The Australian Institute of Valuers and Land Economists Incorporated (AIVLE) Practice Standard No 2, ‘Practice Standard - Discounted Cash Flow’

issued by the Australian Valuation Standards Board was formally launched in Brisbane on 30 August 1996 by the Hon. John Moore MP, Minister for Industry, Science and Education.

In introducing the Standard, Bob Connolly, Chair of the National Valuation Board of the AIVLE, offered a background to the establishment of the mandatory standard. Through the late 1980s, as the property market in Australia went into recession, criticism was laid on valuers by certain investors for not adopting a discounted cash flow (DCF) approach. Whilst the principle of Net Present Value (NPV) was mentioned in the Australian Journal of Valuation back in the 1930s and 1940s, the concept of discounted cash flow have has been slow to find general acceptance in Australia until recently. It could be argued that this might largely have been the fault of the AIVLE or even their National (federal) President. When Alan Hyam (the 1993 National President) attended a conference at the University of Queensland he stated that the DCF was an unacceptable method and was untested by the courts. He reinforced this view in a letter in the Building Owners and Managers journal.

To quote:

“...it (the DCF ) is in the main used as a check or alternate method of valuation because of the number of forecasts and estimates which must be made”

and

“Unless properly applied and qualified the DCF method could leave the valuer open to actions for professional negligence should his forecasts prove inaccurate and are subsequently adjudged to be arrived at without the exercise of reasonable skill and care. The standardisation of the method may accentuate this risk.”

Such views are symptomatic of the subjective rather than objective issues that are raised by the concept of DCF. It is a view that was raised during the qualitative analysis several times under the guise that the method had not been successfully contested in the courts. It further reinforces the impact and concern that practising valuers endure as a result of media

186 The following critique comprises a practice paper prepared in response to the AIVLE DCF Practice Standard (Boydell & Gronow, 1997). It forms the basis for a significant element of the discussion in the “Conceptual Framework: Valuer” of the interview process outlined in Chapter 3. It is reproduced in full, together with adaptations, here as it represents a progress paper of the research cataloguing the background, application and weaknesses in a key component of the research hypothesis when translated to the enclosed regional shopping centre sector.

187 AIVLE (1996)

commentary on such matters. It is a pervading view that was shared in the US at the same time:

“One of the principal problems with spreadsheet modelling (eg, DCF analysis) is the mildly paranoid defensiveness of its Appraisal Institute proponents and even of the Appraisal Institute’s formal position (of DCF as an ‘acceptable’ tool)”. 189

However by 1996 the method had been standardised. Fortunately Hyam’s successor, Gary Rothwell, was a property director of a merchant bank, where DCF appraisal was the norm. Around this period JLW Research launched a supportive Property Research Paper Capitalisation and Discounted Cash Flow Bridging the Gap 190 This was followed by Bill Toxward’s and thereafter useful AIVLE Research Notes An Explanation of Discounted Cash Flows, Their Use in the Valuation and Investment Process and Selected Case Studies 191 The National Valuation Board of the AIVLE ran initial seminars for investment valuers in Sydney, Melbourne, Perth, Adelaide and Brisbane during mid 1995 to canvass practitioner views, and thereafter refined by a committee of 10 in Sydney. This committee attempted to codify the general views on how property should be valued.

The Standard was developed by the AIVLE to provide guidance in the application and construction of DCF valuation and investment analysis techniques and became effective as from 1 September 1996.

General concepts of DCF analysis, applications of DCF analysis and the layout of such models are covered by the Standard which is mandatory for all members of the AIVLE, although departures are permitted provided disclosures to that effect are made.

The Standard relates to DCF valuation and investment analysis techniques only for which “valuation” is defined as “the process of determining the market value of real property” and “investment analysis” as “the process of assessing the worth or performance of an investment to either a particular person or body, or the broader market and typically includes but is not limited to: feasibility studies; reviews of investment performance; the assessment of capital worth on a basis other than market value; and the analysis of transactions”.

The general principles on which the Standard has been based are:

190 JLW Research (1992)
191 Toxward (1993/4)
(1) cash flows derived from real property should be treated in a consistent manner for valuation and investment analysis purposes

(2) where practical, conventions used by other investment markets should be used in the construction of cash flow models and

(3) relevant standards and other guidelines should also conform with the requirements of International Valuation Standards, the Corporations Law, Australian Accounting Standards, Statements of Accounting Concepts and circulars from the Insurance and Superannuation Commission where applicable and any other relevant legal and industry requirements.

The Standard was adopted after consultation with leading practitioners in Australia but this does not at first sight appear to be comprehensive and certainly the views of the academic community have not been sought. The result is that the Standard does not represent contemporary thinking in the evolution of the valuation/appraisal process, tending towards the current (or even historic) approach to DCF modelling rather than being forward-looking. Thus, for example, the need for more explicit consideration of the three key variables of growth, risk and depreciation are not addressed. There is also a need for a clearer definition of “yields” (for example the Isaac & Steley view adopted in Figure 2-7) which are commonly misunderstood within the comparison of evidence.

2.3.9.1 Application

The Standard applies to DCF valuations or investment analyses for the valuation and analysis of a property or portfolio of properties and it is considered appropriate to use DCF modelling as a method of valuation, in typical circumstances, for:

(1) income producing property, including commercial, industrial, retail and tourism property;
(2) development projects; and
(3) land subdivisions.

The Standard states that it is up to the valuer or land economist to assess whether the use of
DCF is appropriate in a given situation and outlines the factors likely to affect a court’s assessment of the appropriateness and use of DCF analysis including:

- market adoption of DCF analysis;
- comparative use of different valuation methodologies including DCF analysis as a primary or secondary valuation method;
- availability of reliable information about comparable transactions;
- criteria affecting selection and application of appropriate discount rates;
- other contextual factors.

2.3.9.2 Concepts

Included in the Standard are basic definitions of what DCF is, Net Present Value (NPV) and Internal Rate of Return (IRR).

The discount rate to be adopted or found from analysis is defined both in the Standard itself and additionally in the accompanying Guidance Notes in the following terms:

- the discount rate which is to be used to calculate an NPV is typically a before tax, nominal, un-g geared rate
- in relation to property valuation the discount rate should be the return required by a hypothetical purchaser for that particular property over the term of the cash flow. The return required by a particular investor will be that required taking into account the property’s class (retail, commercial, industrial, etc.), physical attributes, location, development potential, level of risk and the amount of money invested. For balance sheet valuations, on the basis of the assumption of a going concern, a discount rate which reflects the company’s required rate of return (both debt and equity) may be more appropriate.
- the discount rate should not take into account the following - rental growth including reversions; vacancies during the term of the cash flow; the potential to increase occupancy levels; and the level of outgoings and repairs and maintenance.
- by implication the discount rate reflects the level of risk of achieving the projected cash flow.
- in relation to investment analysis the discount rate should be the investor’s required rate of return or Weighted Average Cost of Capital (WACC). When providing specific
financial advice to a particular client, the client should be consulted as to relevant
discount rates and the required rate of return.

There appears to be some confusion in the terminology between nominal and effective rates
of interest. It is also worth noting that the “pre-tax, nominal, un-gailed rate” is not the same
as the “Weighted Average Cost of Capital” so that discount rates will be calculated on
differing bases if both are used.

WACC is primarily an accounting rather than a valuation/appraisal term. Indeed, this is
symptomatic of some of the difficulties in terminology within the Australian property market,
which commonly lends its origins to a hybrid of US and UK texts and practices. Wurtzenbach and Miles only make reference to WACC in valuing a firm. Whipple underplays WACC in his new, and definitive, Australian text *Property Valuation and Analysis*
although he does enter into a discussion on the cost of capital (principally from a development
standpoint). The other two useful recent Australian valuation texts by Rowland and Robinson only make limited reference to it. Rowland acknowledges the use of WACC as a
screening device for investment comparison between say trusts and managed funds, but
clearly separates it from the discount rate.

2.3.9.3 Industry Standards for Discounted Cash Flows

Specific mention is made as to what should be incorporated in any cash flow and those factors
that must be included. These are represented graphically in Figure 2-9, with anomalies and
some revision suggestions highlighted in Figure 2-10. Specific issues are considered under the
headings of:

*purchase and sale costs* - a cash flow report must explicitly state whether or not purchase and
sale costs are included or excluded. For valuations it is mandatory that both must be included
in the cash flow model and for investment analysis in most circumstances they should be
included. Where a development includes the sale or purchase of property as part of that
development it is mandatory to include purchase and sale costs. There is therefore some

194 Rowland (1993)
195 Robinson (1989)
inconsistency in dealing with these costs which should be approached on the basis of “as you analyse - so you value” and on the same basis as competing forms of investment (bonds and equities) so that a realistic comparison of IRR’s can be made for investment analysis.

rest periods - this refers to the frequency of cash flows (that is annual, quarterly, monthly etc. - the length of one discounting period used in the cash flow). The cash flow must explicitly state what rest period has been used and the time at which within that period the cash flows are assumed to occur (i.e. in advance or in arrears). For presentation purposes a different period may be used. Thus rent from commercial property may be received monthly in advance and outgoings paid monthly in arrears. Whereas the actual IRR and NPV calculations should be performed on the actual rest periods, for presentation purposes the summary yearly totals can be supplied. Where rest periods other than annual periods are used the results from the cash flows must be converted to annual effective rates where applicable.

Figure 2-9: AIVLE DCF Standard (1 of 2)

Source: Boydell & Gronow (1997)

term of the cash flow - which is the length of period of projection of a cash flow - the term of the cash flow can vary from case to case. For development appraisal this will normally be
from inception to disposal of a completed scheme. For investment appraisal, however, it
would have been beneficial to adopt a standard of say ten years so that both valuation and
analysis would be consistent and IRR’s could be compared with purpose and accuracy.

terminal value - in discounted cash flow valuations a terminal value must be included which
reflects the property’s value at the end of the term. When using the conventional
capitalisation of income approach for determining the terminal value, the passing annual net
income as at the commencement of the year immediately following the last cash flow of the
term must be capitalised allowing for any market reversions. Where the terminal value is
calculated on any other basis, this must be disclosed and described in a cash flow report.

In determining the terminal value, no mention is made of explicitly taking account of the age
and depreciation of the property as at the date of the disposal in regard to the fact that the
property has in fact aged during the time of the holding period itself and this should be
reflected in the yield to be used.

analysing sales evidence to support a discounted cash flow - any analysis of sales evidence
must be carried out on a similar basis to that used in the valuation or investment analysis of
the subject property. The Standard states that it would be preferable, provided sufficient
information is available, to derive the underlying IRR deduced in the sales evidence as an
indicator as to appropriate rates of return for subject properties.

cash flow results - these must be presented on a nominal, before interest and before tax basis.
Where investment and finance details are to be included these are to shown separately. For
calculating NPV’s a single discount rate applicable to the term of projection should be used
(Mean NPV).

Sensitivity analysis for assessing the volatility of the cash flow is said to be encouraged for
both valuation and investment analysis and for this the key variables include (but are not
limited to): the discount rate; escalation rates; the terminal capitalisation rate; and capital
expenditure during the term of the cash flow.

These key variables can be more usefully summarised as:

- risk - related to the discount rate and the terminal capitalisation rate
• **growth** - the word “escalation” rate has been used which is less clear
• **depreciation** - this should be incorporated both within the term period and in the terminal capitalisation rate.

There is no guidance, however, as to how these should be considered and explicitly accounted for.

![AIVLE Discounted Cash Flow Practice Standard](image)

**Figure 2-10: AIVLE DCF Standard (2 of 2)**

Source: Boydell & Gronow (1997)

2.3.9.4 **Layout of Discounted Cash Flows**

This is covered under the following headings:

- **commencement date** - this must be disclosed at the start of the cash flow and in any accompanying report. In numbering periods, the first period must be referred to as period 1.

- **part periods** - where a cash flow does not run for an integral or whole number of periods, the part period must be treated as the last period and cash flows and the cash flow model itself
must be appropriately adjusted.

inflows - these may be grouped and categorised for presentation but separate headings must be provided for inherently different sources of cash flows and these must have separate but not necessarily different escalation rates. For development projects involving sub-divisions, selling costs must be separately shown and deducted to arrive at a net realisation. Any vacancy allowances should be based on the tenancy profile taking into account the loss of inflows and recoverable outgoings.

outflows - similar provisions apply for grouping of outflows etc as for inflows above. Cash outflows for valuation purposes must include a provision for future capital expenditure which can be by way of a lump sum in a particular period or over a term of periods or as a periodic contingency allowance or as a combination of both.

net cash flows - being the sum of inflows less the sum of outflows must be separately shown for each period.

investment and finance details - a cash flow which details taxation, equity and finance issues must group such issues and total them separately and distinctly from the inflows, outflows and net flows. DCF valuations must be prepared on a before tax and before finance basis including valuations for hypothetical development purposes and land sub-divisions. For investment analysis purposes if the effects of taxation benefits, or costs, are incorporated their timing must be taken into account and unless there is some reason for not doing so the prevailing company tax rate should be used.

net present values - cash flows should provide either the present value of the net cash flow for each period (both before and after tax and interest where applicable) or the present value of all individual cash in and outflows (including taxation and finance details where applicable) from which the NPV can be reconciled.

timing of finance - where a gearing ratio or level of equity is to be incorporated the cash flow must reflect the periods in which such capital is injected.

funding shortfall - where the sum of equity and finance is insufficient to fund all the capital requirements, the cash flow report must state explicitly the shortfall amount and its timing and
a discussion of possible implications. The shortfall amount will be deemed to be met by finance and cash flows adjusted accordingly.

**interest** - where interest payments are included in a cash flow the amount of interest charged per period must be shown. Interest should be calculated periodically and not included as a lump sum unless there is specific reason to do so - if it is included as a lump sum, this must be explicitly stated and any implications likewise. The rate at which periodic interest is calculated must be clearly shown and expressed as an annual effective rate. If the interest rate varies from period to period the annual effective equivalent interest rate must be shown for each period. This applies also for rest periods. Usually, market rates should be used for the calculation of interest but if this is not the case the cash flow report must explicitly state the annual effective rate used, that it is not a market rate, the reasons for its use and any possible implications. If actual interest payments are known they should be used and the report explicitly state this accordingly. DCF's that include interest calculations should be structured so as to take into account any expected increase or decrease in interest rates for the term of the cash flow based on evidence available at the date of the analysis. Where interest receivable on credit balances is to be calculated and shown in the cash flow, the amount of interest received per period must be separately shown. If actual interest receipts are known, these should be used and stated explicitly in the report. Where actual interest payments and/or receipts are not known, then interest must be calculated on the appropriate capital figure as at the end of the previous period and applying the period interest rate to that amount to calculate the interest payment due or receivable.

**reflecting cash flows over time** - the Standard acknowledges that any projections, escalations and estimates of future growth or decline can only be based on information as available at the date of valuation or investment and states that all cash flows in the first period must be sourced from direct evidence if available, for example from tenancy schedules and budgets of outgoings. If market rentals are to be used, due regard to market practice must be had in relation to lease incentives, lease terms, the nature of rent reviews, the responsibility for the payment of outgoings and other relevant factors and also to any possible changes in variable outgoings resulting from an increase in occupancy. Provision for lease incentives, if applicable, should reflect prevailing market practice, which, as the other matters previously mentioned, are nowhere defined in the Standard. It is mandatory that cash flows reflect anticipated changes over the term of the projection including the impact of growth or decline in values, rents, costs, and any other item. In cases where an option exists to renew an existing
lease during the period of the cash flow, the valuer/land economist must decide whether the option is likely to be exercised and adjust the cash flow accordingly - if the decision is that the option will not be exercised market lease conditions must be assumed at the date for exercising the option. Where client’s instructions are to the contrary this must be specifically noted and a commentary provided as to possible implications. A separate table of assumptions must accompany a DCF model clearly specifying all escalations and growth rates in annual (inclusive of inflation) terms.

Given the discussion on total economic lives of regional shopping centres being some 12 – 15 years, there is a reasonable assumption that a larger part of the investment needs to be recovered annually. Kinnard suggests that this justifies the higher overall capitalisation rates on real estate. In reality, particularly within DCF analysis, including a higher dollar amount for annual capital replacement and capital maintenance expenditure reflects the shorter life. There is a need to distinguish between the “operational” expenses and capital “improvement” expenditure.

2.3.9.5 Reporting Requirements

A report must accompany all discounted cash flows and detail the following:

- the purpose of the report, whether it is for valuation or investment analysis;
- where a NPV has been calculated a discussion of the adopted discount rate;
- whether or not purchase and sale costs were included or excluded in the cash flow;
- what rest period was used;
- where the terminal value was calculated on some basis other than the conventional capitalisation of income approach, a disclosure and description of the approach used;
- a disclosure if there is a funding shortfall, and if so a discussion of possible implications;
- where interest payments have been included in a cash flow as a single capital sum (capitalised interest), a statement to that effect also indicating in which period it is included and a discussion of any possible implications resulting from such an approach;
- if a provision for lease incentives has been included by a means other than using

effective rentals and rent free periods, a discussion of any possible implications resulting from such an approach;

- identify the author or developer of the cash flow model, or in the case of a software package identify the product name and version;
- identify the user of the cash flow model;
- identify the date on which the cash flow was produced.

Appropriate limitations, qualifications and disclaimers must be included having regard to the nature of the instructions and the extent of the information provided by the instructing party and its representatives and when required any report accompanying a cash flow must make clear and unequivocal disclosures.

Any departures from the Standard, absence of full documentation or the presence of specific assumptions resulting from special circumstances must be notified in a “Statement of Exceptions to the AIVLE Cash Flow Standard”, which must be attached to both the cash flow and the cash flow report if both are not included in the same document.

Where the cash flow is compiled for valuation purpose, the valuer shall require as a condition of engagement that any special limitation, assumption or departure be disclosed in any document in which reference is made in relation to the cash flow.

The Guidance Notes also strongly recommend that regular valuations (analysis) be prepared and the results of cash flows be based on information available as at the date of valuation (analysis). Also that reliance on information after an extended period from the date of valuation (analysis) should only be made after written confirmation that is appropriate to do so by the valuer/land economist. If information is supplied by others on which some or all of a report is based then a statement should be incorporated to the effect that such information is believed to be correct but that it has not been verified in all cases and that no warranty is given for its accuracy. Likewise a statement should be incorporated to the effect that the valuation is for the use of the party to whom it is addressed and is for specific (listed) purpose(s) only - no responsibility will be accepted to any third party who may use or rely on the report or any part of it - if a third party wishes to use the report he/she should obtain written approval from the valuer.
2.3.9.6 Responsibilities

The construction of DCF models must be supervised by an Associate, Fellow or Life member of the AIVLE who must have appropriate market knowledge and experience to construct the cash flows and has the responsibility for the integrity of the model, both in terms of the magnitude of the cash flows and the theoretical and mathematical correctness. This may well cause some initial problems for certain practitioners.

2.3.9.7 International Perspective

To put the Standard into context, it is important to consider the role of a valuer within Australia, an aspect that has been raised earlier in the literature review.

It is also worth noting, in comparing the Australian situation with overseas counterparts, that the lease structure is very different with leases ranging from two years upwards, annually indexed to the consumer price index (CPI) with reviews to market ranging from two to five yearly intervals. This lease structure ensures the need for annual growth and/or indexation to be incorporated in the DCF.

2.3.9.8 Review

The intention was to review the Practice Standard twelve months after its issue date. In introducing the Standard, Bob Connolly acknowledged that some of the terms contained within the Standard lacked common ground and there would clearly be scope for refinement. However, it was deemed beneficial to launch the Standard in order that it may be fully tested by practitioners, thus eliciting greater constructive feedback. Unfortunately the review was not completed within the twelve month timescale and was still unavailable at the date of submission this research.

The application of the AIVLE DCF Practice Standard is fundamental to investment appraisal of enclosed regional shopping centres. It is the centrepiece of the ‘evolving appraisal paradigm’.\textsuperscript{197} Practitioner adoption, and understanding, is at the core of qualitative enquiry of property practitioners which follows (Chapter 3 & 4) within the hypothesis of investigating and analysing the valuation methodologies being applied to regional shopping centres. It is

\textsuperscript{197} Mitchell (1993) p. 194
thus part of the immediate hypothesis.

As stated, the cited references for shopping centre appraisal have a tendency towards current practice rather than contemporary approaches. As such, even where DCF’s have been utilised, the valuation aspects of growth, inflation, income receipt timing, yield derivation and adoption and, most significantly, economic depreciation are not developed. In order to develop the argument, it is necessary to consider each of these items in turn as they relate to the enclosed shopping centre definition and then to put them in an investment framework.

2.3.10 Depreciation

Whilst the impact of depreciation is acknowledged by the Appraisal Institute in its core text\(^\text{198}\) the concept is not developed:  

**Trends in shopping centres change so rapidly that many structures may become functionally obsolete before they deteriorate physically.**

Because of the frequent modernising requirement within competitive overbuilt markets, the economic life of an enclosed shopping centre is only about 10 -15 years.\(^\text{199}\) Shopping centre depreciation is mainly functional and economic as opposed to physical\(^\text{200}\) for the physical improvements of a shopping centre may last half a century.\(^\text{201}\) The source of the depreciation estimate is found in the market as the styles and designs of centres change and modernisation becomes important. Even new shopping centres may demonstrate elements of depreciation and obsolescence.\(^\text{202}\)

Before developing the specific factors affecting depreciation as shown in the depreciation literature review model (Figure 2-10), it is necessary to fully investigate the economic and historical evolution of the concept of depreciation. The literature review will thus be expanded in this area. The depreciation literature review model flows on from the issues raised in the AIVLE DCF Practice Standard. Depreciation is acknowledged implicitly in the

\(^\text{198}\) American Institute of Real Estate Appraisers (1987) p. 258.
\(^\text{199}\) Kinnard (1990)
\(^\text{200}\) Garrett et al. (1976) p. 18.
capitalisation rate approach, whereby risk, growth and depreciation are bundled into an ‘all encompassing’ risk rate, the All Risks Yield (ARY) derived from comparable evidence, which equally implicitly, also accounted for these aspects.\textsuperscript{203}

As was discussed earlier (2.2.2) property has a propensity to wear out. This ‘wear’ is usually termed obsolescence and can be attributable to many factors. With this obsolescence comes a deterioration in rental values, or a lower proportional increase at rent review, coupled with an increasing yield as the lease covenant and tenant security deteriorate. These two factors give

\textsuperscript{203} Deddis & McCluskey (1994)
rise to a comparatively lower capital value and a reducing total return figure, which is, a fall in real value. In other words, property is prone to depreciation.

Depreciation, within the cost approach, has a tendency towards an accounting rationale. Within the investment approach (discussed above) little, if anything is done in practice to take explicit account of obsolescence and depreciation issues. This area was explored in the writer’s work for the Financial Times\textsuperscript{204} with Peter Clayton:

There are at least three reasons why this is so. Firstly, there is a general confusion over the relationship of the term’s depreciation and obsolescence. Secondly, the majority of practitioners (chartered surveyors) tendering property advice to investors have been taught to capitalise an income flow in perpetuity. Whilst arguably a naïve practice, this is straightforward and well understood by the market. Thirdly, and perhaps most importantly, there is the fear of the market:

This fear of the market holds the key to practitioners’ reactionary approach. It is the view that ‘we all do it this way so it must be right’ coupled with the belief that if you tell a major investment client that his prime property is no longer prime and that you have historically failed to account for depreciation in your return figures you may no longer have a client!

The term’s ‘obsolescence’ and ‘depreciation’ can be distinguished as follows:

- **Obsolescence** (the cause), derived from the Latin ‘\textit{c\textit{oh}l\textit{e}c\textit{a}r\textit{e}}’ to grow old, means that something is no longer functional, implying a decline in utility (which may not be directly related to physical usage or the passage of time);

- **Depreciation** (the effect), derived from the Latin ‘\textit{d\textit{e}t\textit{r}e\textit{c}a\textit{r}e}’, is the falling of value, the loss in the real existing use value of a property investment.

There is much confusion and error within the terminology with ‘deterioration’ often being called ‘depreciation’, despite the former being a quality concept (obsolescence) whilst the latter refers to financial value.\textsuperscript{205} The confusion that has occurred in the theory of investment replacement is centred on a failure to distinguish the several related but disparate concepts which Feldstein & Rothschild label as **deterioration, output decay, input decay, depreciation, scrapping** and **replacement investment**.\textsuperscript{206}

Expanding on this terminology, **deterioration** (of a piece of equipment) is the increase in real

\textsuperscript{204} Boydell & Clayton (1993) p. 119 et seq.
\textsuperscript{205} Hulten & Wykoff (1996)
\textsuperscript{206} Feldstein & Rothschild (1974) p.394.
resource cost as the machine ages and it comes in two forms. Firstly, **output decay** where an ageing machine yields less output. There is a strong correlation with property where an ageing shopping centre may yield a lower comparative rental income than a new (or newly refurbished) competitor. Secondly, **input decay** relates to the increasing expenditure inputs necessary to maintain the same or near original level of output (in our case, rent). **Input decay** can be likened to the ongoing/periodic refurbishment of a shopping centre. The balance between these issues is an economic decision for the firm (or investment trust/superannuation fund in this thesis).

**Depreciation** is taken in the same context as cited above, a fall in the price (of a machine) as it ages. The rate of depreciation would reflect the overall rate of deterioration and the rate of technological obsolescence (fall in the real resource cost per unit of output on new **vintages** of equipment) in a scenario of zero installation costs and no uncertainty. Feldstein & Rothschild (ibid.) argue that even if the rate of obsolescence could be separately accounted for, the rate of depreciation cannot be used to isolate a measure of the output decay. The rate of depreciation can only deduce the ‘combined’ effects of output decay and input decay.

The concept of **scrapping** is not easily transportable to shopping centres. Land retains an inherent value, unlike a machine that is disposed of when it cannot earn a positive quasi-rent. The inherent value in land would (given location) ordinarily be positive, although site clearance or contamination could infer a negative dollar value.

**Replacement investment** is synonymous with redevelopment/expansion of a shopping centre. It is based on an economic decision by the firm (trust) rather than a technological necessity.

The concept of property obsolescence and depreciation is not new and Thorncroft described the rhythm of obsolescence and renewal as the ‘estate life cycle’.\(^{207}\) He continues:

> A building reaches complete obsolescence - or dies - either when it is physically exhausted or when it is no longer economically worthwhile to keep it in use. In practice the latter is usually the determining factor, as the pace of physical obsolescence can be controlled by repairs, adaptations or improvements, provided the economic incentive to carry the cost is present. It is not age but change that is the chief cause of obsolescence.

Obsolescence is a risk akin to fire, earthquake or burglary which should be addressed, or provided for, in a similar manner through an allowance in the operating budget similar to an

---

\(^{207}\) Thorncroft (1973) p. 51 & Ch. 3.
insurance premium. Obsolescence should thus be explicitly categorised as an operating expense.

Fisher acknowledged the problems of accounting for depreciation. He suggested that it could be dealt with by an adjustment in the interest rate, but only if the monetary implications were known in advance:

To offset a foreseen appreciation, therefore, it would be necessary only that the rate of interest be correspondingly lower; and to offset a foreseen depreciation, that it be correspondingly higher. Since, because of ignorance and indifference, appreciations and depreciations are, as a matter of fact, never fully foreknown and their relation to interest and other business phenomena only dimly perceived, they are only partially provided against in the rate of interest itself.

Current practice within discounted cash flow models has been to reflect depreciation by an [unsubstantiated] adjustment in the terminal (or reversionary) capitalisation rate to reflect the notional sale at the end of a notional ten-year term. Fisher realised over sixty five years ago that such a course of action is naive. He suggested that the best remedy is to standardise, or stabilise, the dollar in the same way as every other important unit of measure employed in business has been. However, it is more difficult to standardise property than to standardise money against gold as Fisher did. This is particularly so in regional shopping centres, as they [at the very least] all have different locations and thus different markets and demographic influences. Similarities and rankings will thus need to be derived. This is an underlying valuation premise: of comparing like with like.

Two definitions of depreciation are offered by Gilpin and the work and context of Fisher errs on the first, i.e. the relationship to exchange rates. Gilpin takes this as the situation of foreign money becoming more expensive in terms of domestic money, then the domestic money has depreciated and the foreign money appreciated. Clearly this and Gilpin’s second definition are, in essence, directly related, but the latter goes into the property related aspect with more clarity: i.e. the diminution in the original value of an asset due to use and/or obsolescence. Gilpin reinforces this by stating depreciation can be calculated at ‘historical cost’ (the price which was actually paid for an asset at the time of purchase) or at ‘replacement cost’ (the amount that it would take to replace the asset at the present time). He contends that historical cost is the method normally adopted, but economists tend to favour the second method.

---

208 Hotelling (1925)
209 Fisher (1930) p. 38.
2.3.10.1 The ‘American School’

One of the earliest treatise on depreciation was *A Statistical Theory of Depreciation - Based on Unit Cost* offered by Taylor in 1923.\textsuperscript{211} As with much of the American literature that follows it, Taylor’s theory is based on the depreciation of a ‘machine’ as opposed to a property asset. Even back in 1923 there had been much discussion concerning the propriety of including interest charges on capital invested in a machine in determining unit cost.\textsuperscript{212} The key question in Taylor’s work supported the book value of a machine being so determined that the unit cost will be the same as that for a new machine under the existing economic conditions. A key part of the problem is the determination of the number of years that a machine may be most efficiently used. Taylor’s model can be summarised thus:

\[
\text{Average unit cost of production for new machine} = \frac{\text{Operating expenses} + \text{Repairs} + (\text{New Replacement} \times \text{interest rate}) + ((\text{new} - \text{salvage value})/\text{annual sinking fund})}{\text{Rent}}
\]

This formula assumes a salvage value of zero, which is when the ‘machine’ is worn out. In the case of property, it has been argued, when the structure (building) - in this case a regional shopping centre - is worn out, there may remain a positive or negative value to the shell together with an expected positive value for the residual land. Such land value may have, ordinarily, further enhanced in value over time through inflation and market forces. Unlike other items of production, multi-tenanted real property (in this case the shopping centre) is not going to offer optimum performance and productivity in year one. Thus depreciation (based on the unit of output – i.e. rental income from a shopping centre) should not be optimum in year one.

Taylor explicitly ignores inflation and income (or rental) growth. Implicitly inflation is inferred in the situation where increased labour and material costs result in the unit cost (plus) for the old machine still being less than for acquiring a new machine. In that situation, the old machine could be retained until its annual unit cost (plus) becomes greater than that for a new machine. Taylor identifies the challenge as the identifying the number of years that a machine may be most efficiency used.

\textsuperscript{211} Taylor (1923)
\textsuperscript{212} ibid. p. 1013.
The issues raised by Taylor raises are developed in much of the literature from the **American School**\(^{213}\) that follows:

- the interdependence of costs of output and depreciation;
- the unit cost (plus) depends in part on how the depreciation charges are distributed;
- the useful life of a machine is affected by the distribution of the depreciation charges;
- the uncertainty/possibility of the machine suddenly becoming obsolete; and,
- critically, the current interest rate.

The uncertainty aspect, the fourth point above, is the most critical in the shopping centre scenario.

Hotelling\(^{214}\) built on the work of Taylor in his *General Mathematical Theory of Depreciation*\(^{215}\). In acknowledging the literature, thus, he identified the quandary of earlier commentary, being that if the operating cost is known so the value can then be calculated. But, operating cost always included value dependent elements. Thus the operating cost is unknown until value is determined, that is until the problem is solved. Hotelling raises the valid question that relates to shopping centres - the concept of charging depreciation as a function of output rather than of time – and the omnipresence of interest preventing this. This is a significant move away from a ‘straight line’ depreciation method. The straight line approach is, he contends, misleading because the assumptions take no account of the almost universal tendency for operating costs to increase inversely to the decrease of output with age, thus understating depreciation in the early years. This supports the contention that depreciation is not, or perhaps should not, be demonstrated as impacting on a real property investment in year one.

Within Hotelling’s model, if the word asset is substituted for machine, a general framework on which the economics of exhaustible resources may be analysed is obtained.\(^{216}\) Hotelling, like those of the **American School** who follow him, took a primarily mathematical approach utilising the calculus of variations. This **American School** is founded largely on an investigation into depreciation of machines, machine tools and automobiles although the principles and evolving depreciation theories do have some portability and adaptability in considering the property

---

\(^{213}\) The ‘**American School**’ is italicised as this is the author’s definition.

\(^{214}\) Hotelling (1925)

\(^{215}\) Refer to Taylor’s articles and sources in Darnell (1990)

\(^{216}\) Darnell (1990)
context and shopping centres in particular.\textsuperscript{217}

The \textbf{American School} takes as its basis the underlying assertion that mechanical book value measures (as adopted by the accountancy profession) bear no necessary relationship to the remaining asset financial value after adjusting for true economic depreciation.\textsuperscript{218} The purpose of the search is for a better model of the reality of depreciation for their assets, or shopping centres in the case of this thesis. They adopt a \textit{quasi-rent} approach, unlike shopping centres where rental is real as opposed to perceptual. Furthermore, the approaches often simplify their investigation by assuming (as only economists can) that demand is constant and that capital is used at a constant rate. Similar broad based assumptions lie at the challenge to the adoption of a capitalisation (cap) rate in property valuation.

Hulten & Wykoff\textsuperscript{219} argue that the data currently available are insufficient to resolve a series of circular equations. In this context, there are an infinite number of variables, with each machine (or shopping centre) having its own discrete pattern of efficiency. The literature on efficiency and depreciation patterns\textsuperscript{220} focuses on three cases: \textit{constant efficiency}, \textit{straight-line decay} and \textit{geometric decay}. The formula demonstration of these is:

\textbf{Constant efficiency}, also known as “one-hoss-shay” depreciation, whereby assets retain full efficiency until they fall apart:

$$\varphi_0 = \varphi_1 = \ldots = \varphi_{T-1} = 1, \varphi_{T+t} = 0$$

\text{where,} \hspace{1cm} \varphi \text{ is the productive capacity of the asset} \\
\text{T is the service life} \\
\text{This approach assumes that real rental is constant for the life of the asset, abruptly diminishing to zero when the asset is scrapped at the end of its life – an unrealistic scenario for property assets.}\textsuperscript{221}

\textbf{Straight-line decay (depreciation)}, is where efficiency falls off linearly (usually by equal annual


\textsuperscript{218} Hulten & Wykoff (1996) p. 11.

\textsuperscript{219} Ibid.

\textsuperscript{220} as cited by Hulten & Wykoff (1996) p. 15.

\textsuperscript{221} Such an approach, as applied to residential real estate models, was criticised by Malpezzi et al. (1987) p. 375.
increments) until the time of retirement, akin to the standard accountancy method. If annual incremental linear decay is adopted in the form of

\[ \varphi_{t+1} - \varphi_t = 1/T, \]

\[ \varphi_0 = 1, \quad \varphi_1 = 1 - (1/T), \quad \varphi_2 = 1 - (2/T), \ldots, \quad \varphi_{T-1} = 1 - [(T-1)/T] \]

\[ \varphi_{T_0} = 0, \quad \delta = 0,1,2, \ldots \]

As with constant efficiency, \( T \) also completely determines the efficiency pattern of straight-line decay.

**Geometric decay (depreciation)**, takes constant decay of the productive capacity as

\[ \bar{a} = (\varphi_{t+1} - \varphi_t)/\varphi_{t+1} \]

which gives an efficiency sequence of

\[ \varphi_0 = 1, \quad \varphi_1 = (1 - \bar{a}), \quad \varphi_2 = (1 - \bar{a})^2, \ldots, \quad \varphi_t = (1 - \bar{a})^t \]

This sequence is also characterised by a single parameter, as in the previous examples, but this time the parameter is \( \bar{a} \) rather than the service life \( T \).

These patterns relate to efficiency over time and should not be confused with economic depreciation, although the two are obviously related. However, straight-line efficiency is not the same as straight-line depreciation. Efficiency is at the heart of these frameworks, but the factor of \( \varphi \) is a ratio of marginal product and so not directly observable. Estimates are required for \( \varphi \) and \( \bar{a} \) which is possible if there is a strong resale market. Unfortunately the regional shopping centre market is not strong on regularity of sales transactions, confounding the formula.

Hulten and Wykoff utilised the above forms in any analysis of second-hand asset resales of fixed business assets in the US ranging from machine tools to office buildings and factories (not retail). Their depreciation rates ranged from 30\% p.a. for Autos and Computing Equipment down to a low 3\% p.a. for ‘non-residential structures’. They noted that straight-line depreciation produced a linear asset value decline; constant efficiency was a slower decline; and, geometric decay resulted in a constant decline with age. The geometric approach, although rejected statistically, offered the closest estimate for approximating broad asset groupings. Such a conclusion is controversial. The \( \varphi \) and \( \bar{a} \) are subject to variability on utilisation and maintenance. There is a concern over the rapid early loss of efficiency which
does not transpose to shopping centres which inevitably demonstrate an increase of efficiency in early years with optimum return not being achieved until first major rental reviews between the third and fifth year of operation.\textsuperscript{222} Interestingly, pure geometric decline implies an infinite service life whereby assets are never completely retired - this is certainly the case with property.

The multiplicity of variables\textsuperscript{223} (real in the property sector) precludes portability into the shopping centre DCF model – such a procedure is only justified if deterioration occurs at a constant exponential rate. This has parallels with the accountancy approach of straight-line depreciation that fails to reflect that shopping centres are constantly evolving assets, influenced by a multitude of economic influences.

There have been many attempts to quantify depreciation in the residential property sector with inconclusive results ranging from $\frac{1}{2}\%$ to $2\frac{1}{2}\%$ per annum.\textsuperscript{224} The nature of the asset complicates analysis in the housing sector, as with the subject area of shopping centres, on three major counts. Firstly the heterogeneous nature of the asset precludes direct comparison of rents and values. The assets are structurally different and in differing states of repair. Finally, it is difficult to separate land and improvement value from total property value in all but newly constructed assets.

\subsection*{2.3.10.2 ‘Lemons’}

There is an air of suspicion when regional shopping centres are sold. A fund would only ordinarily choose to dispose of an asset when it does not appear, on paper, to have the potential to achieve the desired returns for the fund. In other words, it is a ‘lemon’.\textsuperscript{225} Drawing upon the philosophy behind the Akerlof Lemons Model, assets that are resold in second-hand markets are not representative of the underlying population of assets in that only poorly performing (poorer quality) assets are disposed of.\textsuperscript{226} This intuition about ‘lemons’ may be potentially faulty, as a lemon to one fund may be an asset with significant potential to another fund. The decision to buy a used (or second hand) asset, like a building, is usually

\textsuperscript{222} Personal discussion with Ernest Airey, John Laing Developments Ltd. Manchester, UK, 1992.
\textsuperscript{224} Malpezzi et al (1987) tabulate and discuss 12 selected depreciation studies of residential real estate.
\textsuperscript{225} The same terminology was adopted by ‘owners’ within the expert interviews (see Ch. 4)
\textsuperscript{226} Akerlof (1970)
made by experts in the resale market whose economic survival is based on their ability to identify poor assets. Asymmetrical information is a problem, and if it were not overcome by economic incentive on the part of the sellers, the logic of the lemons argument would imply no (or very tiny) used asset markets. Regional shopping centres do demonstrate a very limited resale market. Property, unlike many other assets, can be refurbished.

Given the vagaries of funds over liquidity requirements, cash calls, tax situations and portfolio mix, there is no strong basis for believing that only ‘lemons’ come on to the market.

Much of the econometric research previously undertaken is concerned primarily with the average experience of a heterogeneous population rather than the idiosyncratic behaviour of each individual asset. In contrast, it would appear difficult to take a regional shopping centre other than in isolation, on the basis of its manifest idiosyncrasies. There is an inherent conflict in such a micro approach when the regional shopping centre market has already been acknowledged as a macro concept (encompassing all Australia) for the purposes of comparables and market evidence. What may be true on a case-by-case basis is not, by inference, necessarily true of an entire population. Indeed, econometric evidence whereby the idiosyncrasies are averaged out could lead to the wrong result.

This is a fundamental ‘crux’ of the current hypothesis in supporting the invalidity of a model that would be implicitly idiosyncratic before it is even used. It is an important contention that such a view can be derived from the ‘idealism’ proffered by the hypothetical models emanating from this element of the literature. In essence, the inference is that the multiplicity of econometric influences affecting a regional shopping centre precludes a generalist model, which would have to be so hypothetical as to render it of little validity to the valuation profession. This is clearly the case where a broad, sweeping, 3% p.a. depreciation factor is adopted. Average yields incorporated within valuation models could be criticised in the same way.

2.3.10.3 Economic Life

In acknowledging that the economic life of building varies widely in practice, Goodall realises that the economic life ends because of changes in demand, accessibility, environmental issues,

---

materials, services, economic, social and technological standards.\textsuperscript{228} It is these issues, rather than the building merely wearing out, which influence economic life.

What serves to conflict with the shopping centre situation is not only Jorgenson’s restrictive assumption that all deterioration is output decay and that obsolescence can be ignored,\textsuperscript{229} but also the critique of Jorgenson’s earlier work proffered by Feldstein and Rothschild.\textsuperscript{230} They suggested that all replacement is technically necessary rather than the result of specific economic choice. Baum classes such replacement as \textit{structural risk} (the chance of high repair and maintenance costs, refurbishment and ultimately rebuilding).\textsuperscript{231} This is identified as a risk not borne by other investment sectors. Structural risk is not the only cause of replacement in shopping centres where expenditure is outlaid in situations where economic impact is the cause (in the case of a re-active fund).

\textbf{2.3.10.4 UK Research}

The three most cited pieces of UK research in the area of depreciation and its impact on property investment have been carried out by Bowie, Salway and by Baum.\textsuperscript{232} These three prime references appear to have largely ignored the work of the \textit{American School}. Salway undertook major research into the impact of depreciation on commercial properties. The average depreciation in rental value over the first 20 years of a building’s life is shown in Table 2-1.

The evidence suggests a low incidence of depreciation over the first 5 to 10 years with a sharp fall in rental value thereafter. This can in part be explained by virtue of the building being in essence ‘modern’ at that stage, and it is the passage of time coupled with the advancement of technology and working practices which renders the property less functionally suitable.

The impact of the annual depreciation rate was softened if not lost in the mid- to late 1980s during the property boom when exceptional demand for prime investment property ensured continued rental growth and a firming of yields. The situation has changed and in a weak

\begin{footnotesize}
\begin{itemize}
\item[228] Goodall (1972) pp. 207 – 212.
\item[229] Jorgenson (1996)
\item[231] Baum (1989) p. 9.
\end{itemize}
\end{footnotesize}
economy with an over-supply of property, including new/modern stock, the ravages of depreciation become all the more apparent.

<table>
<thead>
<tr>
<th></th>
<th>Average (p.a.)</th>
<th>Range (p.a.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offices</td>
<td>3.0%</td>
<td>1.4% - 4.8%</td>
</tr>
<tr>
<td>Industrial</td>
<td>3.3%</td>
<td>1.25% - 5.5%</td>
</tr>
</tbody>
</table>

Table 2-1: Depreciation and rental value, years 1 to 20

Source: Salway (1986)

Baum developed Salway’s work to demonstrate a depreciation-sensitive model for investment appraisal. In developing his hypothesis, Baum raised two questions that initially appear portable and relevant to the current study. Firstly, is it possible to find out more about depreciation and obsolescence in order that developers and property managers can limit the impact? Secondly, can explicit estimation of depreciation as a risky variable be incorporated within cash flows? He aimed to develop the CALUS research study in three of its main issues:

- an examination of current investor practice in accounting for depreciation in acquisition, management and valuation of investment properties;
- the impact of building depreciation on property values; and
- establishing a methodology for investment appraisal explicitly accounting for building depreciation.

The current study endeavours to develop these themes into enclosed regional shopping centres in Australia, as opposed to the London office market that was Baum’s prime focus. What transpires as a challenge to the portability of methodology is the very different leasing structure surrounding the UK research with ‘institutional’ 25 year leases established with upwards only rent reviews. This contrasts with the Australian market where only the anchor tenants hold long (20+ year) leases. Specialty stores are commonly on 3 – 5 year lease structures, annually indexed to the Consumer Price Index (CPI) with reviews to market every 2 or 3 years and a component of turnover (overage) rental.

As with any modelling, the results are only as good as the subsequently validated or proven
forecasts or income projections. Herein lies the difficulty. How many analysts could have anticipated the Gulf War of 1990-91 or the impact it would have on the property market when coupled with an economy that was entering into a deep recession?

Baum highlighted the differences between curable and incurable depreciation. Curable depreciation is taken as costing a smaller or equal amount to cure than the value that will be added to the property as a result; whereas incurable depreciation costs more to cure than the resultant increase in value. Again, regional shopping centres have to be addressed differently to some of Baum’s commentary on maintenance – there has to be an assumption that a regional shopping centre asset worth in excess of $100 million would be properly managed.

In looking at land and the improvements thereon, site value can fluctuate up or down as a result of a complexity of issues, whereas building value must decrease or depreciate in real terms. The UK work suggested that site value evidence is rare and likely to be highly imperfect in contrast to the Australian approach to rating which adopts an ‘unimproved’ land value, i.e. a site value with the benefit of appropriate planning zoning. Baum held site values constant to remove the effect of site changes whilst using property value as a proxy for building value.

The longitudinal analysis makes some sweeping assumptions in tracking performance of the building sample over time; variation of site factors over time, lack of full data, retrospective and subjective building description/classification and the cyclical nature of the market all create difficulties. Cross-section analysis had been favoured in the CALUS report, albeit that it raises its own challenges: building differences reduce validity, site factor variables cannot be isolated, the onset of obsolescence isn’t revealed, and the impact of expenditure (structural risk) cannot be monitored. Whilst three ‘experts’ were used to offer advice on the variables in the sample, just their opinion was used rather than market evidence. Barras and Clark developed this theme in considering the UK Investment Property Databank (IPD) data for

---


234 Baum (1989) p. 73.
the London Office Market.\textsuperscript{235} However, their cross-sectional analysis did not indicate any consistent trend in the obsolescence rate in that market.

As has already been stated, Baum and his predecessors in the UK market were dealing primarily with offices, an asset which is notionally fully mature from the day it is first leased. The outcomes of the research are therefore ‘cleaner’ or more simplified than a shopping centre that is growing in size and evolving as an asset for at least the first 25 years of its life. Baum demonstrated that within his sample depreciation is not straight-line, in contrast to the CALUS findings that indicated similar depreciation rates over the first four rent review periods (i.e. 20 years). Rental value depreciation of the original (un-refurbished) building is highest in years 18-26 compared with 2-6 and 11-16 for refurbishments.\textsuperscript{236} In contrast, yields rise (and thus capital values fall, or depreciate) fastest in years 7-12 for original buildings and years 11-16 for refurbishment’s suggesting investor inability to predict rental value depreciation. The rates of capital value depreciation varied, suggesting refurbishment’s depreciate 50% faster than the original structure. In criticism, the analysis does not acknowledge that periodic refurbishments may occur with greater frequency than the 11-16 year value loss, or which indeed may be initiated by the prudent investor prior to diminution in value.

Building quality was identified as being more strongly correlated with depreciation than age, or the effluxion of time. Identifying building qualities in the office context (and subsequently industrial) seven office relevant issues were identified for incorporation in his depreciation-sensitive model. Baum quantifies adaptability and flexibility of use as a significant regulator of depreciation rate. The ranking of depreciation factors in an office scenario is shown in Table 2-2. The building flexibility model scores the listed factors on a scale of 1 (poor) to 5 (good) and then weights them accordingly before dividing the total by 10 to realise the weighted average. The resultant weighted score is on a scale of 1 (low flexibility) to 5 (high flexibility) with the range of 1.68 to 3.33 considered as medium flexibility.

Whilst these components could be adapted as micro issues in the shopping centre scenario, Baum’s hypothesis is not easily or relevantly adaptable to the current study. It overlooks the critical issues of competition and ability to expand. Obviously expansion is not a realistic (or at least, common) component in office buildings (although the addition of several floors to an

\textsuperscript{235} Barras & Clark (1996)

\textsuperscript{236} Baum (1989) p. 125, 159, & 219.
existing structure is gaining popularity. Competition must inevitably impact on both rental values and yields (and thus on capital value) significantly in the office market, as it does in regional shopping centres.

The depreciation of assets in the accounting sense of the term is not the accepted norm in UK property investment. Institutional investors do not generally ‘write off’ their property holdings or alternative investments over time. However, the significance of writing off properties by a depreciation factor plays a more important role in Australia and particularly the US. This is unquestionably an area for continuing debate over the coming years.

<table>
<thead>
<tr>
<th>Step</th>
<th>Question</th>
<th>Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Is the floor layout capable of flexible use?</td>
<td>2</td>
</tr>
<tr>
<td>2</td>
<td>Is the floor to ceiling height generous?</td>
<td>1</td>
</tr>
<tr>
<td>3</td>
<td>Can the services be easily upgraded?</td>
<td>2</td>
</tr>
<tr>
<td>4</td>
<td>Are the interior fittings easily changed?</td>
<td>1</td>
</tr>
<tr>
<td>5</td>
<td>Are the entrance hall and common areas capable of improvement?</td>
<td>2</td>
</tr>
<tr>
<td>6</td>
<td>Is the external appearance capable of cost effective alteration?</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>Is the potential building depreciation likely to be curable?</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 2-2: Depreciation in the office scenario

Source: Baum (1989)

2.3.10.5 The shopping centre lifecycle

Much of the research on depreciation has concentrated on plant and equipment, and for property the office, industrial and residential sectors. In order to contextualise the literature and progress the thesis, a life cycle scenario considering the changing pressures on the shopping centre over time helps to paint a backdrop to the process.237 This scenario and the related figures set a framework for the wider exploratory investigation that follows. It offers validity and explanation in the qualitative interview process that follows. In considering depreciation and obsolescence as key issues affecting property it is relevant to consider the

---

237 This scenario was developed early in the research (1992) by the author whilst still in the UK and subsequently incorporated in Boydell & Clayton (1993) Ch. 9, pp. 117 – 130.
The Boydell & Clayton model (Figure 2-12) demonstrates the property life cycle as a micro model notionally for a single property, but adapts adequately to a single investment, as in the case of an enclosed shopping centre. The model shows the five stages in a property's life cycle running from pre-development to total obsolescence. The length of the cycle is difficult to quantify because of the potential for repeated refurbishment and redevelopment before total obsolescence is reached.

![Figure 2-12: The Property Life Cycle](source: Boydell, in Boydell & Clayton (1993))

**STAGE ONE: PRE-DEVELOPMENT**

**Flexibility**

The pre-development period is the one where the potential longevity of a property is determined. Obsolescence, with consequent depreciation, is often built into properties by

---

238 This section builds on Boydell & Clayton (1993), Boydell & Clayton (1994) and Boydell (1995a).
complicated designs and layouts. Such complications should be avoided and, furthermore, serious consideration should be given to not acquiring an existing building that demonstrates such facets.

Nuisance
The holding of a land bank or of a cleared or virgin site for a potential development contains an inherent cost liability in guarding against possible nuisance. Such nuisance may emanate from vandalism, trespass, squatting, tipping or flyposting. Given the expense of legal tipping in urban areas, the costs of such nuisances and land contamination can run into many thousands of dollars which can have a resultant impact on the initial development return in the appraisal.

Hope value
The value of a vacant cleared or virgin site will increase dramatically with the grant of planning permission. The investor contemplating development must weigh up the relative risk in acquisition of a site at the lower price without statutory approvals against the increased price coupled with certainty of development for a site with formal planning approval.

The real value over time curve and range for an individual property is conceptualised in Figure 2-13. Subsequent to the granting of statutory consents and approvals, the value of the property (initially just land and then land plus buildings) will increase. This growth will notionally increase at a steady rate over the construction period, assuming a buoyant economy and demand led market. Within the increasing value slope, there will be a point during construction where the value may fall in relative terms as the 'point of no return' is reached for a specific development and the partially complete shell is worth less than the cleared site. Assuming a demand led market, this 'blip' is short lived and quickly bridged.

STAGE TWO: INITIAL/NEWLY DEVELOPED

In the mid 1980s it was reasonable to assume that in the right location most prime properties coming on stream would easily be let and thus become viable growth-orientated investments. At that time the newly completed building in its initial life-cycle stage would demonstrate a good initial yield with the pace and viability of the development being bolstered by successful 'pre-lets'. The property, when new, should have the ability to attract a good use class covenant.
The ‘optimum’ value of the property should be achieved immediately after the first rent reviews have been agreed, the property having established its market position and being fully let. The total return since purchase (TRsP) and the total return on year (TRoY) will also take a boost at this period (as at every subsequent positive rent review) which will be of strategic importance in the holistic portfolio.

The period of the rental and capital appreciation, though a short part of the full property life, is difficult to quantify but could realistically be gauged at around 10 to 15 years. As long as demand for the product remains, the pattern of rent reviews will ensure that rental and capital appreciation are maintained in real terms. As time passes, problems of constructional defect may manifest themselves and as the property starts to be ‘not modern’ it may begin to lose popularity to newer competition.

Figure 2-13: Real value over time

Source: Boydell, developed for this research

This early ageing and the impact of no longer ranking a property as ‘modern’ must be offset against the benefits of a property being ‘established’. By this is implied a suspicion of the new
and a faith in the known. Furthermore, there is the obligation of the 25-year ‘institutional' lease in the UK (England and Wales) which ensures that tenants are locked into a commitment extending beyond a property's period of optimum popularity and demand. Whilst all property sectors are subject to this popularity-led demand, it is most visible within the retail sector in general and enclosed shopping centres in particular.

Take the scenario of a new in-town enclosed shopping centre that for the purpose of the example could be situated in any large town or city. Assuming the location already had an established retail core, and even possibly an established older enclosed shopping centre, several factors are immediately obvious. Firstly, the life cycle of the new enclosed shopping centre will follow a clear pattern. Over the first five or so years it will slowly establish its place in the market by courting shoppers to change their shopping patterns and enter in; this is achieved by a strong marketing campaign linked to a popular and locally meaningful identity and name. The public will be attracted by curiosity and opportunity if the new centre can offer an improved retail experience, most notably offering the consumers the tenants they want (or are led to believe they want them by the efficacy of sophisticated media advertising).

During the initial five years, the centre should become fully let or suffer minimal voids.

After five years the investment should have seen the benefit of the first rent review cycle. Its place in the market should be established and the tenants trading successfully. The enclosed shopping centre, properly managed, should be able to maintain and improve its ranking over the subsequent five years.

By year 10 and later, problems are foreseeable for the enclosed centre that will affect investor and tenant alike. Such is the pace of consumerism and the retail sector that the fabric and style of the centre will start to look dated. Subject to the decision of the local planning authority, investment opportunists will have new schemes coming on stream to entice away the devotees that the subject centre has established. By year 10 the investor/owner is faced with the dilemma of when to undertake a refurbishment or redevelopment of the scheme in order to stem the depreciation caused by these factors. What can be done to unlock the lease structures which have been entered into with the object of guaranteeing a growth-orientated return over 25 years? At this stage the same leases that institutions demanded to secure finance on the investment may serve to choke interim refurbishment proposals. Where, too, is the funding for this refurbishment to be drawn from? Tenants trapped by an effective full repairing and insuring (FR & I) lease structure are obliged to contribute towards the
maintenance of the centre, but how far can they be expected to contribute towards refurbishment or redevelopment under their service charge agreement? How are tenants to be compensated from the disturbance and consumer distraction of refurbishment? The yield and return on the investment are also likely to be prejudiced at this stage and after refurbishment are unlikely to be restored to the optimum, thus ranking the centre as a weaker investment.

This scenario raises more questions than it answers. The major ones are:

- Why do tenants enter into 25-year agreements in the UK, and why do anchors contemplate such long leases in Australia and the US?
- Why do institutions seek long leases?
- Why are turnover rents not more popular for both parties in a buoyant as well as a recessional market?
- Why is the partnership between landlord and tenant not enhanced so that the centre can be run as a business for the mutual benefit of all concerned?
- Who funds the inevitable refurbishment?

Whilst this scenario may be perceived as extreme, with a shorter cycle than offices or even high street shops, its validity is that it highlights the pace of depreciation and obsolescence that can occur but which is often largely ignored in appraisal and valuation. In hindsight, what it fails to acknowledge in taking an in-city (or in-town) model, is the evolutionary nature of the regional shopping centre as an asset. The modest beginnings of most regional centres have been discussed earlier. Within the Australian market the only exception may be Robina Town Centre. The model retains relevance and significant validity if the evolutionary cycle is recognised with periodic refurbishment and expenditure.

STAGE THREE: MIDDLE LIFE

This is potentially the longest stage in the property life cycle and its duration is largely dependent on a positive management approach. The quantifiable length of this stage is dependent on several factors. The assumption is that the tenant quality or ‘covenant’ remains high, with a low level of tenant dissatisfaction and a corresponding low tenant turnover. If tenant quality is high there should be little difficulty with voids or empty floors, no arrears or only nominal arrears of rent and service charges, quickly agreed rent reviews, and an
acceptance of the mutual benefits of a reasonable service charge level to maintain and improve the property. The property enters ‘old age’ once any of these factors start to slip.

During the mid life of the property, there will come a stage when, due to its age and the strength of its covenant, the notional full rental value starts to fall in real terms and the yield starts to increase. At this point the capital value begins to fall and depreciation of the investment worth becomes significant. This is the mid-life crisis of the property. It is from this time, through to old age, that the refurbish/redevelop line of opportunity takes on relevance (see Figure 2-12).

In late middle life the refurbishment option is the obvious first consideration. Provided that there has been a positive and pro-active approach to management of the investment, the refurbishment option should be anticipated well in advance so that the funding and investment return implications can be considered. This is a time of curable depreciation. Re-investment will enhance the property so that rental income can continue to appreciate, with the property holding its place in the market, and yields may also be maintained. This is a critical time for taking professional valuation advice to quantify the multiple scenarios for a refurbishment scheme so that a cost benefit analysis can be considered and a valid feasibility study for the optimal scheme put before the investors related to their risk/return philosophy.

A properly executed refurbishment will regenerate the investment worth and set the life cycle into its second evolution. The refurbishment feasibility study becomes the pre-refurbishment period and the newly developed stage becomes the newly refurbished stage and so on.

According to the location, suitability and centrality of the property, the cycle of regeneration through refurbishment can recur several times, if the market demand and economic situation are favourable (this is identified by the ‘Redevelopment Curve’ in Figure 2-13).

STAGE FOUR: OLD AGE

It is as the property enters ‘old age’ that redevelopment may become a more viable option than refurbishment. The transition from middle age to old age is an indeterminate period during which the physical signs of deterioration and wear manifest themselves more visibly. It becomes apparent through this deterioration that the longevity of the fabric is in question. The property may fall into a poorer class of use with less dependable tenant covenants, and
may suffer difficulties in reletting and attracting new tenants on anything other than a short lease. The problems inherent with voids, the prospect of major redevelopment with short-term loss of revenue, and the possible funding difficulties of major re-investment, shorter leases, lower rentals and poorer tenants all give rise to significant management problems. The capital value of the investment in this cycle will have been falling in both real and nominal terms and a point may ultimately be reached where the investment could have a negative value with the cost of redevelopment outweighing the redeveloped market capital value, particularly in a time of economic recession and falling demand. The property is heading towards total obsolescence with incurable depreciation.

STAGE FIVE: TOTAL OBSOLESCENCE

As outlined above, the effects of obsolescence are apparent from early in the property life cycle and the stage of total obsolescence is likely to come to most property over time for a variety of reasons which can be categorised as physical, functional and economic obsolescence. Hypothetically it is possible to create a building that is almost immune from ageing and all three categories of obsolescence; time has proved that places of worship can endure for centuries provided they are adequately maintained. A similar retail example can be found in heritage areas of the UK such as the Rows in Chester, the Shambles in York and similar trading areas of Durham and Oxford.

The ideal situation is for the physical, functional and economic life expectancies of a building to be coterminous and for all elements to become obsolete at the same rate. This would make it easier to gauge the optimal time to refurbish and subsequently redevelop. However, ideals are not the norm, and the physical life of a building is usually some two to three times longer than its economic life. The result is that buildings stand for longer than they fulfil their optimum function and provide their optimal economic return; herein lies a major cause of urban decay.

2.3.10.6 Physical obsolescence

All buildings age, wear out and perish over time. This wear is not uniform as the different elements age at different speeds as shown in Table 2-3.

All the elements perform differently and a building's physical life may be extended by
periodically renewing items with a medium life span under a planned maintenance scheme. Elements with a short life span should normally be attended to under annual/triennial management schemes. It is the more durable elements with a long life, which are the most difficult and least practicable to replace; when the building shell wears out total obsolescence looms and the building faces redevelopment as opposed to refurbishment.

<table>
<thead>
<tr>
<th>Long life span</th>
<th>Medium life span</th>
<th>Sort life span</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foundations</td>
<td>Joinery</td>
<td>Decorations</td>
</tr>
<tr>
<td>Main walls</td>
<td>Plumbing</td>
<td>Services</td>
</tr>
<tr>
<td>Masonry</td>
<td>Cast rainware</td>
<td></td>
</tr>
<tr>
<td>Structural frame</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 2-3: Physical obsolescence

Source: adapted from Salway (1986)

2.3.10.7 Functional obsolescence

This occurs when a building has become less suitable than its contemporaries because of a deficiency in:

- design
- layout
- equipment.

Take the example of an old Victorian office building. It may still be structurally sound, but becomes functionally obsolete when compared to a modern building offering the versatility of an ‘open-plan’ design compared to smaller Victorian rooms. Thus the Victorian building faces a mismatch of size to meet modern demands.

Functional obsolescence is often in-built through eccentric design. Alternatively functional obsolescence may be intentional, incorporated to stimulate or preserve the future of the property market or construction industry. There are also functional design problems which were unplanned but related to utilising advancements in building technology which have resulted in the problems of asbestosis in buildings and the vagaries of high alumina cement.
Within the gamut of functional obsolescence lies the topical but difficult area of ‘sick building syndrome’. This may be either a functional or a physical factor as it relates to user illness attributable to aspects of the building’s environment such as air conditioning, fluorescent or artificial lighting, carpeting and VDUs. It is an area of major current research and thus far is considered most significant within the enclosed office environment. It remains difficult to quantify or anticipate, but can have a significantly detrimental impact on the investment worth of a building.

2.3.10.8 Economic obsolescence

This arises when there is a loss in the usefulness of a building attributable to a change in the market for its services, an example being the early 1990s over-supply of office space in London's Docklands. It is not necessarily a permanent obsolescence as the causes may be within or affecting the whole economy.

The factors that cause economic obsolescence include cash flow, money supply, interest rates, demographics, transportation, political intervention and technological advancements. Where the resultant depreciation is incurable it can only be measured in value terms by market comparison and capitalisation of the perceived income loss. There is a social measure pertaining to the psychic income/loss from a property but this has a subjectivity which, whilst potentially relevant if it fulfils investment goals, cannot be quantified in market terms.

2.3.10.9 Other categories of depreciation/obsolescence

In his subsequent work, Baum \(^{239}\) adds Wurtzebach & Miles \(^{240}\) definitions:

- **Aesthetic or visual obsolescence** resulting from outdated appearance;
- **Legal obsolescence** resulting from the introduction of new standards (e.g. safety regulations); and,
- **Social obsolescence** resulting from increasing demands by occupiers for a controlled environment and improved facilities.

\(^{239}\) Baum (1993)
Taking the word depreciation as pervasive in the property/real estate context, Wurtzenbach and Miles develop the theme in the subsequent edition of their text\textsuperscript{241} to consider ‘accrued depreciation’ within the framework of the original three – physical, functional and economic – taking more recognition of the curable/incurable aspects.

2.3.10.10 Masking obsolescence

All too frequently, sinking funds are forgotten and capital re-investment left too late for refurbishment, leaving redevelopment as the only viable option. The reasons why this occurs are:

- Whilst site values rise owners/investors are not worried or concerned by a decline in the value and usefulness of a building as the increase in site value for redevelopment cancels out the loss.
- The effects of inflation. The falling value of money results in a rise in nominal values that will hide the extent to which real values may be falling. This means that despite a decline in real value due to obsolescence, the property appears to be rising in value compared to historic cost; but the building will be under-performing. Inflation also makes the provision for replacement by means of amortisation more difficult as the sum required to renew the property asset is constantly rising.
- The value of planning permission. An obsolete property can increase in real value as a result of the grant of beneficial planning permission. An example might be permission to increase the plot ratio for a site; it is at this point that the inherent investment ‘hope value’ may be realised. There are also examples in the US and Australia where rezoning upwards can occur over time.

2.3.10.11 The length of a property lifecycle

As must be anticipated from the many variables discussed, this is difficult, if not impossible, to quantify for any one property, but by implication the ‘averaging’ of life span and cycle is valid as a planning tool in the holistic portfolio. In averaging it is easier to put a term of years on a building’s initial life cycle up to middle life and optimal refurbishment than to quantify the full cycle up to total obsolescence. It must be accepted that the timetable in Table 2-4 is a broad

\textsuperscript{241} Wutzenbach & Miles (1991)
simplification. The table is also conservative compared to Butcher who suggests that shopping centres will require a minor face lift on average every 5 – 6 years and a major refurbishment or expansion every 10 years.\textsuperscript{242}

The sentiments of the above data are supported by DLG\&P\textsuperscript{243} who concur that refurbishment can be less than 5 years or more than 15, but the average is a 5 –10 year band. There is an accepted view that 20 years ago you would consider renovation on a 10 year cycle, whereas now 5 – 6 years is the norm\textsuperscript{244} and very few centres don’t look tired after 8 years.

<table>
<thead>
<tr>
<th></th>
<th>Office</th>
<th>Industrial</th>
<th>Retail</th>
<th>Shopping Centres</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-development</td>
<td>1 – 3</td>
<td>1 – 2</td>
<td>1 – 4</td>
<td>2 – 8</td>
</tr>
<tr>
<td>Newly developed</td>
<td>2 – 5</td>
<td>3 – 5</td>
<td>3 – 5</td>
<td>3 – 5</td>
</tr>
<tr>
<td>Middle life</td>
<td>10 – 20</td>
<td>10 – 15</td>
<td>10 – 20</td>
<td>5 – 10</td>
</tr>
<tr>
<td>Refurbishment</td>
<td>20 – 30</td>
<td>15 – 30</td>
<td>20 – 30</td>
<td>10 – 15</td>
</tr>
<tr>
<td>Old age, Redevelopment, &amp; Total Obsolescence</td>
<td>50+</td>
<td>35+</td>
<td>40+</td>
<td>25+</td>
</tr>
</tbody>
</table>

Table 2-4: Property life expectancy (in years)
Source: Boydell & Clayton (1993)

There are undoubtedly many advanced design and material features being included in the latest specification ‘high-tech’ plans of the 1990s that will prove to be the asbestos or HAC of tomorrow or certainly of the next decade. Furthermore, as research evolves into sick building syndrome a quantification of a building’s suitability for purpose will undoubtedly be established which, by implication, must have a correlation to achievable relative rental income and yield. Thus there will be a direct relationship to investment return.

Work on shopping centre life expectancy has been undertaken in the US. The International Council of Shopping Centers (ICSC), whilst being the representative body of the shopping centre industry, does not carry data on all shopping centres. This is done by some of the business publications. With a total of 40,368 shopping centres currently within the US,\textsuperscript{245} it is easy to appreciate the difficulties of collating data. As such there has been no research on shopping centre lifecycles/refurbishment/depreciation in the US since Shopping Center Useful

\textsuperscript{242}Butcher (1994) p. 232.
\textsuperscript{243}Damond Lock Grabowski & Partners (1993) p. 11.
\textsuperscript{244}McEwan (1994) citing Bill Woodburn.
\textsuperscript{245}National research Bureau Shopping Centre Database and Statistical Model 1995, in Shopping Centers Today, ICSC, April 1995.
Lives an economic analysis in 1976. This research concluded that the average life of the structural shell of a centre lies at 36 years:

Based on analysis of a sample of shopping centres identified as representative of the class as a whole and specific evaluation of economic factors which affect their useful lives, the depreciation period for the structural shell of regional shopping centers and regional shopping center-based department stores has been calculated at 36 years.

The analysis was confined to 22 centers (in 14 cities) considered representative of the market and ran from their date of opening through to 1972. The probable useful life is used for income tax purposes as well as valuation and financial statement purposes. The survey focussed on the shell as the most physically durable of the building components. 40 observations were made per center considering physical, functional and economic aspects of depreciation. The results demonstrated that useful lives for centers are constrained by economic rather than physical factors.

A situation can occur where land value is increasing and the value of the improvements is falling. The only way to optimise return is then to take down the improvements and rebuild with associated capital injection. The survey focussed on date from construction to full obsolescence and the sample age ranged from 3 to 22 years. There is a weakness (or hypothetical vagary) in the survey in this regard, because there must be a form of negligence (or lack of prudence) on the part of an investor who allows a shopping centre to achieve full physical obsolescence without considering the appropriateness of capital injection to maintain and improve income flow. This view would also serve to undermine the “S” curve work of Britton and Connellan in respect of its applicability to immature assets, such as regional shopping centres, despite their confirmation as ‘specialised’.

The value of an asset was derived from taking the Net Operating Income (NOI) and capitalising into perpetuity. The weakness in this methodology has already been considered (2.3.7).

Stage 1: Determine NOI
Stage 2: Capitalise NOI (using market rate) to determine Economic Value
Stage 3: Economic Value - Current Fair Market Value of Land = Economic Value of Building

246 Gladstone Associates (1976)
Stage 4: Economic Value of Building - Cost of Building to Date \(=\) Economic (Obsolescence)/Appreciation

Stage 5: Economic (Obsolescence)/Appreciation to Date (from Stage 4) divided by Cost of Building to Date (from Stage 4) = Percentage (Obsolescence)/Appreciation

At this stage it is possible to calculate the full useful life of the structure as at Obsolescence = 100%, by dividing 100% by the annual rate of obsolescence.

Stage 6: Percentage of Obsolescence divided by number of years Center has operated = Annual Rate of Obsolescence (as a %). 100% is then divided by the Annual Rate of Obsolescence to derive an Estimated Years of Useful Life.

A Prospective Analysis was undertaken by reversing the process, but was only considered to have a valid life of 4 years (to 1980) as market penetration could only be gauged for that duration. A 10% capitalisation was taken as conservative. No worked examples were shown.

In considering depreciation, the data indicated high depreciation in the early years of life. This, in itself, leads to some confusion. The figures are clearly distorted (indicating depreciation/appreciation from -20% to +10% in the first few years) by the establishment of the centre, so if it is not fully let in the first few years, the NOI will be adversely prejudiced and NOI to Cost to Build will serve to confuse. In the sample, useful lives ranged from 9 to 59 for 14 of the sample and over 60 years for the other 8, thus a median of 36 years was achieved using prospective analysis and 33 years for retrospective analysis. This approach may evidently serve to cloud and averages are dangerous. Due to econometric and demographic influences, each centre must be considered on its own merits.

Using the ULI Dollars & Cents of Shopping Centers 1993 information some interesting observations about depreciating retailer performance (quantified on a return per square foot (psf) of retail operating space based on net lettable area) can be observed (Table 2-5).

This data is very supportive of the argument that over time values do decline in real terms.

---

248 Based on original cost of building + original cost of additions and renovations (adjusted to constant dollars).

249 If this is a negative, incurable economic obsolescence is deemed to have occurred.

250 This function would make more sense if classed as “Stage 7”.

251 ULI (1993)
Obviously there can be some criticism of the statistical base, sizes and the fact that (as with all such data) geographical locations are not provided. Given those constraints, what is demonstrated is a fall off of receipts and a fall in NOI over the period. Given the vagaries of the >20 years data, it is reasonable to assume that some refurbishment/expansion activity may have occurred. Due to the 1,2,3 year sample size, some of the input data is unavailable, but it is reasonable to deduce that lease structures allow for a better reclaim of expenses.

<table>
<thead>
<tr>
<th>Age</th>
<th>1,2,3</th>
<th>4,5,6</th>
<th>7,8,9</th>
<th>10-19</th>
<th>&gt;20 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sample</td>
<td>6</td>
<td>6</td>
<td>16</td>
<td>40</td>
<td>26</td>
</tr>
<tr>
<td>Size (total)</td>
<td>N/A</td>
<td>N/A</td>
<td>464,506</td>
<td>614,862</td>
<td>515,081</td>
</tr>
<tr>
<td>Un-owned</td>
<td>105,111</td>
<td>99,492</td>
<td>39,896</td>
<td>78,486</td>
<td>83,681</td>
</tr>
<tr>
<td>Dept. Store</td>
<td>260,840</td>
<td>307,893</td>
<td>319,493</td>
<td>345,952</td>
<td>268,007</td>
</tr>
<tr>
<td>GLA Mall</td>
<td>199,163</td>
<td>215,776</td>
<td>240,766</td>
<td>258,097</td>
<td>235,545</td>
</tr>
<tr>
<td>Mall tenant sales $psf</td>
<td>$200.01</td>
<td>$171.62</td>
<td>$163.69</td>
<td>$172.00</td>
<td>$189.40</td>
</tr>
<tr>
<td>Rental Income 253</td>
<td>$14.90 +</td>
<td>$14.49 +</td>
<td>$11.65 +</td>
<td>$9.91 +</td>
<td>$10.79 +</td>
</tr>
<tr>
<td></td>
<td>$N/A =</td>
<td>$0.60 =</td>
<td>$0.82 =</td>
<td>$0.85 =</td>
<td>$1.45 =</td>
</tr>
<tr>
<td></td>
<td>$15.79</td>
<td>$15.07</td>
<td>$12.61</td>
<td>$10.78</td>
<td>$12.36</td>
</tr>
<tr>
<td>Total Operating Receipts</td>
<td>$34.70</td>
<td>$20.26</td>
<td>$19.99</td>
<td>$16.49</td>
<td>$17.36</td>
</tr>
<tr>
<td>Total Operating Expenses</td>
<td>$12.03</td>
<td>$4.64</td>
<td>$7.06</td>
<td>$6.36</td>
<td>$5.16</td>
</tr>
<tr>
<td>NOI –Net Operating Balance 254</td>
<td>$22.84</td>
<td>$14.66</td>
<td>$13.15</td>
<td>$10.09</td>
<td>$11.80</td>
</tr>
</tbody>
</table>

### Table 2-5: Depreciating retailer performance over time

Source: adapted from Dollars & Cents of Shopping Centers™: ULI (1993) 255

The literature on depreciation and life cycle is therefore inconclusive for regional shopping centres, identifying a clear knowledge gap. Another aspect of the life cycle is the evident need to refurbish/renovate property assets in general, and regional shopping centres in particular,

252 This means year center opened 1988,1989,1990 and so on - meaning >20 years is pre 1971.
253 Includes Base + Overage.
254 Note: Because data are means, medians, and deciles, detailed expense amounts do not add up to totals. No median figures are shown if fewer than five values were reported for any income or expense category, and no lower and upper decile amounts are shown if fewer than ten values are reported (within the fuller information in the guide). The figures that I have abstracted are taken from the averaged figures provided, hence the fact that the totals do not add up exactly.
255 ULI (1993). This information is abstracted from the expansive charts on pp. 83 - 87.
over time. The level of capital expenditure has increased dramatically in the last 15 years. Harrington highlighted that an average of 35% of net income from CBD offices was spent recapitalising the building in 1995 compared with an average of <1% in the 1980s. No percentage was offered for the shopping centre sector.

2.3.10.12 Optimal time to renovate a shopping centre

Wong and Norman offer a maximisation model determining the optimal time at which a shopping centre should be renovated. The model assumes the possibility of restoring the mall to ‘brand new’ status and then highlights the marginal benefits of capital injection (expenditure) and their impact on net rents and yields over time. Essentially a micro model, it enables the likely impact of changes in market conditions on proposed renovations to be identified. For example the ‘competition’ element whereby increased competition from new retail schemes is a catalyst for a faster rate of decline in net rental incomes of the existing shopping centre – so encouraging a shortening in the optimal renovation period. This is the only significant reference to the ‘competition’ impact in the property related depreciation literature and highlights a key issue for development in the qualitative interviews. The model affords a useful forecasting tool to determine capital expenditure within the cashflow albeit that the use of calculus may cause/result in resistance to its adoption by some of the valuation profession.

Expenditure on retail refurbishment and expansion is significant with $593 million being spent in Australia in 1994 compared with $489.6 million on new retail. The need for periodic expenditure on any property investment to mitigate the effects of obsolescence has been acknowledged. Refurbishment capital must be injected into the cash flow from ‘time-to-time’ to maintain (rather than, say, improve) the original market appeal from both an investment and letting market viewpoint. Traditionally, in contrast, the simplistic capitalisation approach is to adopt a yield that reflects such expenditure and assume that following purchase no further expenditure is anticipated. Despite suggesting a numeric

---

256 Harrington (1995a)
257 Wong & Norman (1994)
258 ABS statistics cited by McEwan (1994)
259 Following earlier literature reviews and supplemented by Sykes (1984) p. 32.
model, Sykes acknowledges that in reality the decision to undertake capital expenditure (or refurbishment) will very much depend on the particular circumstances of the investment and the investor.

Sykes’ work was criticised for the assumption that yields ignore future capital expenditure in subsequent work by Brown.\footnote{Brown (1985) p. 231.} Valuers rely, where possible, on comparable evidence. It is reasonable to conclude that comparable properties will also require ongoing capital expenditure. Thus, a simple yield analysis should implicitly account, in some way, for an amount of future capital expenditure. Whilst Brown suggests building a workable model to analyse obsolescence and its impact on valuations to test empirically, such a model would be unlikely to satisfactorily account for a ‘competition’ variable. Brown’s model suggests a longitudinal survey to analyse 25 years of data would draw some worthwhile conclusions about obsolescence, but accepts that such data is unavailable in a reliable format. He makes the unjustified (from the data presented) statement that it is more than probable that valuers are getting it right and adjusting yields (to reflect obsolescence and depreciation) as new information becomes available. Whilst a theoretical model can reasonably easily identify when refurbishment or replacement should occur, it is difficult (or not possible) to apply in practice because of the uncertainty over future expenditure, changes in risk and land values.

A logical model for optimal mall refurbishment is offered by Pugh\footnote{Pugh (1992) p. 41.}, refurbishing when:

NPV of refurbished scheme > NPV of the existing scheme

Put into simple formula,

NPV of refurbished scheme is:

\[
R_f - [C_f + M_f + D_f]
\]

And the NPV of the existing scheme is:

\[
R_e - [C_e + M_e + D_e]
\]

Where:

\[R_f\] is rent receivable;
\[C_f\] is capital costs (i.e. the opportunity cost of the depreciated capital sum represented
in the buildings);
\[ M \] is maintenance costs;
\[ D \] is the rate of obsolescence/depreciation;
\[ r \] is the relevant rates after refurbishment;
\[ \theta \] is relevant rates of the existing building.

A couple of issues arise from Pugh’s model that require discussion. Firstly, quantifying the rate of depreciation is an enormously subjective issue. He realises that the problems of divergent interests and responsibilities arise because the capital expenditure for refurbishment had not been acknowledged before a shopping centre had run one fifth of its projected life. McKenzie expressed the same sentiment\(^{262}\) - no one had grasped, in the early years, that quite apart from maintenance, centres would become dated aesthetically and functionally. This returns to the issue of centres having a facelift (which is often accounted for in cash flows) compared to a major expansion, which equates to a remodelling, with significantly different floor area and demographics. Refurbishment is an issue that requires consideration and inclusion in the initial (original) planning of a centre. Refurbishment is now important as a defensive measure (pro-active or re-active) against competition which could result in falling rents and increasing yields. Very often it is difficult to justify the increase of capital in the scheme – the work being defensive, to hold market share rather than increasing it.\(^{263}\) It is essential to treat refurbishment as a ‘positive’ action. Revitalising centres is not tenant driven. In research undertaken by DLG&\(^{264}\) only 2.3% of retailers initiate refurbishment (a case of “the landlord rules, OK?”)\(^{265}\) suggesting that retailers may bear no particular long-term allegiance to a particular centre. They suggested that none of the refurbishment was design driven, although the design aspect is critical according to Bolotin.\(^{266}\) The secret of successful shopping centre refurbishment is cited as:

- Repositioning
- Improving
- Space Planning
- Revitalising

\(^{262}\) McKenzie (1987)
\(^{264}\) Damond Lock Grabowski & Partners (1993) p. 3.
\(^{265}\) Bowyer (1990) p. 23.
\(^{266}\) Bolotin (1994)
Renovating is usually maintenance driven and in isolation will rarely be successful from a retail or marketing viewpoint. Whereas DLG&P indicated that increased (or at least not diminished) perceived capital value was the prime rationale – in other words, defending the centres existing market sector. The impact on rents is difficult to gauge. Of least concern is the condition of the building fabric. Refurbishment and expansion projects are lengthy exercises with average lead-in times of two years whilst many take in excess of three.

2.4 Conclusion

The two key questions that the literature raises are centred on the valuation and the depreciation aspects of shopping centre investment appraisal. This chapter has reviewed the literature relating to enclosed regional shopping centres. The nature of appraisal has been considered in detail, as has previous work in the area of depreciation and obsolescence. The literature supports the contention that a regional shopping centre’s effective life may differ from the perceived ‘taxation’ life of the bricks and mortar. It is evident that shopping centres are evolving assets that require ongoing significant capital expenditure. As an asset class, regional shopping centres have outperformed other property sectors in the last decade. The timing, amount or nature of capital expenditure required is not properly addressed in the literature. Moreover, in the appraisal area, it is significantly underplayed. The area of risk is confused from an appraisal viewpoint, with different meanings for the terminology and no assistance offered in this respect by the AIVLE DCF Practice Standard. Similarly, there is an expectation of the valuation profession to provide (growth) forecasts of future rental income, capital expenditure and yield (risk/return) movements although they are not, by dint of their training, economic forecasters.

These ‘gaps’ in the literature form a basis for establishing research questions. Importantly, it establishes the theoretical framework that will feed back into the research findings.

267 Dudman (1987)
References: Chapter 2


Gladstone Associates (1976) Shopping Center Useful Lives: an economic analysis, prepared for the National Retail Merchants Association (NRMA), New York.


ICSC (undated) ICSC Shopping Center Definitions, Published by the International Council of Shopping Centres, New York, US. The ICSC librarian provided this in April 1995.


Trimboli, F. (ed.) (1979) A Glossary of Terms used in Real Estate and Valuation Practice (2e), The Real Estate Institute of Australia, Canberra.


Chapter 3

METHODOLOGY

In this chapter the research methodology is explained and evaluated. The background and rationale for adopting a qualitative approach are introduced and discussed as the optimum vehicle to elicit and analyse a deeper insight into the philosophy and operation of the investment appraisal of enclosed shopping centres. The challenges of data collection in an environment of secrecy and confidentiality, where knowledge is power, are discussed and available alternative data sources for a quantitative analysis or case study approach are considered. The research methodology literature relating to the process has been incorporated into this chapter.

3.1 Introduction

The nature of this research is to learn from the literature, then question current practice to elicit an understanding of current processes and analyse the outcomes. The phrase ‘perceptual or factual’ is repeated several times during this chapter. Its use stems from the researcher’s evolving understanding coupled with interviewee’s views, which in some cases may err more on the subjective than the objective. The nature of academic research ensures that the researcher brings a caucus of background knowledge of enclosed regional shopping centres to the research methodology, based primarily on the literature, but augmented by the researchers practical industry experience. The background knowledge leads into questioning, which surely must be the purpose of academic research. Is it paradox or is it paradigm?

Kuhn268 defines a paradigm in part as a scientific achievement that is:

Sufficiently unprecedented to attract an enduring group of adherents away from competing modes of scientific activity. Simultaneously, it is sufficiently open ended to leave all sorts of problems for the redefined group of practitioners to resolve.

---

268 The initial research methodology outlined in this Chapter has been published, in part, in Boydell et al. (1997a) and Boydell et al. (1997b). These papers were developed primarily by Boydell as part of this doctoral research. The constructive responses of delegates have been incorporated into this Chapter, together with the responses from Australian Universities Building Educators Association (AUBEA) referees and 2 referees from the Journal of Real Estate Research.
Thus it is true to consider this research an evolving paradigm, for it leaves the topic more open, more visible. At its heart is the nature of property ownership and investment per se, and enclosed regional shopping centres in particular.

3.1.1 Establishing a Philosophy

"And what is good, Phædrus,
And what is not good -
Need we ask anyone to tell us these things?"

It is appropriate to start with this quotation. Pirsig used it as a prelude to his exploration of anthropology and enquiry into value, worth and truth. That perhaps is the connection. That is not to set an agenda under which the arbiter of value or worth, the valuer or appraiser, is implicitly an anthropologist. It is, rather, a means of introducing and supporting the merit of writing about people, or ethnography, as a fundamental tool of property research.

3.1.2 The Research Dilemma

Property researchers have a problem. Property investment is fundamental to western economies with billions of dollars allocated as both investment and occupancy capital. Therein lies the dilemma. Knowledge is power. Knowledge, in property's case, relates to the specific investment decision factors of risk, forecasting, rental income and management expenditure.

Research by the valuation profession lags considerably that of other disciplines. What research has been completed is often predominantly market oriented, emanating out of the large international commercial valuation practices to ease the sale or leasing of their clients' schemes. These companies, along with industry lobbying groups such as, in Australia, the Property Council of Australia (PCA) and professional bodies such as the Australian Institute of Valuers and Land Economists' Inc. (AIVLE), are now recognising the need for pure research. This reinforces the need to move away, or above, the market image, to create a purer, more academic research view. In some ways, this academic view is questionable, given the constraints of both time and money on funded research projects that favour more direct and/or applied research.

269 Kuhn (1970) p. 10
270 Pirsig (1974)
This long-standing dichotomy between materialistic constraints and the development of theory is summarised thus:

“…(Darwin) used the same method as all true philosophers, it is important to ask but there is no haste to provide the answer.”\textsuperscript{271}

On a positive note, there is a move towards collaborative research between the professional and industry bodies with academic institutions.

It was in the spirit of collaboration that the framework for a case study approach was anticipated in the embryonic stages of the research. Having been awarded pump-priming research funding from Healey & Baker under the Healey & Baker Award in 1991 the researcher was quickly confronted with the harsh reality of academic research in the property sector. The evolving property research paradigm is supportive, until the knowledge is asked for. Client confidentiality is the byword of most property consultants. Of course this is as it should be - professionally upholding contractual duty of care to the client. Similarly, approaches by the researcher to the client - be it superannuation fund or Listed Property Trust - can be equally thwarting. The agreement of all the trustees must be obtained, the advice of their property consultants is confidential (although the edited summaries end up in the public domain in the form of annual reports to trustees and investors), and so it goes. Most funds are wary of divulging their goals and aspirations for various investments, per chance the competition will use such information to their advantage.

It quickly became apparent that using a professional “network” as a Chartered Surveyor would not open the necessary doors to a case study approach that had initially been anticipated. The confidentiality issue was taken to levels of paranoia as property consultants and valuers were clearly not going to be able to open their files in the interest of academic research. It was apparent that there was a subtler side issue afoot, given the uncertainty or lack of confidence that many practising valuers had in the numbers behind their own professional reportage. It was apparent that alternative avenues would need to be explored to collate the necessary raw data to develop the hypothesis.

After moving to Australia in 1993, knowledge and interest in this research grew in certain spheres of the property industry. Based on mutual trust and most importantly mutual interest, the property department of Australia’s largest superannuation fund, AMP, agreed to participate.

\textsuperscript{271} Gaarder (1995) p. 315.
in the research in early 1995. AMP Property Investments agreed to contribute three case studies of regional/super regional shopping centres from their portfolio. The case studies offered locational diversification with one in Queensland, one in New South Wales and one in Victoria. At the time this appeared to be a major breakthrough in what had become a stumbling block for the progression of the research.

Confidentiality remained an issue. The full financial details of the centres and the detailed in-house valuations were made available to the research, in confidence. The most significant aspect of this opening was the opportunity to investigate and rebuild the framework for a DCF model with the whole shopping centre team from Australia’s biggest superannuation fund. This team were able to draw on their experience in owning, developing, managing and valuing a property portfolio worth some $8 billion at the time. The framework/agenda for the workshop with AMP in Sydney is set out in Appendix 1.

Having addressed the access, albeit confidential, to case studies and used the opportunity as an industry based vehicle to develop a basic DCF model, challenges to the further collection and analysis of data remained. To what degree the case studies could be developed to fruition was uncertain if key trading data, commentary on competition and demographics as well as financial appraisal details were ultimately to remain confidential. A case study, or case studies, developed on such lines would ultimately need to be so couched in the hypothetical as to render their published validity open to question, and create a difficulty of defence within a Ph.D. The opportunity to investigate three separate case studies was also limited by the great Australian tyranny, that of distance, and inherently cost.

Critically, the support of the team at AMP lent an invaluable basis for early discussion and rationalisation of the literature as well as indicating credence of the burgeoning research philosophies in the eyes of the other players in the market - who were to subsequently become the “experts”. It would be an injustice not to acknowledge the cachet that AMP’s involvement, in the forum that became the pilot study for the testing/questioning the hypotheses, lent to opening doors and interest in the qualitative approach some eighteen months later.

The forum with AMP highlighted uncertainty over aspects of the hypothesis on depreciation, in so far as it was an area hitherto underplayed by the valuation profession, although not for the reasons initially anticipated. It allowed for a deeper understanding in what would later become the conceptual framework and the way that depreciation was more fully investigated. The forum also highlighted the irrelevance in the current Australian lease environment of the
‘contemporary’ Three Y.P (or Triple Y.P.) approach proffered by Baum & Crosby.  

Hitherto, the research had clung to a perception of the importance of linking the Baum and Crosby model into the shopping centre scenario.

Through trust, access was made available to the BOMA (now Property Council of Australia) Shopping Centre Database (SCD) by BOMA’s head of research, Adrian Harrington. In its published (print medium) form, the BOMA SCD retails at several thousand dollars per annum to obtain coverage of all states and territories. Access to the full directory was provided in spreadsheet format. The SCD potentially offered a useful tool to investigate ownership, expansion and refurbishment of the 72 regional (or larger) classified enclosed shopping centres.

3.1.3 Extension Frequency

The BOMA SCD contains some worthy confidential data locked within the spreadsheet. The full (reported) data on date of construction and subsequent extensions (or refurbishment/expansion) were included. This saved the need to detail an inquiry to each of the owners/managers in order to collate this data. Such an inquiry was, as it transpired, fraught with difficulties as in many centres the original developers, or owners who undertook subsequent expansions, may not be the current owners and the source of information would not be forthcoming.

The refurbishment/extension data, on analysis, offers no valid correlation between original date of construction and frequency of expansion. Ten centres built between 1957 and 1980 have had four significant extensions. This data is summarised in Appendix 5. It was clear that factors beyond mere age lay behind the re-injection of capital into shopping centre investments.

Furthermore, no clear or valid correlation can be drawn between the size of extensions and site area. What is clear is how, over time, the maximum Gross Lettable Area (GLA) of retail space in square metre terms has increased. There was a maximum threshold of expansion to circa. 60,000m² in the 1980s to 100,000m² by the late 1990s with a couple of centres expanding to 120,000m². However, an analysis of the database revealed that ownership (and other related involvement) was limited to a handful of players in this major (in dollar value) market sector.

---

272 Baum & Crosby (1988, 1995)
273 BOMA (1996)
3.1.4 Art or Science?

Traditionally the vast majority of academic research undertaken on property has adopted a quantitative and numerate philosophy. It is a reasonable assertion that this is the result of property research being driven by economists and statisticians whose numeracy, in all but rare cases, surpasses that of the valuer. This assertion is perhaps a little extreme if we accept the definition of the appraiser (valuer) as an applied urban land economist.\(^{274}\) Debating such definitions, or delving into such history, will ultimately lead us back to the debate over the perplexing question, “Is valuation an art or (as well as) a science”. A resolution to such a question is not the purpose of this research. The literature in this area does, however, serve to raise some appropriate questions. For instance, by concentrating on the scientific (quantitative) method, are valuers charting a truly progressive course or are they being lured by data's sweet song into riding their computers onto the rocks? \(^{275}\) At its most scientific the investment appraisal becomes a formal case of structured reasoning that conforms to the scientific method. Deductive reasoning dictates that when presented in a logical framework, information allows the development of an equation from which the conclusion necessarily follows. Implicitly, there is nothing in the conclusion that is not also in the premises. Verbal relationships and mathematical calculations become essentially the same.\(^{276}\) This view is supportive of adopting an ethnographic, or qualitative, research methodology.

An investigation into the verbal relationships - a process of cultural description - can evolve. In this instance the culture is the property industry and those involved within it. The people involved are not the subjects. In ethnography they are ‘experts’ on what the ethnographer wants to find out about.\(^{277}\) Only by understanding the reality of the people who come before us can we see why we look at the world the way we do.\(^{278}\) The emphasis in quantitative research is on the testing of theory. In contrast, ethnographic research takes as its central concern the generation and development of theory. Gathering and analysis of non-numeric data are desirable in qualitative research.\(^{279}\) Whilst acknowledging that quantitative and qualitative approaches can be complementary, the application of a qualitative approach enables researchers

\(^{276}\) ibid p. 319.
\(^{277}\) Burns (1994) p. 245.
\(^{278}\) Redfield (1994)
\(^{279}\) Henwood & Pidgeon (1995)
to sensitively explore the multiple interpretations that may be placed on thought and behaviour when their full complexity is viewed in context.

The “art or science” debate is equally applicable in addressing qualitative research, where ‘systematic methods’ represent the science question.\textsuperscript{280} The term ‘grounded theory’ is synonymous with a systematic approach to qualitative research. Theory is grounded in the experiences and accounts of the interviewees. A grounded theory is one that inductively derives from the study of the phenomenon (or fact) it represents.\textsuperscript{281} It aids discovery, develops, and provisionally verifies through systematic data collection and analysis of data related to and associated with the fact. In quantitative analysis the intent is ordinarily to test a theory. Grounded theory focuses on the development of theory, without any particular commitment to specific kinds of data, lines of research, or theoretical interests.\textsuperscript{282} In other words, in grounded theory one begins with an area of study and what is relevant is allowed to emerge. Tools, rather than rules, apply. These tools include indexing, coding (open, axial and selective), analytic memoing and theoretical sampling. Grounded theory proves that rigour is not solely restricted to the verification in science.\textsuperscript{283} Grounded theory helps to undermine the false dichotomy between ‘soft’ qualitative and ‘hard’ quantitative research. Paradoxically, the ‘softer’ a research technique, the harder it is to do.\textsuperscript{284}

3.1.5 Grounded Theory

Much of the writing on grounded theory suggests that the philosophy of grounded theory is new.\textsuperscript{285} Indeed the title of Glaser and Strauss’ (1967) treatise "The Discovery of Grounded Theory" makes such a view explicit. The naming attributed to the process may be new, but the process and its philosophical routes can be traced back to Plato (c.428 - c.348 BC). Strauss and Corbin contend that formulating theoretical interpretations of data grounded in reality provides a powerful means both for understanding the world ‘out there’ and for developing action strategies that will allow for some measure of control over it.\textsuperscript{286} They outline the requisite skills for undertaking qualitative research as the ability to: step back and critically analyse situations, recognise and avoid bias, obtain valid and reliable data, and think abstractly. This sounds like

\textsuperscript{281} Strauss & Corbin (1990) p. 23.
\textsuperscript{282} Strauss (1987) p. 5.
\textsuperscript{283} Henwood & Pidgeon (1995)
\textsuperscript{284} Yin (1989) p. 27.
\textsuperscript{285} Glaser & Strauss (1967); Glaser (1978); Strauss (1987); and Strauss & Corbin (1990)
\textsuperscript{286} Strauss & Corbin (1990) p. 9.
the expected skills of a professionally qualified appraiser - and perhaps, inherent within this justifies why appraisers are (or possess the skills to be) good at qualitative analysis. Indeed the word ‘qualitative researcher’ in Strauss and Corbin’s definition could easily be replaced with ‘appraiser’ to achieve a definition common to professional property bodies internationally. That is:

“…to do these a qualitative researcher (read appraiser) requires theoretical and social sensitivity, the ability to maintain analytical distance while simultaneously drawing on prior experience and theory to interpret what is seen, astute powers of observation, and good interpersonal skills.” 287

3.2 Justification for the paradigm and methodology

The framework above sets a background to adopting a qualitative methodology. This section investigates the specific application to property investment and considers tools (software) to support the methodology.

3.2.1 Application to Property Investment Appraisal

What is established from the above is that grounded theory is conceptually steeped in the oldest of philosophies. That, by inference alone does not justify its adoption. However, most quantitative research has at its origin a collection of qualitative ideas. It is also the optimal methodology to adopt where any industry data is likely to be shrouded in secrecy. It is further contended that appraisers are ideally skilled to undertake qualitative research. In introducing qualitative research the discussion focused on grounded theory in particular. Qualitative research also includes the phenomenological approach, life histories, conversational analysis, case studies and ethnography. The case study combined with ethnography approach has been successfully applied to property investment and risk appraisal in particular. Turner developed the theory that the use of Environmental Management Systems (EMS) can assist in reducing property investment risk. 288 He adopted a grounded theory approach based on the analysis of interviews and questionnaires. The analysis focused on a collection of semi-structured interviews that he conducted with environmental auditors, tenants of industrial properties, valuers, environmental lawyers, institutional investors and lenders.

287 ibid p. 18.
288 Turner (1995)
The main focus of Turner's data collection was by face to face interview. Such an approach allows peoples' views to be probed for in-depth information. Interviews allow the researcher to ask for explanations or clarification. They also allow the researcher to provide information on the respondent's (interviewee's) reactions that may be incorporated into the analysis. Turner also incorporated some questionnaire analysis on the basis that, as this was the mode preferred by the potential respondent, such preferences would serve to enhance the quality and credibility of the response. There is a risk that conclusions may fail to fit reality if behaviour is studied in a symbolically reduced manner. Such an approach would be the adoption of a ‘yes’ or ‘no’ questionnaire with associated statistical testing. A semi-structured interview approach gives direction to the interview to ensure that the content focuses on the crucial issues of the study. This approach allows greater flexibility than rigid (or closed) interview structures while ensuring an increased validity in the informant's perception of reality.

The semi-structured approach requires more skill in the analysis, notably coding, of the data. Turner transcribed some 29 hours of tape-recorded interviews that needed coding. To give rigour to the coding and develop its validity, he used computer software analysis in ‘The Ethnograph™’. It has become accepted that computer-aided analysis of qualitative data is the norm. There are counter arguments that computers do not actually save time because of the lead time to learn the program and the enticement to use features that may cloud rather than focus the research. The indication is that ultimately the learning curve is short, the outcome is more efficient and of a higher quality for the same total time investment.

3.2.2 Supporting Software

There are currently many qualitative software applications on the market that extend the analysis process considerably beyond the search facilities of word processors such as Microsoft™

\[290\] ibid p. 19.
\[292\] Mills (1959)
\[293\] Burns (1994) p. 279.
\[294\] Turner (1995)
\[295\] Tesch (1989); Miles & Huberman (1994); and Weitzman & Miles (1995)
\[296\] Horney (1994)
\[297\] Weitzman & Miles (1995) p. 4
Word\textsuperscript{TM} or WordPerfect\textsuperscript{TM}. Weitzman & Miles\textsuperscript{298} offer detailed reviews of the 24 leading qualitative analysis software packages. These programs can be broken into five groupings: text retrievers; textbase managers; code-and-retrieve programs; code-based theory-builders; and conceptual network builders. ‘The Ethnograph\textsuperscript{TM},’ as adopted by Turner\textsuperscript{299}, is classed as a code-and-retrieve program. This group helps in dividing text into segments, coding the segments and then displaying the coded groupings. Such processes save on the scissors, glue and note cards of qualitative researchers of yesteryear. It is interesting that Turner resorted to coding the paper copy of his files rather than relying on an on-screen-coding approach.\textsuperscript{300} The Ethnograph\textsuperscript{TM} was one of the first code-and-retrieve programs to be introduced, dating from 1985 with over 4,000 copies subsequently in circulation. The early popularity no doubt owes something to its pertinent name. It is acknowledged to have limitations and has been overtaken by the more sophisticated and interactive Code-Based Theory-Builders. This is not to say that theory cannot be evolved from the code-and-retrieve programs, or the scissors-and-glue method. Development of theory is the purpose of all such qualitative research. What sets the code-based theory-builders apart is their ability to develop higher-order classifications and categories, to formulate (or rather assist in the formulation of) propositions or assertions of conceptual structure and to test the propositions. Such tools allow for the depth of coding and enhanced theoretical sensitivity deemed fundamental to evolve grounded theory.\textsuperscript{301}

Clearly, no computer software will actually build theory, and nor should one want to abdicate such responsibility to a machine, even if such a facility was available. However, theory is derived from sub-sets of logic – and that is what machines are good at. Ideally, the thought and understanding originate and evolve through the understanding and skill of the researcher. What the programs do is tender both support and powerful tools to ease the researcher’s theory building and testing. Weitzman & Miles review five code-based theory-building packages, of which ATLAS/ti\textsuperscript{TM} and NUD ISt\textsuperscript{TM} offer the greatest flexibility.\textsuperscript{302}

Both ATLAS/ti\textsuperscript{TM} and NUD ISt\textsuperscript{TM} allow for extensive coding (indexing), filtering and memoing following grounded theory principles. The strength as a tool comes in the searching of data. In this area NUD ISt\textsuperscript{TM} has the most extensive and powerful set of code-based retrieval operators available. The process allows ‘system closure’ by which the analysis and codification become

\textsuperscript{298} ibid
\textsuperscript{299} Turner (1995)
\textsuperscript{300} ibid p. 192.
\textsuperscript{301} Strauss & Corbin (1990)
\textsuperscript{302} Weitzman & Miles (1995)
part of the data. Both allow theory building with associated graphical interpretation.\textsuperscript{303} As this thesis has its origins in Australia, the joint ethic of buying Australian and the ease of technical support access swayed the decision to use NUD\textsuperscript{IST}. NUD\textsuperscript{IST} also claims the largest circulation/highest licence for qualitative software with over 10,000 licensed users worldwide.\textsuperscript{304} This builds on the experience of Turner, by using a more powerful and evolved software tool.

\section*{3.3 Research procedures}

\subsection*{3.3.1 Risk, Growth and Depreciation}

As stated, the ‘knowledge and power’ aspect is at the root of the research problem. The hypothesis centres on the three key aspects of risk, growth and (specifically) depreciation as they affect the investment appraisal of enclosed regional shopping centres. There are seventy-two regional (or larger) enclosed shopping centres in Australia. They have a total investment value of c. $14 billion. It is a high performing sector, yielding the best returns in Australian property over the last 10 years.\textsuperscript{305} Diversification is restricted at this level of investment with only six funds owning three or more centres. It is valid and pertinent to triangulate both analysis and theory by undertaking some complementary quantitative analysis of available data. Available Property Council of Australia returns data was analysed in Section 2.2.2. By triangulating, or combining, these two approaches to the research problem the validity of the conclusions are enhanced if there is evidence of mutual confirmation.\textsuperscript{306} A qualitative, grounded theory, approach allows the only true empirical insight into this sector. Interviews with key participants are recorded and transcribed, while maintaining full confidentiality. The original philosophy behind data collection focused on semi-structured interviews with:

\begin{itemize}
  \item owners
  \item developers
  \item managers
  \item architects
  \item valuers
\end{itemize}

\begin{itemize}
  \item six owning three or more centres
  \item five developing three or more centres
  \item seven managing three or more centres
  \item six designing three or more centres
  \item five valuing three or more centres
\end{itemize}

\textsuperscript{303} The relative merit of the finer points of both programs is fully espoused in Weitzman & Miles (1995)

\textsuperscript{304} Q.S.R. (1997)

\textsuperscript{305} Property Council of Australia (1996)

The above groupings, whilst seemingly clear from the BOMA SCD, served, on investigation (through establishing interviews) to be quantitatively clouded because certain owners also played a major role in the development, management and design (architect) functions. This is better explained by expanding on the key players (a summary is provided below - full details can be found in Appendix 6).

3.3.2 EMPIRICAL WORK

3.3.2.1 Conceptual Framework

A semi-structured interview format was adopted. This was based around a ‘conceptual framework’ which was sent to all “experts” in advance of the interview. Each appointment was confirmed by fax, and each participant was sent a concise covering letter of introduction (see Appendix 7) together with a conceptual framework overview (Figure 3-1) and a conceptual framework specialism (owner, developer, manager, architect or valuer) (Figure 3-2, 3-3, 3-4, 3-5, 3-6).

The conceptual framework overview is illustrated in Figure 3-1. Each of the conceptual frameworks evolved out of the literature and pilot interviews that were undertaken in the US and UK in 1995. The purpose of the pilot interviews was to discuss the outcomes of the literature and establish if there were any ‘gaps’ emanating from new UK, or US research. Furthermore it enabled an evolution of the conceptual frameworks by ‘bouncing’ the issues off academics, appraisers, developers and shopping centre owners (Appendix 2) in the larger US market whilst keeping abreast of evolutions in theory and practice in the UK. The meetings/interviews took the form of a mutual exchange of information, disseminating views highlighted in the literature and questioning practice in that context.

The conceptual frameworks that were developed from the literature review and pilot study discussions serve as a visual representation of the interview guide approach for the researcher and the ‘experts’. An interview guide allows topics and issues for discussion to be specified in advance in outline form. The interviewer then decides the sequence and wording of questions during the course of the interview. The benefits of such an approach are that the outline ensures the comprehensiveness of the data, enabling systematic data collection from each respondent. Whilst logical gaps can be anticipated and closed, it allows the flexibility to follow and expand on aspects that the researcher may not have been aware of prior to the interview.

The conversational and situational nature of the interviews also serves to put the participants (experts) more at ease. The specialism frameworks allow for a commonality for subsequent coding, even though elements of the interview may have been handled in a different order or style with each respondent.

![Conceptual Framework: OVERVIEW of Qualitative Interview Process](image)

**Figure 3-1: Conceptual Framework: Overview**

Source: Boydell, S. developed for this research

The evolution of the conceptual framework is a key tool of theory building. The purpose of research is to investigate, describe and analyse a pattern of relationships. At each stage of the research conceptual frameworks offer a visual synthesis of the researchers developing understanding, using labels to categorise intellectual bins. Researchers, however inductive their approach, know which bins are likely to be in play in the study and what is likely to be in them.\(^{308}\) The bins come from theory (the literature review), experience (as a qualified valuer and researcher on property investment and appraisal) and the general objectives of the study envisioned.

\(^{308}\) Miles & Huberman (1994) p. 18
The conceptual framework is a brief that can change en route and develop out of the fieldwork itself and it is normal for there to be several iterations as the theory evolves/develops. The evolution and synthesis of the frameworks following from the data analysis and coding in Chapter 4 demonstrate this.

The initial conceptual framework (overview), as shown above, attempts to contextualise the key “players” and their inter-relationship within the backdrop of the enclosed regional shopping centre. Critical to understanding the appraisal issue is the relationship and influences between the players. This ranges from the owner who takes a macro overview to consider their investment strategically as well as a detailed microanalysis of the performance and life cycle of individual centres and the need for cash injection to maintain or increase investment return. The key (presumed) theme of depreciation is dominant, as are directions that the data can indicate for the future.

Conceptual frameworks were thus developed for each of the “players” as a basis for the expert interviews and subsequent analysis.

3.3.2.2 Owners

The owner conceptual framework (Figure 3-2) was organised in such a way as to enable a series of “establishing” questions to be asked about investor motivation and rationale for the involvement in shopping centre investment in particular. Such a “focused” preamble was conceived as a prelude to put the “expert” respondents at ease, and thus in a comfortable mind frame to progress the interview enabling the optimum information to be elicited from the meeting. A similar “establishing” prelude was adopted for each category, and proved beneficial to ease into the interview and clear up any misconceptions that may have been brought to it by the researcher.

The linkage to the Property Council of Australia (PCA) view with the rationale, goals and return was important as the participants had market domination and thus the PCA ‘hype’ over the high returns in this sector was, in reality, based largely on the participants published aggregated return figures.

309 ibid. p. 20.
The investment horizon and life span ‘bins’ leading through depreciation are common ground with the other players (developers, managers, architects and valuers). The aspect of “masking” depreciation was a product of pilot study discussions. Similarly, the percentage of capital cost re-injection was an aspect that is seemingly overlooked in the appraisal process despite there being indications through the research evolution that major capital re-injection was an expectation of owners.

Three main players dominate the Australian regional shopping centre sector: Westfield Trust, Lend Lease, and AMP Society. Together these three organisations own (or co-own) 60% of the sector (43 out of 72 centres) [note: all data as at 01/05/96]. The owners interviewed represent the expert view of over 68% of the market sector (by GLA). This represents major market significance demonstrated by Table 3-1.
<table>
<thead>
<tr>
<th>Owner:</th>
<th>No.</th>
<th>as %</th>
<th>GLA m²</th>
<th>as % GLA</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMP Society</td>
<td>12</td>
<td>16.67%</td>
<td>662,084</td>
<td>17.98%</td>
</tr>
<tr>
<td>Westfield Trust</td>
<td>20</td>
<td>27.78%</td>
<td>1,092,476</td>
<td>29.67%</td>
</tr>
<tr>
<td>Lend Lease</td>
<td>11</td>
<td>15.28%</td>
<td>535,076</td>
<td>14.53%</td>
</tr>
<tr>
<td>QIC</td>
<td>2</td>
<td>2.78%</td>
<td>105,428</td>
<td>2.86%</td>
</tr>
<tr>
<td>Schroders</td>
<td>3</td>
<td>4.17%</td>
<td>122,395</td>
<td>3.32%</td>
</tr>
<tr>
<td>Interview Total</td>
<td>48</td>
<td>66.67%</td>
<td>2,517,459</td>
<td>68.36%</td>
</tr>
<tr>
<td>Sector Total</td>
<td>72</td>
<td>100%</td>
<td>3,682,459</td>
<td>100%</td>
</tr>
</tbody>
</table>

Table 3-1: Regional Shopping Centre Ownership

Source: adapted from BOMA (1996)³¹¹

The original intention was to interview all owners holding three or more centres. This would include the Coles/Myer group and Gandel. Coles/Myer are currently attempting to disinvest their property portfolio and the location of their corporate headquarters in Melbourne precluded inclusion. Gandel were also excluded due to difficulty in making contact to foster support for the research.

In contrast, Queensland Investment Corporation (QIC) which is Brisbane based was included due to their current acquisition policy, having taken co-ownership in two additional centres since the 1996 BOMA data was published. This increased their holding to 4 regional (or larger) shopping centre investments. Similarly, by the time of interview, Schroders had increased their holding to four.

A full list of all “expert” interview participants is included in Appendix 3. In the interests of confidentiality, participant’s names and organisations are not included in the methodology or analysis sections.

It should be noted that not all the shopping centres are held in sole ownership. Table 3-2, below, highlights the vehicle and co-ownership’s that are included. The interviews covered 68% of the market view.

³¹¹ Note: in this table the three centres in joint Westfield Trust/AMP Society ownership are counted for each owner.
<table>
<thead>
<tr>
<th>Owner</th>
<th>Type</th>
<th>Name</th>
<th>State</th>
<th>G.L.A. m²</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMP Society</td>
<td>M</td>
<td>Macquarie Shopping Centre</td>
<td>NSW</td>
<td>62,829</td>
</tr>
<tr>
<td>AMP Society</td>
<td>M</td>
<td>Garden City</td>
<td>QLD</td>
<td>51,591</td>
</tr>
<tr>
<td>AMP Society</td>
<td>R</td>
<td>Garden City - Booragoon</td>
<td>WA</td>
<td>48,618</td>
</tr>
<tr>
<td>AMP Society</td>
<td>R</td>
<td>Garden City Kotara</td>
<td>NSW</td>
<td>41,455</td>
</tr>
<tr>
<td>AMP Society</td>
<td>R</td>
<td>Colonades Shopping Centre</td>
<td>SA</td>
<td>39,351</td>
</tr>
<tr>
<td>AMP Society</td>
<td>R</td>
<td>Mt Ommanney Centre</td>
<td>QLD</td>
<td>34,442</td>
</tr>
<tr>
<td>AMP Society</td>
<td>S</td>
<td>Warringah Mall</td>
<td>NSW</td>
<td>89,124</td>
</tr>
<tr>
<td>AMP Society</td>
<td>S</td>
<td>Pacific Fair</td>
<td>QLD</td>
<td>85,413</td>
</tr>
<tr>
<td>AMP Society:</td>
<td></td>
<td>Knox City Shopping Centre</td>
<td>VIC</td>
<td>62,600</td>
</tr>
<tr>
<td>Westfield Trust/AMP Society *</td>
<td></td>
<td>Westfield Shoppingtown Southland</td>
<td>VIC</td>
<td>63,470</td>
</tr>
<tr>
<td>Westfield Trust/AMP Society *</td>
<td></td>
<td>Westfield Shoppingtown Tea Tree Plaza</td>
<td>SA</td>
<td>58,082</td>
</tr>
<tr>
<td>Westfield Trust/AMP Society *</td>
<td></td>
<td>Westfield Shoppingtown Bondi Junction</td>
<td>NSW</td>
<td>25,109</td>
</tr>
<tr>
<td><strong>Total Lease</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>535,076</strong></td>
</tr>
<tr>
<td>Aust'n Prime Prop Fund/MLC Life</td>
<td>M</td>
<td>Greensborough Plaza</td>
<td>VIC</td>
<td>50,173</td>
</tr>
<tr>
<td>Aust'n Prime Property Fund/MLC Properties</td>
<td>R</td>
<td>Macarthur Square Shopping Centre</td>
<td>NSW</td>
<td>37,687</td>
</tr>
<tr>
<td>GEM Retail Property Trust</td>
<td>R</td>
<td>Carlingford Court Shopping Centre</td>
<td>NSW</td>
<td>30,735</td>
</tr>
<tr>
<td>GEM Retail Property Trust</td>
<td>R</td>
<td>Northgate Shopping Centre</td>
<td>NSW</td>
<td>29,467</td>
</tr>
<tr>
<td>General Prop. Trust/Aust. Prime Prop. Fund</td>
<td>M</td>
<td>Sunshine Plaza</td>
<td>QLD</td>
<td>52,123</td>
</tr>
<tr>
<td>General Property Trust</td>
<td>R</td>
<td>Charlestown Square</td>
<td>NSW</td>
<td>38,729</td>
</tr>
<tr>
<td>General Property Trust</td>
<td>R</td>
<td>Woden Plaza</td>
<td>ACT</td>
<td>46,197</td>
</tr>
<tr>
<td>General Property Trust/ANZ</td>
<td>M</td>
<td>Penrith Plaza</td>
<td>NSW</td>
<td>63,500</td>
</tr>
<tr>
<td>General Property Trust/Aust'n Prime Property Fund</td>
<td>M</td>
<td>Erina Fair</td>
<td>NSW</td>
<td>65,076</td>
</tr>
<tr>
<td>General Property Trust/MLC Life</td>
<td>M</td>
<td>Dandenong Plaza</td>
<td>VIC</td>
<td>54,317</td>
</tr>
<tr>
<td>General Property Trust/VSB</td>
<td>M</td>
<td>Bankstown Square</td>
<td>NSW</td>
<td>67,072</td>
</tr>
<tr>
<td><strong>Westfield Trust</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>1,092,476</strong></td>
</tr>
<tr>
<td>Westfield Trust</td>
<td>M</td>
<td>Westfield Shoppingshown Tuggerah</td>
<td>NSW</td>
<td>51,400</td>
</tr>
<tr>
<td>Westfield Trust</td>
<td>R</td>
<td>Westfield Carousel</td>
<td>WA</td>
<td>40,490</td>
</tr>
<tr>
<td>Westfield Trust</td>
<td>R</td>
<td>Westfield Shoppingtown Toombul</td>
<td>QLD</td>
<td>39,345</td>
</tr>
<tr>
<td>Westfield Trust</td>
<td>R</td>
<td>Westfield Shoppingtown Strathpine</td>
<td>QLD</td>
<td>32,050</td>
</tr>
<tr>
<td>Westfield Trust</td>
<td>M</td>
<td>Westfield Shoppingtown Eastgardens</td>
<td>NSW</td>
<td>50,195</td>
</tr>
<tr>
<td>Westfield Trust</td>
<td>R</td>
<td>Westfield Shoppingtown Burwood</td>
<td>NSW</td>
<td>28,052</td>
</tr>
<tr>
<td>Westfield Trust / CFM</td>
<td>M</td>
<td>Westfield Shoppingtown Indooroopilly</td>
<td>QLD</td>
<td>71,094</td>
</tr>
<tr>
<td>Westfield Trust/AMP Society *</td>
<td>M</td>
<td>Westfield Shoppingtown Southland</td>
<td>VIC</td>
<td>63,470</td>
</tr>
<tr>
<td>Westfield Trust/AMP Society *</td>
<td>M</td>
<td>Westfield Shoppingtown Tea Tree Plaza</td>
<td>SA</td>
<td>58,082</td>
</tr>
<tr>
<td>Westfield Trust/AMP Society *</td>
<td>R</td>
<td>Westfield Shoppingtown Bondi Junction</td>
<td>NSW</td>
<td>25,109</td>
</tr>
<tr>
<td>Westfield Trust/Commonwealth Funds Management (CFM)</td>
<td>M</td>
<td>Westfield Shoppingtown Marion</td>
<td>SA</td>
<td>59,812</td>
</tr>
<tr>
<td>Westfield Trust/Commonwealth Funds Management (CFM)</td>
<td>M</td>
<td>Westfield Shoppingtown Belconnen</td>
<td>ACT</td>
<td>61,323</td>
</tr>
<tr>
<td>Westfield Trust/Commonwealth Funds Management (CFM)</td>
<td>R</td>
<td>Westfield Shoppingtown Amadale</td>
<td>SA</td>
<td>34,223</td>
</tr>
<tr>
<td>Westfield Trust/National Mutual Life</td>
<td>M</td>
<td>Westfield Shoppingtown Doncaster</td>
<td>VIC</td>
<td>53,860</td>
</tr>
<tr>
<td>Westfield Trust/National Mutual Life</td>
<td>R</td>
<td>Westfield Shoppingtown West Lakes</td>
<td>SA</td>
<td>49,045</td>
</tr>
<tr>
<td>Westfield Trust/National Mutual Life</td>
<td>S</td>
<td>Westfield Shoppingtown Miranda</td>
<td>NSW</td>
<td>102,755</td>
</tr>
<tr>
<td>Westfield Trust/Rodamco</td>
<td>M</td>
<td>Westfield Shoppingtown Liverpool</td>
<td>NSW</td>
<td>57,664</td>
</tr>
<tr>
<td>Westfield Trust/Rodamco</td>
<td>S</td>
<td>Westfield Shoppingtown Parramatta</td>
<td>NSW</td>
<td>113,814</td>
</tr>
<tr>
<td>Westfield Trust/SASB</td>
<td>M</td>
<td>Westfield Shoppingtown Hurstville</td>
<td>NSW</td>
<td>58,039</td>
</tr>
<tr>
<td>Westfield Trust/TAC</td>
<td>R</td>
<td>Westfield Shoppingtown Fountain Gate</td>
<td>VIC</td>
<td>42,654</td>
</tr>
<tr>
<td><strong>QIC</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>105,428</strong></td>
</tr>
<tr>
<td>Queensland Investment Corporation (QIC)</td>
<td>M</td>
<td>Westpoint Shopping Centre</td>
<td>NSW</td>
<td>58,919</td>
</tr>
<tr>
<td>Queensland Investment Corporation (QIC)</td>
<td>R</td>
<td>Castle Towers Shopping Centre</td>
<td>NSW</td>
<td>46,509</td>
</tr>
<tr>
<td><strong>Schroders</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>122,395</strong></td>
</tr>
<tr>
<td>Schroders Australia Property Manag't Ltd</td>
<td>R</td>
<td>Chatswood Chase</td>
<td>NSW</td>
<td>45,788</td>
</tr>
<tr>
<td>Schroders Australia Property Manag't Ltd</td>
<td>R</td>
<td>Karrinyup Shopping Centre</td>
<td>WA</td>
<td>43,607</td>
</tr>
<tr>
<td>Perpetual Trustee Company Ltd</td>
<td>R</td>
<td>Capalaba Park Shopping Centre</td>
<td>QLD</td>
<td>33,000</td>
</tr>
<tr>
<td><strong>Total Stock</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>3,682,459</strong></td>
</tr>
<tr>
<td>Ownership (Big &quot;3&quot;)</td>
<td></td>
<td></td>
<td></td>
<td><strong>2,289,636</strong></td>
</tr>
<tr>
<td>as percentage</td>
<td></td>
<td></td>
<td></td>
<td><strong>62.18%</strong></td>
</tr>
<tr>
<td>Total Ownership (5 included)</td>
<td></td>
<td></td>
<td></td>
<td><strong>2,517,459</strong></td>
</tr>
<tr>
<td>as percentage</td>
<td></td>
<td></td>
<td></td>
<td><strong>68.36%</strong></td>
</tr>
</tbody>
</table>

* n.b. Westfield/AMP counted for each

| R = Regional, M = Major Regional, S = Super Regional |

Table 3-2: Ownership of Centres by parties interviewed.

Source: adapted from BOMA (1996) for this research.
Through analysing the BOMA SCD, it became apparent that developers are not, largely, a separate grouping or category to owners. This is demonstrated by the summary data in Table 3-3. Four of the owners (AMP, Westfield, Lend Lease and QIC) dominate the development sector. Thus, in interviewing “expert” owners, whose roles ranged from General Manager down, I was also possible to access the development arm.

<table>
<thead>
<tr>
<th>Developer</th>
<th>No.</th>
<th>as %</th>
<th>GLA m²</th>
<th>as % GLA</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMP Society</td>
<td>6</td>
<td>8.33%</td>
<td>333,253</td>
<td>9.05%</td>
</tr>
<tr>
<td>Westfield Trust</td>
<td>18</td>
<td>25.00%</td>
<td>1,006,699</td>
<td>27.34%</td>
</tr>
<tr>
<td>Lend Lease</td>
<td>12</td>
<td>16.67%</td>
<td>604,777</td>
<td>16.42%</td>
</tr>
<tr>
<td>QIC</td>
<td>1</td>
<td>1.39%</td>
<td>46,509</td>
<td>1.26%</td>
</tr>
<tr>
<td><strong>Interview Total</strong></td>
<td><strong>37</strong></td>
<td><strong>51.39%</strong></td>
<td><strong>1,991,238</strong></td>
<td><strong>54.07%</strong></td>
</tr>
<tr>
<td><strong>Sector Total</strong></td>
<td><strong>72</strong></td>
<td><strong>100%</strong></td>
<td><strong>3,682,459</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Table 3-3: Developers of Regional Shopping Centres
Source: adapted from BOMA (1996) for this research.

Conceptual Framework: DEVELOPER

Qualitative Interview Process

DEVELOPER

Categories

Developer TRADER

Developer INVESTOR

Owner Subsidiary

DIFFERING PHILOSOPHIES

Short/Long Term View?

Merits of shopping centre development (cf. other development)

Original Planned Lifespan

Anticipated Lifespan

DEPRECIATION

“definition”

What % of initial cost would need to be reinvested to maintain income flow? (over say a 10 year holding)

Before Major Refurbishment

Main structure

Relationship with: OWNER MANAGER ARCHITECT VALUER

“Sophistication” Impact

FUTURE

Figure 3-3: Conceptual Framework: Developer
Source: Boydell, S. developed for this research
The ‘sophistication impact’ component was included to gauge the effect of the markets evolving sophistication over time – an aspect which could not have been foreseen or designed for when the centre was originally built.

The interviews covered 54% of the market view.

3.3.2.4 Managers

This aspect of market dominance in the hands of a few was further apparent in the property management sector. The management function falls into two categories:

Macro: the strategic portfolio level where shopping centres are competing with other property assets for allocation within the property portfolio and then property is competing with the wider assets of bonds, equities and cash.

Micro: the operational property aspect. The day-to-day management of the individual centre.

The “experts” were primarily involved in the macro view and in several cases also had involvement in competing property sectors. All had experience in the micro function, from a refurbishment consideration through to appraisal.

QIC are not included in the table below which is the compilation of statistics relating specifically to operational centre management. Byvan undertake the operational function on QIC’s behalf, whilst the macro views of QIC (in an ownership capacity) were included in the interview data.

The interviews covered 67% of the market view.

<table>
<thead>
<tr>
<th>Manager:</th>
<th>No.</th>
<th>as %</th>
<th>GLA m2</th>
<th>as % GLA</th>
</tr>
</thead>
<tbody>
<tr>
<td>AMP Society</td>
<td>9</td>
<td>12.50%</td>
<td>515,423</td>
<td>14.00%</td>
</tr>
<tr>
<td>Westfield Trust</td>
<td>21</td>
<td>29.17%</td>
<td>1,155,152</td>
<td>31.37%</td>
</tr>
<tr>
<td>Lend Lease</td>
<td>11</td>
<td>15.28%</td>
<td>535,076</td>
<td>14.53%</td>
</tr>
<tr>
<td>Byvan</td>
<td>3</td>
<td>4.17%</td>
<td>135,484</td>
<td>3.68%</td>
</tr>
<tr>
<td>Schroders</td>
<td>3</td>
<td>4.17%</td>
<td>122,395</td>
<td>3.32%</td>
</tr>
<tr>
<td>Interview Total</td>
<td>47</td>
<td>65.28%</td>
<td>2,463,530</td>
<td>66.90%</td>
</tr>
<tr>
<td>Sector Total</td>
<td>72</td>
<td>100%</td>
<td>3,682,459</td>
<td>100%</td>
</tr>
</tbody>
</table>

Table 3-4: Managers of Regional Shopping Centres

Source: adapted from BOMA (1996)
The balancing of the Architect framework was to add a dimension, which investigated the process of design from both a new build green field site approach, and the (now) more common expansion/redevelopment angle. Design obsolescence was added to the depreciation bin together with a deeper consideration of cost benefit analysis issues, which could ultimately feed back into the costing/outgoing component of a DCF.

The architects are the most diverse grouping. The category was included to offer a balance on the life cycle and depreciation aspects in particular. Westfield and Lend Lease both have their architectural and design companies as part of the wider group. Cameron Chisholm and Nicol (CC&N) were also included given their independent brief for the contemporary and controversial Robina Shopping Centre on the Gold Coast.
Table 3-5: Architects of Regional Shopping Centres
Source: adapted from BOMA (1996)

The interviews covered 47% of the market view.

![Conceptual Framework: ARCHITECT Qualitative Interview Process](image)

Figure 3-5: Conceptual Framework: Architect
Source: Boydell, S. developed for this research

3.3.2.6 Valuers

The role of the valuer is central to the whole thesis. At the regional shopping centre level there are comparatively few firms of property consultants approved to provide valuation advice. Interestingly, the owners tend to relate to the individual valuer as a personality rather than the company that they represent. The valuers interviewed were all derived from the reputational...
guidance (see references under Analysts below) by the owners in the first instance. It is also worth noting that of the 19 participants interviewed, 14 hold a valuation qualification or had valuation training. As a result, whatever their current role these 14 all had a valid insight to add to the valuer framework.

The valuer conceptual framework is the crux of the thesis. From the appraisal viewpoint it stimulated discussion on appraisal philosophy stemming from the AIVLE DCF Standard and the nature of computer tools/models adopted. Taking risk, growth and depreciation as three key components of return within shopping centres (and wider valuation) the framework allowed for deep investigation of yields and depreciation/life span issues in particular. Risk in this context follows the Baum and Crosby discussion in terms of uncertainty in respect of both monetary and real income which are directly influenced by variations in the yield of investments.312

---


---

The components of this crucial framework will be described in more detail.
**Motivation** – this relates to the reason for valuations to be undertaken, building on the list from Hines (and others) in the literature review.

**Annual Valuation Process** – this is a natural progression from the motivation. It was assumed that most investment appraisals of enclosed regional shopping centres were initiated by the reporting requirements of the fund/trust.

**AIVLE DCF Guidelines** – the AIVLE DCF Practice Standard was published two months before the interviews. This component was included to ensure awareness of the standard and to stimulate responses. It is linked into the valuation model and aspects of investment return.

**10-year model** – what time-span is adopted within the investment appraisal, the rationale for the choice, fees, charges and a linkage to forecasts.

**Software** – this was a check on the use of Excel\textsuperscript{\textregistered}, Lotus\textsuperscript{\textregistered}, or QPro\textsuperscript{\textregistered}, or the adoption of a proprietary package. Two sub questions followed this: **Who designed** – which links into the level of literacy and also compliance with the standard, and **Client Specified** to quantify if the prescriptive US route was being adopted.

**Determinants of Return** – was a bridge into Yields (risk), Growth and Depreciation.

**Yields** – this allowed for a qualification of risk and a detailed inquiry into the terminology, which from the AIVLE DCF Practice Standard remained very unclear.

**Growth** – there is a close linkage here with **Forecasting** but the question was designed to understand how rental growth, yield variation and capital expenditure are linked into the appraisal.

**Depreciation** – understanding, appreciation and inclusion? How, if at all, depreciation is reflected in the appraisal cash flow, and similarly, compensated for in the simple capitalisation approach.

**Forecasting Techniques** – is fundamental to each of the above, and the question also elicited the nature of forecasting resources utilised by the valuers.

**Anticipated Life span** – as it related to the **Main structure** and the **Refurbishment** angle, which cross reference back into Yields, Growth, Depreciation and Forecasting by qualifying the nature of expenditure, how it is accounted for and the impact, if any on yields.
Future– was included in all the frameworks, to elicit perceptions of industry direction and to highlight any issues overlooked due to the ‘historical’ nature of the literature.

Each of these headings within the conceptual framework becomes a node as part of the analysis (related in Chapter 4). Nodes act as a point of reference for data, so that relevant sentences or paragraphs are linked to nodes through a coding process within the analysis.

As was stated earlier, the conceptual frameworks were not intended to be prescriptive. The design and use was to stimulate discussion and allow flexibility to lead into areas which may have been overlooked from utilisation of the literature and researcher experience. This is demonstrated through the ‘evolved’ conceptual frameworks in Chapter 4.

3.3.2.7 Analyst

The inclusion of an analyst in the process was the result of reputational case selection. This interview came out of the recommendation of an “expert” on the valid basis that it would serve to increase confidence in the analytic findings on the grounds of “representativeness”. The analyst had undertaken major research into property trusts and developed an overview of owner strategies and had, as a non-valuer been given full access to “confidential” valuation reports. It could be argued that the inclusion of just one analyst is unable to provide a bona-fide opinion. However, as the analyst had been privy to appraisal information relating to most of the owners and valuers for industry benchmarking, the opinion carried much greater depth than the view of one might otherwise imply.

The analyst’s view fed into all frameworks, but complimented the valuer and owner processes most significantly.

3.3.2.8 Expert Interviews

These interviews allow for the analysis of the key participants’ views on risk (yield), growth and specifically depreciation. These are the three key components of investment appraisal within discounted cash flow analysis. With the exception of one interview (during which written notes were made) all interviews were recorded and subsequently transcribed. The interviews lasted between 45 and 75 minutes. Each interview was completed in the office or boardroom of

313 Miles & Huberman (1994) p. 28.
314 Boydell & Gronow (1997).
the expert. The completed transcriptions of the expert interviews totalled 119,399 words and comprise 384 pages of 1.5 space text. In accordance with the qualitative methodology and the signed confidentiality agreement with each of the ‘experts’, these transcripts do not form part of the submitted thesis. A ‘sample’ anonymised transcript with a valuer ‘expert’ has been incorporated in Appendix Nine (at the behest of the external examiners).

3.4 Ethical considerations

As was mentioned in the introduction to this chapter, knowledge is power in the commercial and materialistic world of investment and property. All participants are busy senior executives for whom time is money. Interviews at this level are an intrusion which demand of the expert’s time, not only during the interview, but also undoubtedly in some introspection after the interview. This introspection largely results from the fact that people in interviews will tell you things that they never intended to tell.\(^{315}\) Human nature dictates that people like the opportunity to talk about themselves. The cachet of being interviewed by an academic who they would envisage to have a depth of knowledge in the area (if only through the literature and prior professional experience) can be seen as a positive opportunity by the ego. With the promise of confidentiality, interviews can become confessions. The risk is two-way. Social scientists can be summoned to testify in court and the power of interviewing can put both interviewer and interviewee at risk.

As stated, interviews are an intrusion. Establishing the interview, accessing the relevant expert within an organisation and generating both interest and mutual trust in the first few minutes of a cold telephone contact is critical to the process. What the researcher brings to that first point of contact needs to entice the expert to forsake of their time, to share their power base, knowledge and confidences. In the initial point of telephone contact and subsequent letter of introduction (Appendix 7) the concept of ensuring confidentiality through the analytical interface that NUD\(\text{T}^{\text{TM}}\) offers was reinforced. It was necessary to ‘name drop’ so that contacts would be aware of the league of experts who had agreed to share of their time and experience. The AMP cachet referred above was an important ‘door opener’. An element of brinkmanship was evident as more appointments were arranged - with one party subsequently changing heart after an initial rebuttal.

\(^{315}\) Patton (1990) p. 355
Under a ‘psychology of treats’ it was felt important to arrive at the interview bearing gifts, however humble. Bound copies of two papers considered relevant to the area of enquiry from the participant’s view were proffered at the start of the interview. Such an offering was unexpected and thus warmly received by the participants.

All experts were happy to be acknowledged for their support and contribution with most stressing that the views they offered were their own, and not necessarily corporate. It was agreed that the analysed data would be presented without named attribution (anonymously), all interviews being referenced by file code. Without such reassurance, considerably less empirical data would have been forthcoming, and tape recording would not have been permitted.

3.5 Analysis

With empirical data comprising some 120,000 words of transcribed conversational interviews, analysis is a critical issue. As mentioned above, it was the intention prior to commencing interviews that the empirical data be analysed using NUD·IST™. The analytical process of NUD·IST™, which stands for Non-numerical Unstructured Data Indexing Searching and Theorizing, is depicted in Figure 3-7.

It is a reasonable assertion that the analysed data, which are based on current practice and recent professional experience will have historic roots. In contrast, the evolution of theory allows development based on this grounding.

316 Boydell et al. (1997a); and, Boydell & Gronow (1997)
3.6 Conclusion

Herein lies something of a dilemma relating to the use of views, the roots of which are implicitly founded in the historic as opposed to futures forecasting. Property, and the investment in it, is however a futures concept. Some worthwhile commentary comes out of Strauss & Corbin on

---

the use of literature, which is also, in essence, historical background.\textsuperscript{318} In considering the ‘traditional’ approach of quantitative methods, the literature review process enables the researcher to identify the previous research and identify gaps in understanding. It also highlights the conceptual and theoretical frameworks that will feed back into the research findings. The dichotomy with grounded theory research is not to merely test relationships among variables. The purpose is to discover categories and the relationships between them, grouping them in new rather than standard ways. Therefore, the inference (after working through much of the literature) is that the history may cloud, or more likely obscure, the discovery. An accusation could, however, fall on the researchers for having their heads in the sand, running the risk of reinventing the wheel. Such is the dilemma.

The problem is one of perception rather than reality. Related literature identifies the gap in knowledge while painting an essential backdrop. What is important is not to be constrained by having to follow a previously developed theory. Such theories may or may not apply, for instance, to the investment appraisal of enclosed shopping centres or, indeed, highlight the relevance of depreciation as the ‘gap’. Strauss and Corbin\textsuperscript{319} further contend that there is no need to review all the literature beforehand. Because if the process works, new categories or theories will emerge that neither we, nor anyone else, will have thought about previously. Thus, the whole process will be justified through its contribution to knowledge. Dogma shrouds us all, so we must challenge our assumptions to delve beneath experience and look beyond the literature. Therefore, the literature review was approached with the caveat that it would not be constraining on what followed. Thus, it will not serve to stifle the further contribution to knowledge.

This chapter has introduced the research methodology, discussed the challenge of obtaining ‘knowledge’ where it has a monetary impact, justified a qualitative approach and introduced the conceptual frameworks which are the basis of the interview process and subsequent coding – the analysis of which is described in Chapter 4.

\textsuperscript{318} Strauss & Corbin (1990) pp. 49–50.
\textsuperscript{319} ibid., p. 76
References: Chapter 3


BOMA (1996) *Australia Shopping Centre Database* (version dated 01/05/96), Building Owners and Managers of Australia, Sydney.


Software References:

**ATLAS/ti\textsuperscript{TM},** (Release 1.1E) designed by Muhr, T., Scientific Software Development, Trautenaustr. 12, D-10717 Berlin, Germany.

**The Ethnograph\textsuperscript{TM},** (Version 4.0) designed by Seidel, J.V., Qualis Research Associates, PO Box 2070, Amherst, MA 01004, US.

**NUD\textsuperscript{IST}\textsuperscript{TM},** (Version 3.0) designed by Richards, T. & Richards, L., Qualitative Solutions & Research Pty. Ltd., Box 171a La Trobe University Post Office, Vic.3083, Australia.
Chapter 4

ANALYSIS OF DATA

4.1 Introduction

This chapter presents patterns of results and analyses them for their relevance to the investment appraisal of enclosed regional shopping centres. Frequent summaries and figures (demonstrating the evolved conceptual frameworks) are provided so that readers can easily see patterns in the mass of data presented in this chapter.

Tables of statistical data are presented in quantitative research and matrices are used in qualitative research. The conceptual frameworks (and the evolution of them) are what Miles and Huberman would call matrices because they show the relationships between various aspects of the analysis. What is relevant is to lead towards a synthesis of the most critical/relevant issues in the concluding section of this chapter - with a model/framework/matrices that brings them all together. In addition to the normal linkages to the previous chapter, chapter objective and outline, it is relevant to include any basic justified assumptions such as significance levels. The significance levels of respondents were related in Chapter 3 and can be summarised thus in respect of coverage of market view:

- Owners 68%
- Developers 54%
- Managers 67%
- Architects 47%
- Valuers 100%

As it is the views of the Valuers and Owners that are analysed and presented in greatest detail in this chapter, adequate significance is provided. In order to constrain the detailed analysis to a manageable level, the views of the other players (developers, managers and architects) have been included, where appropriate, in the coding related to either the Owner or Valuer

---

frameworks. This allows issues of significance to be incorporated within the main framework of the analysis.

Where qualitative research is undertaken, an additional section should somehow be provided for data that was collected which does not fit into the research categories developed in the literature review of Chapter 2. This has been done, although not in the analysis presented below as a specific new section, as it is essential not to be constrained by preconceptions that emanated out of the literature review.

**Limitations:** Chapter 4 is restricted to presentation and analysis of the data collected, without drawing general conclusions or comparing results to those of other researchers discussed in Chapter 2 - the discussion is the role of Chapter 5.

### 4.2 Subjects

In order to analyse the data derived from the interview process, it was necessary to evolve the original conceptual frameworks. This was fundamentally the result of the unconstrained nature of the interview process, which took the conceptual framework as its basis, but did not allow the conceptual framework to constrain the thought processes of the experts. This ensured areas/issues that may not have appeared significant, or as important, during the preparation (and from the literature review) were free to be incorporated in the evolving paradigm. It was only as a result of the analysis that the relationships, and indeed indicative categorisation, became apparent. A full listing of the categories (nodes) for each of the groupings can be found in Appendix 8.

The analysis process allowed the 119,399 words of transcribed interviews contained in 17 documents (relating to 17 interviews with the 19 ‘experts’ – two of the interviews were attended by two ‘experts’) to be broken down into 2381 individual text units (notional paragraphs of prose). The coding process allowed these text units to be allocated to individual or multiple nodes (totalling 215) within the six categories:

1. **Overview** [31 nodes] This category was not used for initial analysis.
2. **Valuer** [45 nodes]

---

321 Perry (1994)
These nodes are an evolution of the conceptual framework (referred to in Chapter 3). Given the focus of the research, the author’s background and that of the majority of “experts”, more nodal categories were relevant and manifest for the “Valuer” category.

By way of explanation, an example of the evolved framework for the “Valuer” and the “owner”, which highlight the key issues, are dealt with in detail in this Chapter. The layout of the evolved framework for the ‘Valuer’ is presented in Figure 4-1 and the ‘nodal’ headings follow. The explanation of how these nodes were evolved and the analytical process and outcomes is presented in section 4.3 (The Analytical Process).
Q.S.R. NUD.IST Power version, revision 3.0.4d GUI.
Licensee: Spike Boydell.

(2) Valuer
(2 1) Valuer/Ann Val Process
(2 1 1) Valuer/Ann Val Process/Knowledge
(2 1 1 1) Valuer/Ann Val Process/Knowledge/Independence
(2 1 1 2) Valuer/Ann Val Process/Knowledge/Player
(2 1 2) Valuer/Ann Val Process/Pressure
(2 2) Valuer/AIVLE DCF Guidelines
(2 3) Valuer/10 Year Model
(2 3 1) Valuer/10 Year Model/Advance or Arrears
(2 3 2) Valuer/10 Year Model/Period
(2 3 3) Valuer/10 Year Model/Cap Rate
(2 3 4) Valuer/10 Year Model/Tenant XT
(2 4) Valuer/Software
(2 4 1) Valuer/Software/Designer
(2 4 2) Valuer/Software/Client specified
(2 4 3) Valuer/Software/Project\textsuperscript{TM}
(2 5) Valuer/Return
(2 5 1) Valuer/Return/Yields
(2 5 1 1) Valuer/Return/Yields/Initial
(2 5 1 2) Valuer/Return/Yields/Equated
(2 5 1 3) Valuer/Return/Yields/Equivalent
(2 5 1 4) Valuer/Return/Yields/Reversion
(2 5 1 5) Valuer/Return/Yields/Cap Rate
(2 5 1 6) Valuer/Return/Yields/IRR
(2 5 2) Valuer/Return/Growth
(2 5 3) Valuer/Return/Depreciation
(2 5 3 1) Valuer/Return/Depreciation/Redevelopment
(2 5 4) Valuer/Return/Analysis
(2 6) Valuer/Lifecycle
(2 6 1) Valuer/Lifecycle/Main Structure
(2 6 2) Valuer/Lifecycle/Retrofit
Total 45 “Valuer” nodes.

These nodes are now investigated and key data analysed. They are presented with their “Nudist” definition and statistical details of how many document related references are based on together with relevant cross-references.

### 4.3 The Analytical Process

In order to demonstrate the analysis, two early nodes (2 and 2.1) are summarised and shown in full detail below. Then for each, the relevant text is presented from which the summaries are drawn. The prime focus is on risk, growth and depreciation and relates back to the research questions in the literature review. However, from the researcher’s point of view, being so close to it all, it is very difficult to treat say the 2.5.* nodes in isolation to the essential “complete” picture which evolves out of treating the investigation and analysis holistically. For the subsequent analysis, the full breakdown is saved for the researchers own records, whilst full analysed summaries including ‘expert’ quotations are provided in this Chapter. This avoids the need to provide statistical summary data for each node. Once the process has been explained, this Chapter is then devoted to providing the key analysed data for each node in a clear and coherent format.
To ensure clarity in the analysis, a numbering pattern was devised for each grouping - Roman numerals to avoid conflict with the Arabic numbering of the nodal references. From a qualitative research view, the jury is out over how one reports back one’s findings and the level of detail, although there is general support for the inclusion of some direct participant quotation to support, or otherwise, various aspects of the hypothesis. Where appropriate, the views have been summarised and supported by the ‘experts’ own words, or left in the ‘experts’ own words alone if reasonably concise and clear. The important issue is the findings, which are based on a sound analytical process. What evolves out of the data is a major contribution to knowledge in its own right for an investigation at this level has never before been undertaken. It also, as it progresses, serves to question part of the original hypothesis and highlights the hypothetical irrelevance of certain aspects of the literature review because reality (in this material context) is driven by the dollar.

It must be emphasised that the summaries are fully supported by textual references. The comments in the summary sections arise from the analytical process. They are not the opinion of the researcher, therefore, but something that has been generated from the data analysed through NUD•IST™.

4.3.1 The Valuer Analytical Detail

This section presents the nature of the analysis undertaken with explanations as appropriate. The information provided has been imported from the empirical data stored, coded and evolved within the NUD•IST™ program. Whilst this section is challenging to read in the format presented it gives an essential insight into the qualitative analysis undertaken. The detail in this format is restricted to a major node (2) – Valuer – and its child (2 1) – Valuer/Annual Valuation Process. The subsequent analytical stage comprises a refinement of the presentation and summary of the key points, with extensive direct ‘expert’ quotation. For clarity and ease of access to the data, the précis of the nodal information is presented for the Valuer and the Owner in section 4.4 and 4.5 respectively.

In the format presented in this section, it will be evident that the researcher is presented with a considerable volume of data to analyse at each stage of the process. As the data stored at each node is revisited at each stage, the researcher remains very close to the data. The analytical process required to condense the data into the final format (as presented in 4.4 and 4.5) is a very time consuming exercise. The final result of this involved qualitative analysis
process is the presentation of easily accessible empirical data on the investment appraisal of enclosed regional shopping centres.

(2) / Valuer

*** Definition:
Valuation Practitioner, Appraiser
This node indexes 5 documents.

Explanation:
(2) is the prefix that has been given to all nodes relating to the ‘Valuer’ function;
‘Definition’ - is the more detailed explanation of what node (2) incorporates within the analysis.
‘This node indexes five documents’ - means that the views of five of the transcribed interviews were incorporated in this analysis, as a result of the coding process. In certain cases zero documents were indexed, indicating that the researcher’s perception from the literature was not fulfilled in respect of data analysed.

Summary:
i. The majority of players in the market (from the owner’s side) also have a valuation background.

ii. The valuer is used as a check - to reconcile (superficially independently) the owner’s opinion of asset worth.

iii. Valuers are not privy to the market information - it is all very secretive on the part of the owners.

iv. The valuation of shopping centres is an art form.

v. There are different views of valuers in the eyes of owners. Some argue that “they are in a different world, reporting on the past - they get to a point where they believe their own bullshit”.

vi. Whereas others consider valuers’ models to be more sophisticated than their own and that “their view of the market becomes the market’s view of the market”.

vii. Valuers are more historians than forecasters whereas their clients prefer them to be forecasters rather than historians.

151
viii. Valuations frustrate by failing to annotate or explicitly state assumptions.

These comments are supported by the following edited textual references:

+ ON-LINE DOCUMENT: BRIS02TX
+++ Retrieval for this document: 3 units out of 187, = 1.6%
++ Text units 3-3:

<table>
<thead>
<tr>
<th>Explanation:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Online document: BRIS02TX</strong> is the file name for the transcribed interview</td>
</tr>
<tr>
<td><strong>Retrieval for this document: 3 units out of 187, = 1.6%</strong> means that the interview document is broken down into 187 units of text, and that 3 are incorporated together, representing 1.6% of the text units.</td>
</tr>
<tr>
<td><strong>Text units 3-3:</strong> means that what follows is the third textual unit of the document.</td>
</tr>
</tbody>
</table>

**Note** in this introductory explanation, which supports the summary process which follows for all the other nodes, the textual references – which are direct quotations – have not been italicised. The spoken word has been transcribed verbatim, and as such has not been edited into a written format. Accordingly, as is demonstrated in the direct transcription below, the often grammatically and structurally incorrect spoken English has been presented.

And we are mostly all, somewhere in our qualification, is a valuation background. So we conduct, internally, quarterly valuations of all assets before preparing a package that gets sent out for external valuers to confirm the numbers.

<table>
<thead>
<tr>
<th>Explanation:</th>
</tr>
</thead>
<tbody>
<tr>
<td>The numbers (2) (2 1) (3) (3 10) relate to the other nodes where this textual reference has been incorporated. That is, it is included in the subject node (2) as well as (2 1), (3) and (3 10). Through this process, the actual number of words to be analysed and summarised expanded to 1,400,000 or thereabouts. Within the analytical process, (2) is classed as a sibling of (3), whereas (2 1) is a child of (2) adopting what equates to a genealogical framework for the coding.</td>
</tr>
</tbody>
</table>

+++ Text units 93-94:
I don't know how external valuers can possibly come up with a number for shopping centres. They just are not privy to the information. It is all very secretive. All of the owners keep everything very secretive. I really feel for them. I am thinking of people like “x” and “y” and so on and it is a bit of a best guess. We do a fair bit of work because a lot of things get handled off the market these days. Big assets don't get a 'for sale' sign put on them. People don't even know that they are in play and the next thing that you know a new owner pops up.

I kind of think valuation of shopping centre is an art form in itself, and I guess that is probably what this (as in 'this research') is going to show.

I mean most of the valuers I've dealt with in recent times, I think are in a different world, but it's the world they're are required to be in. I mean generally speaking they don't have that access to what everybody else's value of their assets are so they can only use discount rates in relation to the people they are talking to and what they have valued the assets for. In other words you get to a point where they believe their own bullshit.

There is no doubt the valuers are probably too far out of it in a number of instances because they report on the past and we spend the whole time talking to people about the businesses and the future.
It's a valuation model but it's not quite as sophisticated as the detailed models that the valuers build up. But it gives us a very clear indication of what we think the thing is worth. What we really look for from the valuers is an indication on where cap rates are moving and their call on growth rates and how they kind of relate to ours because, as I said, we are closer to the property, we are closer to the market. And we are probably closer to the competition. So we feel that we can probably make more accurate calls on the like ten-year cash flow. But our theory is that they're representing what the market will perceive the property is worth. So we kind of think, well okay, this is our view on what the property is worth and this is the market's view on what the property is worth, how close is that.

Well they have their own internal research groups. I am not saying that our view on where the market is going is worse or better, well it is probably better than their view. But I guess what I am saying is that their view on the market, kind of becomes - we can explain to them our view on the market - but their view on the market more or less becomes the market's view on the market. So that we find that generally they kind of in modern ways put onto sales evidence. Not as much weight is put onto longer-term performance trends and how cap rates should be adjusted in line with the way the discount rate is going for instance.

*SB - Is that not because they forced by their training and the requirements of the Institute of Valuers to be historians rather than forecasters? That is what I'm saying, they are more historians than forecasters. Whereas we prefer them to be forecasters rather than historians.

But the value we see from them is not telling us what happened. It's telling us what they think is going to happen.

You can look at it on a very theoretical, very accurate or as accurate as you can be if you are forecasting on a DCF basis, but then overlaid on that there has to be a gut feeling in the
market. Because what we want at the end of the day is what the market will foresee is the value of that property, because that is the most accurate indication of what the thing is truly worth. So it's a hybrid of a number of things, and I'm not being overly critical of the valuers, because I think generally they are very close to the market in terms of what somebody is prepared to pay. I'm critical of their ability to argue that on a more theoretical, say ten year, time horizon.

(2) (2) (3) (7) (3 10)

+++ ON-LINE DOCUMENT: SYD10TX
+++ Retrieval for this document: 17 units out of 106, = 16%
++ Text units 40-51:

There are not many sort of clear, there wasn't a very clear assumption page. Which, of course, I found really frustrating. They didn't tell me what they were assuming to arrive at wherever they are arriving at. 47

(2)

*SB - It was all reconciliation?

(2)

That's right, yes. 49

(2)

Section statistics - Node (2):
+++ Total number of text units retrieved = 49
+++ Retrievals in 5 out of 17 documents, = 29%.
+++ The documents with retrievals have a total of 616 text units,
so text units retrieved in these documents = 8.0%.
+++ All documents have a total of 2381 text units,
so text units found in these documents = 2.1%.

Explanation:
The **all documents have a total of 2381 text units** is the total number of text units in all 17 transcribed interviews.

SB refers to Spike Boydell, the researcher – demonstrated where a text unit was used to further question, clarify or elaborate a point made by an ‘expert’. Within this version, all ‘experts’ initials, or indications that could lead back to them have been removed for reasons of confidentiality.
Motivation for annual valuation process

This node indexes 10 documents.

Or, to demonstrated the more expanded information:

Motivation for annual valuation process

*** Created: 19:58, 10 Apr 1997.
*** The siblings of this node are:
(2 2)  /Valuer/AIVLE DCF Guidelines
(2 3)  /Valuer/10 Year Model
(2 4)  /Valuer/Software
(2 5)  /Valuer/Return
(2 6)  /Valuer/Lifecycle
(2 7)  /Valuer/Forecasting
(2 8)  /Valuer/Future
(2 9)  /Valuer/Miscellaneous
*** The children of this node are:
(2 1 1)  /Valuer/Ann Val Process/Knowledge
(2 1 2)  /Valuer/Ann Val Process/Pressure
*** Documents indexed by this node are:
1: BRIS01TX    2: BRIS02TX    3: BRIS06TX    4: SYD02TX
5: SYD03TX    6: SYD04TX    7: SYD05TX    8: SYD08TX
9: SYD10TX    10: SYD12TX
*** This is 10 documents out of 17, = 59%

This node indexes 10 documents.
Summary:

i. Basis of valuation includes primarily periodic valuation reports to trust, but also due diligence, ongoing advice, development advice, funding “splits”, ownership apportionment or finance reports.

ii. Short-termism. Property Trusts, in particular, are not interested in what the investment will be worth in the future - the value at present is the critical issue.

iii. The annual (periodic) trust work starts with a full valuation, followed by updates and ongoing advice.

iv. Often (normally) the client conducts internal valuations of all the assets prior to instructing external valuers.

v. Frequency of valuations depends very much upon the client’s requirements and ranges from quarterly to triennially.

vi. Valuers normally value on a two-year cycle - “dancing” two years on, two years off, to satisfy the legal requirements of the funds.

vii. In that context, however, the funds do attempt to influence by passing on previous reports.

viii. Valuers do not get involved at early enough a stage, particularly with development work.

ix. Many clients seek a valuer who will put the right number on it. Clients have large teams of experts striving to maximise return and they don’t want the valuer to come in and tell them something that they don’t want to hear.

x. Conversely, the valuers question why a client would pay them $40,000 to pay them lip service and acquiesce to the client’s indicated value.

xi. Clients take a macro view, whereas the valuer is paid to take a micro view.

xii. There is a changing emphasis on the instructions given to valuers - including methodology pro-formas. (tendering is dealt with later)

---

Quarterly. And it is a "report by" date at the end of the quarter day, the accepted quarter day of the quarter - that is December 31st, March 31st etc. Otherwise, yes, annual valuations
normally. But “x” being a very sensitive portfolio I can see the logic and the sense of reviewing everything every three months. I think that makes good sense.

So we conduct, internally, quarterly valuations of all assets before preparing a package that gets sent out for external valuers to confirm the numbers.

We've got almost $2bn worth of property and it has got to be valued every quarter, so we've got a million and one valuations from supposedly the best in the country.

Externally, every three months. And,

*SB - You have got a smaller fund than “y” but you are producing more money for the valuers than “y” potentially because they only have to be valued every two years so you are doing it eight times more frequently.

But, there is an example, and it happens in a lot of trust valuations too, whilst they can’t value it for any more than two years in a row - or is it twice, no, they can’t value it more than twice -
*SB - Or they tend to hold it for two years often... a two-year cycle.  
(2 1) (2 5 4) 

Yes, two years, you try and hold it...  
(2 1) (2 5 4) 

In a way a lot of these trusts and funds and everyone else influences you. They say, we'd like you to value this, here's a copy of the last one. I mean...  
(2 1) (2 1 2) 

++ Text units 164-164: 

*SB - And you are doing more due diligence work now?  
(2 1) (2 5 1) (2 5 2) (2 5 3) (2 5 4) 

Yes I do quite a bit.  
(2 1) (2 5 1) (2 5 2) (2 5 3) (2 5 4) 

+++ ON-LINE DOCUMENT: SYD02TX  
+++ Retrieval for this document: 27 units out of 247, = 11%  
++ Text units 2-3: 

We do a lot of annual trust work. We have a number of specific clients which we sit on their panel of valuers. Generally had a lot of work lately 2 year appointments of a rotating cycle, we do a full valuation the first year and an updated, although it is a full valuation the following year, because it is an update of the previous year. A 2-year cycle, we would probably go off rotation and someone like “y” come on, etceteras, etceteras. We do a similar thing with “x”, although we do quarterly updates for them. So it all starts with a full market valuation, that is the first thing that we do, then thereafter there may be updates and on going advice. And we're actually involved at the moment with probably a dozen different regional shopping centres in NSW that we give ongoing advice on, particularly from a development point of view as well.  
(2 1) 

++ Text units 117-136: 

As another scenario, we do do development valuations, that is scenario A. But as scenario B
we may well do a development cash flow, which, we don't do a great deal of that. You find with these trust guys, I mean trusts at the moment really don't want to know what anything is going to be worth in the future, they want to know what it is worth now. We are finding that a lot with PT (ed PT is a reference to property trusts) at the moment. They are not really interested in what you think five years down the track, what's it worth now?

*SB - So short termism is the order of the day?

Well, it seems to be. It's all very well to say this thing is worth $100m now, but if we do this massive redevelopment now, come the year 2000 its going to be worth $340m. That's all very well...

But so what. What is it actually worth today. You have been instructed to value on market value, here are your sort of six criteria - willing vendor etceteras, etceteras... You know, you can pass comment on that in the report. I am just trying to think, to be honest of where we...

*SB - So they don't really want to see you, it is not maximising their valuation figure which is what they ultimately what they want to see.

- You are probably right. We probably don't get involved at an early enough stage. We're normally brought into these processes when the thing has been designed, and pretty well finished and then we are asked to value it. Obviously the owner will employ a number of consultants, they tend to do their own in house schemes, well not so much their schemes - I mean I am no great planner of regional shopping centres, but just in terms I suppose of valuation rationale. It is assumed that they will find a valuer out there I suppose, some of the perhaps lesser clients, who will put the right number on it. We don't want to get involved with those sort of things, but you see a number of these shopping centres and you think that's fundamentally wrong, you know, we would have done something different.

*SB - That's a valid point really.
We don't, valuers, I think it is across the board whether it be shopping centres, office buildings, it doesn't really matter, valuers are never involved in an early enough stage in any of these places.

*SB - At a tangent, is that perhaps because of the narrow perception which the AIVLE put out on the valuer to be a valuer, and wear very much a valuation hat?

Yes. Exactly.

*SB - Whereas your counterparts in the London office will take a much broader view. The Chartered Surveyor is a jack of all trades...

Exactly, whereas he is literally a capital valuer as it were. You know, I sit down and write valuation reports and run cash flows....

*SB - But you don't look at, you don't get the opportunity because of the marketing aspect, presumably, to look at the bigger picture.

Exactly, to get involved at an early stage, just to pass comment. We do from time to time, but very rarely.

*SB - You don't get sucked in to advise the board with the development guys or whatever...

Look at “x”, at the end of the day they have got how many thousand people designing these shopping centres. They don't want some bloke from “y” to come in and tell them something
they don't want to hear. They have done enough of these things now to know that by hook or by crook they'll make it work, even if it doesn't they will get it to work. Then you end up coming into the process at a pretty late stage.

I think what you have to say to yourself is look, that is the information, the valuation you are going to put on this property is going to be made public and I think that you have got to be as honest as possible. I would be lying if I said pressure didn't come to bear at some stage or some times. It is better than digging your heels in sometimes. If you genuinely believe that the yield has moved from 7.5% to 7.75% and you have the evidence. Why pay me $40,000 to pay you lip service. You are paying us to value your asset for you. And I mean these guys look at it from a, they don't look at it so much from an individual basis, it is a portfolio. Okay one has gone down so they will probably delve into the pot and find one that they think has probably gone up. That is outside the gambit of my area. You are looking at an overall performance rather than perhaps whether Westfield Shopping Town at Herston has dropped, or Miranda has gone up a bit.

*SB - They look at the big picture.

Of course they do, whereas we're paid to look at that specific little picture, that specific property.

*SB - You are taking a real micro view of it?

Yes, and I think you have got to do that. As a valuer, at the end of the day we pay our PI insurance and we are being paid by the client to do that.
I would say we do a hell of a lot of work for the trusts. We pick up a fair share of annual regional shopping centre valuation requirements.

We use valuation as a tool for actually managing assets as well. We're a manager of a listed property trust, so in the course of day to day activity of managing a portfolio we use a live valuation model. So any decision that we take we test in the model as we go along. So if there is a tenant review or if there is a rent variation, if there is an expiration or whatever we are constantly testing the outcome of the revised deal in a value consequence.

*SB - With the annual valuation process, are you linked in with a 2-year valuation cycle?

Yes we are. Two years on and two years off. We find that a number of the valuers dance together on that. There's a rotational thing. But we do 2 years and in the case of one of the major office buildings in the city here, “y” do the next 2 and they know that we are going back in for the next 2.

*SB - You presumably have your fund valued every year, and you cycle round the different valuers?

Yes. As required because we are all public, we are all subject to the same requirements.
The last major ones I was involved with were both because they had to determine the split between the developer and the owner. There was a trust structure and I'll cite you where they are if you want me to. They had to have an independent valuation done i.e. it wasn't just me and my employer and another firm jointly to do a valuation to determine the profit share if any, the next tier of ownership to the next time they had a right to buy out or sell down. So, sure the more usual one is on annual revaluation cycles for asset purposes, but I assure you as these developments are getting larger and larger I know for example the reason why they wanted to spread their risk and they funded the development.

*SB - So they don't use their own funds, they use commercial funds?  

Exactly.

And they are using some of Prudential's funds. They will then revalue, be sure until a time frame set up in the trusts and i.e. work for valuers, and they will then split up any profit value, based on the trust. So the last two happened to be not for asset purposes, they happened to be for apportionment of ownership. So I'll stop there. Do you want me to mention one point you just mentioned? I'm sure you are aware of it, but I will say it just for the record, obviously in such a case there is a greater emphasis on the instructions given to the valuer. Obviously the deed is attached, which is a legal document, then they set out virtually a pro forma, I don't know if they want it actually broadcast to the whole marketplace, but we were surprised that they actually were writing without the figure work, the methodology of these two unusual valuations. They didn't put any figures in the last line, but if we gave you this work and we are pretty sure that we will and they said the same thing to my colleague, what was, this is how we go about it. It came from the owner with approval of the funder. And we were a little bit taken aback initially until, and we thought oh well it is just marketing.
All of them, unlisted funds have to value their property once every year as opposed to listed valuing every three years.

And they do the internal valuations and in fact most managers do their internal valuations as well and then the external valuer comes in and they compare.

+++ ON-LINE DOCUMENT: SYD12TX
+++ Retrieval for this document: 6 units out of 94, = 6.4%
++ Text units 5-10:

Yes, annual or quarterly, we do quite a few quarterly valuations and portfolio work, so that obviously requires going through the whole exercise every quarter, all the numbers, and doing and redoing the cash flow. Yes, that would be the bulk of the work that I am involved in and probably the bulk of it would be I would say 80% retail, most of it would be regional centres, we do some sub-regional centres too, but probably the majority would be regional centres.

It is a national market. That's true and there is not a huge variation between investor's criteria between states, there are obviously demographic differences, but generally speaking all other things being equal, a major shopping centre in Melbourne can be quite comparable with one in Sydney.

Summary statistics - Node (2 1):
+++ Total number of text units retrieved = 75
+++ Retrievals in 10 out of 17 documents, = 59%.
+++ The documents with retrievals have a total of 1536 text units,
so text units retrieved in these documents = 4.9%.
+++ All documents have a total of 2381 text units,
so text units found in these documents = 3.1%.
4.4 Analysed Valuer Interviews

For the purpose of completeness of the empirical data, the evolved conceptual framework, nodal references and nodal data for (2) and (2 1) are repeated below. The evolved conceptual framework for the ‘Valuer’ (Figure 4-1) is also represented again as a visual summary of the process as it evolved from analysis of the data. By using the ‘Valuer’ nodal prefix, i.e. ‘2’ along with the ‘Anticipated Lifespan’ (sub node [child] ‘6’) and its sub node [child] on ‘How Funded’ (sub-sub node [grand-child] ‘6.3’) the analysis of data relating to funding refurbishment can be found (i.e. 2.6.3). This allows this section to be considered in full as a separate data resource, as with the Analysed Owner Interviews that follow (4.5).

It is important to reiterate the philosophy behind the evolution of the conceptual frameworks. This was outlined in the fourth paragraph of section 3.3.2.1. and is, for the sake of clarity, reiterated here: ‘the evolution of the conceptual framework is a key tool of theory building. The purpose of research is to investigate, describe and analyse a pattern of relationships. At each stage of the research conceptual frameworks offer a visual synthesis of the researchers developing understanding, using labels to categorise intellectual bins. Researchers, however inductive their approach, know which bins are likely to be in play in the study and what is likely to be in them. The bins come from theory (the literature review), experience (as a qualified valuer and researcher on property investment and appraisal) and the general objectives of the study envisioned.’

As explained above (sections 4.3 and 4.3.1) the analysis of the data highlights certain relationships that had hitherto not been considered in the literature. The new ‘categories or theories’ (summarised in the relationships and headings in Figure 4-1) that emerge are a new way at looking at the investment appraisal of enclosed regional shopping centres.

322 ‘These ‘bins’ are referred to as ‘nodes’ in the software adopted for this research.
323 Miles & Huberman (1994) p. 18
324 To use the phraseology from Strauss & Corbin (1990) pp. 49-50 cited in section 2.1 above.
Figure 4-1: Evolved Conceptual Framework: VALUER

Source: Matrices evolved from analysis of interview data, developed from research in Chapter 3.

Q.S.R. NUD.IST Power version, revision 3.0.4d GUI.
Licensee: Spike Boydell.

(2) Valuer
(2 1) Valuer/Ann Val Process
(2 1 1) Valuer/Ann Val Process/Knowledge
matu(2 1 1 1) Valuer/Ann Val Process/Knowledge/Independence
(2 1 1 2) Valuer/Ann Val Process/Knowledge/Player
(2 1 2) Valuer/Ann Val Process/Pressure
(2 2) Valuer/AIVLE DCF Guidelines
(2 3) Valuer/10 Year Model
(2 3 1) Valuer/10 Year Model/Advance or Arrears
(2 3 2) Valuer/10 Year Model/Period
(2 3 3) Valuer/10 Year Model/Cap Rate
(2 3 4) Valuer/10 Year Model/Tenant XT
(2 4) Valuer/Software
(2 4 1) Valuer/Software/Designer
(2 4 2) Valuer/Software/Client specified
(2 4 3) Valuer/Software/ProjectTM
(2 5) Valuer/Return
(2 5 1) Valuer/Return/Yields
(2 5 1 1) Valuer/Return/Yields/Initial
(2 5 1 2) Valuer/Return/Yields/Equated
(2 5 1 3) Valuer/Return/Yields/Equivalent
(2 5 1 4) Valuer/Return/Yields/Reversion
(2 5 1 5) Valuer/Return/Yields/Cap Rate
(2 5 1 6) Valuer/Return/Yields/IRR
(2 5 2) Valuer/Return/Growth
(2 5 3) Valuer/Return/Depreciation
(2 5 3 1) Valuer/Return/Depreciation/Redevelopment
(2 5 4) Valuer/Return/Analysis
(2 6) Valuer/Lifecycle
(2 6 1) Valuer/Lifecycle/Main Structure
(2 6 2) Valuer/Lifecycle/Retrofit
(2 6 3) Valuer/Lifecycle/Funding
(2 6 4) Valuer/Lifecycle/Yield implications
(2 7) Valuer/Forecasting
(2 8) Valuer/Future
(2 9) Valuer/Miscellaneous (Misc.)
(2 9 1) Valuer/Misc/Cinema
(2 9 2) Valuer/Misc/M&S
(2 9 3) Valuer/Misc/International
(2 9 4) Valuer/Misc/Service
(2 9 5) Valuer/Misc/Gambling
(2 9 6) Valuer/Misc/Investment Vehicle
(2 9 7) Valuer/Misc/Robina
(2 9 8) Valuer/Misc/Corruption
(2 9 9) Valuer/Misc/Negligence

Total 45 “Valuer” nodes.
For the following nodes, a summary of the relevant issues is included in Roman numeral ‘dot point’ form. All direct quotation is italicised.

### Valuer

*** Definition:
Valuation Practitioner, Appraiser

i. The majority of players in the market (from the owner's side) also have a valuation background.

ii. The valuer is used as a check - to reconcile (superficially independently) the owner’s opinion of asset worth.

iii. Valuers are not privy to all the market information – the owners are very secretive.

iv. The valuation of shopping centres is an art form.

v. There are different views of valuers in the eyes of owners. Some argue that ‘they are in a different world, reporting on the past - they get to a point where they believe their own bullshit.’

vi. Whereas others consider valuers models to be more sophisticated than their own and that ‘their view of the market becomes the market view of the market.’

vii. Valuers are more historians than forecasters whereas their clients prefer them to be forecasters rather than historians.

viii. Valuations frustrate by failing to annotate or explicitly state assumptions.

### Valuer/Ann Val Process

*** Definition:
Motivation for annual valuation process

i. Basis of valuation includes primarily periodic valuation reports to trust, but also due diligence, ongoing advice, development advice, funding “splits”, ownership apportionment or finance reports.

ii. Short-termism. Property Trusts, in particular, are not interested in what the investment will be worth in the future - the value at present is the critical issue.

iii. The annual (periodic) trust work starts with a full valuation, followed by
updates and ongoing advice.

iv. Often (normally) the client conducts internal valuations of all the assets prior to instructing external valuers.

v. Frequency of valuations depends very much upon the client’s requirements and ranges from quarterly to triennially.

vi. Valuers normally value on a two-year cycle - “dancing” two years on, two years off, to satisfy the legal requirements of the funds.

vii. In that context, however, the funds do attempt to influence by passing on previous reports.

viii. Valuers do not get involved at early enough a stage, particularly with development work.

ix. Many clients seek a valuer who will put the right number on it. Clients have large teams of experts striving to maximise return and they don’t want the valuer to come in and tell them something that they don’t want to hear.

x. Conversely, the valuers’ question why a client would pay them $40,000 to pay them lip service and acquiesce to the clients indicated value.

xi. Clients take a macro view, whereas the valuer is paid to take a micro view.

xii. There is a changing emphasis on the instructions given to valuers - including methodology pro-formas. (rendering is dealt with later).

(2 1 1) /Valuer/Ann Val Process/Knowledge

*** Definition:

Why instructed/specialism

i. The investment appraisal of enclosed regional shopping centres is more of an art than a science: ‘I think (that the) valuation of shopping centres is an art form in itself, and I guess that is probably what this (research) is going to show’

ii. Whilst some valuers operate ‘a valuation practice dealing only with shopping centres’, owners generally prefer to employ a valuer ‘that has major experience in shopping centre management, ownership consulting. Knows, talks to the major tenants on a regular basis which he does. He negotiates leases and that sort of thing’

iii. There is a perception that it is best (greater comfort) to put a valuation in the hands of someone who is ‘in the market’ (i.e. through management or agency) rather than
someone who is not in the market on a ‘day-to-day’ basis. In this context the ‘database’ is an essential emotional (or confidence) crutch, ‘because we are working the market, and we are in regular contact with the players and in fact we are valuing for them on a regular basis, we’re getting constant feedback, so that’s our special knowledge. That’s what differentiates us from some prick in a Commodore with a mobile fax. We’re actually at the coal face dealing with the guys.’

iv. This ‘knowledge’ includes an understanding of a retailer’s ability to pay rather than valuing to the precise (indicated) word of the lease.

v. In valuing any shopping centre, whether it is regional or anything else, you have to look at the philosophy of the owner of it. There is a differentiation between some investors who just look at the initial return (income stream) and major funds that can understand (hopefully) and relate to discounted cash flows.

vi. There is a need to appreciate that some investors don’t follow the market - they make the market and have the ability to do so by buying at an initial yield 1% below what the rest of the market may anticipate.

vii. There's no substitute for gut feeling in looking at a shopping centre investment appraisal. I used an analogy when we used to value a whole lot of hotels. I would say you would walk in and virtually sniff it and you’d know what it’s worth. And you’d ask one or two questions, you would have a preconceived idea of this thing - it might be $0.5m. You walk in the door and ask 2 questions of the licensee, the publican. Bang bang. Yes, give or take a bit. I don’t say regionals (shopping centres) are that easy but the more you do the easier they get.

viii. However, valuers are very much kept in the dark and the funds are almost amused by that.

ix. In contrast, valuers acknowledge ‘...it doesn’t take a scholar to get a tenancy schedule and dump it into a model, it’s monkey work, give them bananas. It really doesn’t take a whole lot of brain matter to do it. The brain matter comes in the collective knowledge that you’ve got over a number of years in looking at the sales, the trends in the market, both past and future, talking to the players and there is no formula around. It is a science, formulating all that information into and all those inputs into a model.’

x. The bigger firms of valuers take a view that the market and the information within it feeds on itself. A case of ‘the stronger you are - the stronger you become’. By valuing a lot of regional malls over a period of recent years they consider that they have an enormous amount of data - but to what degree does that serve to compound the myth?

xi. This perceived “knowledge” of fee valuers is succinctly addressed by a valuer within a
major fund: ‘most of the valuers I’ve dealt with in recent times are in a different world, but it’s the world they’re required to be in. I mean generally speaking they don’t have that access to what everybody else’s value of their assets are so they can only use discount rates in relation to the people they are talking to and what they have valued the assets for. In other words you get to a point where they believe their own bullshit.’

xii. The use of this knowledge is, however, positively acknowledged by some funds: ‘What we really look for from the valuers is an indication on where cap rates are moving and their call on growth rates and how they kind of relate to ours because, as I said, we are closer to the property, they are closer to the market.’ Thus, the fee valuers can provide the ‘markets’ view of the investments worth.

xiii. The funds don’t specifically nominate valuation firms, but rather go ‘for specific individuals who we know are expert in those areas and if they, as they sometimes do, move to another firm then generally our business would follow them. In other words, we totally, we are just looking into an individuals expertise rather than a particular firms expertise.

xiv. There is considerable rivalry between some of the valuers in respect of their valuation approaches and knowledge: ‘We find a few practitioners, okay, the others will say the same about us, who tend to just roll with it and then equalise it with a rate that gives them the answer they thought of in the first place. And it throws it, it’s buggered, because it’s not a document the client can use well. It doesn’t take a scholar to come up with a number first by some rudimentary means and then just get a cash flow to support it. That would be almost demoralising you know to waste their time what is the point in doing it.’

xv. The continual theme is that knowledge is power: ‘some clients won’t be prepared to give their full forecasts of growth, what they anticipate or their expected IRR, so you are really stuck in a situation where you have to fill in the gaps yourself, it’s not easy to get all of that information from a client who has just purchased a property - often that information is quite sensitive and confidential and they’ll only give you bits which they feel comfortable about. They won’t give you the whole lot, with it’s - on a couple of occasions I’ve got 90% of what I need, but in most cases they are not willing to have that... Even if you keep that information here and don’t put it in a report they’re not happy about giving too much away in case the competitors get their hands on it. Knowledge is power. It’s a very closed market.’
(2 1 1 1) /Valuer/Ann Val Process/Knowledge/Indep
*** Definition:
Independent Valuer (no management or sale conflict)

i.  There is a balance to be drawn between those valuation practices which gain knowledge as a result of their management of agency activities and those who are entirely independent: ‘getting nothing other than the valuation fee to do the valuation properly’

(2 1 1 2) /Valuer/Ann Val Process/Knowledge/Player
*** Definition:
Active in management/leasing/sales/invest advice

i.  A conflicting view to (2 1 1 1) is the need for a huge database of management related information in order to be able to properly synthesise the information which a client is providing.

ii.  This view is reinforced by the sentiment that the funds (clients) ‘give the valuers 80% of the information and expect them to trawl around for another 10% and if they are very good maybe another 15%. But there is always that little bit that is sort of withheld’

iii.  There is also an inference that the main funds who now deal with their management ‘in-house’ see the international property consultancies as something of a competitor, albeit that they do not manage at the regional level nowadays.

iv.  Those property consultancies which do a reasonable amount of management and agency do, at least, have the benefit of ‘combined sales reports’ showing relative turnover figures for various tenant types nationally.

(2 1 2) /Valuer/Ann Val Process/Pressure
*** Definition:
Pressure to meet client expectations

i.  ‘In a way a lot of these trusts and funds, and everyone else, influences you. They say, we’d like you to value this, here’s a copy of the last one. I mean...’

ii.  The new pressure related to tendering for valuation work is very real, particularly as annual valuation fees on regional shopping centres are in the range of $40,000 - $50,000 plus. The emotion of the valuer is clear as follows: ‘you’ll get “X” calling for proposals to value shopping centres... give us your cost and give us an indicative yield. In fact it is in writing- give us your
indicative yield within the range of 1%. How is that for pressure? When the valuation departments of some of these companies might be... and you might feel the squeeze a bit and you might think your philosophy might be... maybe it is a 10% or, not a 10.75% - and so you put down an indicative yield of 9.5% - 10.5% and you put your price in, how much you charge to value it. Tending to value it. But they ask for two parameters: what are you going to charge me to do it and what is your indicative yield. I speak to the valuers around the traps who value stuff for them and I can tell you what happens to them if they don't come up with the bloody numbers. They get wiped. They'll get wiped for a couple of years; they won't even get on the bloody list again.

iii. The ‘pressure’ on valuers is even taken to physical intimidation by fund managers, ‘And “x” will, they will literally hop on a plane, fly up, get the valuer in a corner and hold him up against the bloody wall and say this is not what we wanted. We want you to come up with this. I have seen it. I have seen it happen. I have sat there and tried to act as a mediator: I'd try and say to “x”, look, calm down a bit, the blokes following the market, that's how he sees it, you asked him to do it and that's what he did. And that's what started these bloody letters that go out now, calling for fee proposals together with a little bloody one liner that says and also your indicative cap rate….’

iv. Some fund managers acknowledge the “pressure” aspect - particularly when statutory requirements necessitate an external view to validate an extension or purchase proposal. It is clearly in the funds interest to ensure that the external valuer produces a value in line with the internal one.

v. If a fund manager cannot agree (or rather, is concerned) with an external valuation, the normal practice is to commission a further independent valuation.

vi. Instances were also reported where funds, in considering lending proposals, sent valuers detailed valuation pro-formas with detailed instructions, asking the valuer to do little more than validate them in order to receive their fee.

vii. The owner’s view, as reported by a fund manager can be summarised thus: ‘I'm the first to admit that in a wider industry sense there are lots of examples and I'm sure you'll find valuers that will tell they have been put under immense pressure about the availability of future work and all sorts of things if they don't perform along certain lines. Well, it is a fact of life. Unfortunately it's a profession that is wide open to that sort of thing. It's just something I guess we've got to live with.’

---

**(2 2) /Valuer/AIVLE DCF Guidelines**

*** Definition:
Relationship & understanding of 1996 AIVLE DCF Practice Standard

i. Whilst all the valuers interviewed acknowledged the AIVLE DCF Practice Standard, there was a high level of complacency and concern from some in respect of the
Standard.

i. The complacency appeared to relate to the fact that the practice was a large player and thus had some representation on the AIVLE committee: ‘I’ll be honest, I have looked at them, I haven’t fully digested them. I believe that we are pretty close to the sort of things that they are after’ and… ‘I guess we had a fair amount of involvement in putting them together, so they’re certainly along the lines of what we do and what we undertake in relationship to a specific area, I’m sure’

ii. Negative reaction from valuers against the standard was seemingly based on insecurity: ‘I think essentially it just comes down to the commercial reality is, that one of the reasons why this practice actually exists is because of the people it employs, innovation, resources, skill bases, etc. To then come along with a Standard, that’s like hey guys how about you all belong to this club how about you all chuck in your collective knowledge so we can disseminate it against our brothers out in the industry for the betterment of the industry. The simple fact is, I can’t think of another word, but say you are Joe Bloggs out the back of Whoopwhoop, having the benefit of that information at his advantage or to his peril. That’s ultimately what we are getting. It’s formularising the process and it’s almost infers anyone who grabs this document is an equal and that’s not true’

iii. The consensus was, however, that the Standard provided a sound basis for development: ‘I think we are going to see, we are going to need to see, some common base for the valuation particularly of regional malls. Certainly the AIVLE’s DCF guidelines have, or will, force some of the older skilled valuers to significantly re-appraise the way that they look at the DCF. Hopefully the courts will start to better reflect an adoption of the DCF methodologies, being a better reflection of how the market will behave. I think that there are some good opportunities for improvements in the way that DCF analysis is done, and a deeper understanding of the input and particularly the discount rate, and the methodologies of establishing discount rates. We are sophisticated by this markets criteria, but we would regard ourselves still as unsophisticated compared with the United States’

---

<table>
<thead>
<tr>
<th>(2.3)</th>
<th>Valuer/10 Year Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>Nature of model adopted, e.g. 10 year with assumed sale adopting year 11 income</td>
<td></td>
</tr>
</tbody>
</table>

i. The adoption of the ten year model is taken as the norm with only one respondent dissenting in favour of a 15 year view and another acknowledging that for a period a fund had requested that they adopt a fifteen year view.

ii. The Valuer view was that the client and the “market” opted for a ten-year view rather than fifteen. The majority had the flexibility to adapt to a five year model as well (say for a funding appraisal), if requested.
iii. In contrast, the rationale for a fifteen year view is given as: ‘We have looked at the pattern of ownership of the regional shopping malls, which is the retail area that we value and they’ve all got holding periods of 15 years or more. It seems illogical to hypothesise on a holding period that is shorter than experience has shown the average holding period to be.’ The principle being that you can’t accept some aspects of market reality whilst ignoring others.

iv. There was a disagreement over this aspect: ‘we generally go over 10, because we judge by what the institutions sort of look, how they look at these investments, not many of them seem to look at a 15 year holding period.’

v. It was noted that the AIVLE guidelines leave the duration of the cash flow flexible.

vi. There was reasonable comfort in projecting out the cash flow for five years as often that correlated with the management plan, but vagueness prevailed beyond year five. There was considered to be a reasonable accuracy in the next couple of year periods to determine rental levels and forecast population growth.

vii. A problem is identified in any element of forecasting, be it for a ten or fifteen year cash flow that valuers are ‘modelling out leases a lot further than they go. The sentiment being ‘crap in - crap out’.

viii. This concern over forecasting is replicated in development appraisal where some funds take the period of development plus five years.

ix. Fairly arbitrary over capital expenditure (for improvements) through the DCF term. Some valuers do discuss such aspect in detail with the client.

<table>
<thead>
<tr>
<th>(2 3 1)</th>
<th>Valuer/10 Year Model/AdvanceArrears</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>Valuations calculated in advance/arrears</td>
<td></td>
</tr>
</tbody>
</table>

i. There was no consensus over the adoption of an “in advance” or “in arrears” approach to dealing with rental income within the cash flow. Indeed several valuers adopt a “mid-year” approach in the hope of balancing out any differentials.

ii. The justification for some is the word of the lease: ‘We always follow the terms of the lease. So if the lease says that the rent is payable in advance, or in effect advance, then we would take all the cash flow in advance. If it is in arrears we would do the same - we would move everything into an in arrears
iii. The funds view differs in some cases as some value on a quarterly basis, transferring ‘budget income into actual income on a quarterly basis within the valuation model.’ This update being carried out “in arrears”.

iv. Those in favour of a mid-year approach cite the lack of delinquency (rental arrears - also referred to as revenue retardation) at regional level as justification in mimicking the market, whereas the level of delinquency is considerably larger for sub-regionals.

v. The issue of turnover income caused some confusion, suggesting that several practices have not considered the issue. This being the overage element which is normally payable a quarter year after the end of the trading year - that is a year and three months in arrears... for example: ‘I am not even sure that we would time the turnover...’ And as to how it is written into the DCF: ‘We just juggle it. It doesn't enthusiastically receive it, but we adjust it.’ The question is relevant, particularly when the approach to analysis is considered.

vi. One practice stated that ‘We do it annual, mid term and monthly in arrears. And we give that to our client.’ When questioned if they analyse them in the same way the response was ‘We usually don’t.’ And when pushed further on this issue the response was ‘In terms of regional shopping centres there is little; there is negligible difference between the two approaches.’ The rationale for this was developed thus: ‘The commercial reality is you are only analysing a regional shopping centre with a degree of accuracy and it's not going to be accurate because it will change daily. If you have already done work on the centre and you know all the lease terms and conditions you are not going to build a 300 tenant model to analyse your sale. You're not going to do it. If you've done it and then it sells, you can run it back and get exactly that. Now the clients won't afford the luxury of that sort of time consuming analysis. That is in a practical sense. We'll do it if we value the centre and then it subsequently sells, we'll repackage it. In an academic sense we would do it in exactly the same way, as we would value the property we were looking at.’

<table>
<thead>
<tr>
<th>(2 3 2)</th>
<th>/Valuer/10 Year Model/Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td>Monthly/Quarterly/Annually etc.</td>
</tr>
</tbody>
</table>

i. The rationale for not adopting an “in advance” approach was cited by one practice as a lack of computer memory.

NOTE: there was a significant amount of overlap between issues raised in nodes (2 3 1) and (2 3 2). They should be read in conjunction with each other.
Paranoia over DCF or initial approach

i. The line of questioning asked about the impact on the terminal (reversionary) capitalisation rate and the fact that at reversion (year 10) the centre would be ten years older than comparable evidence today. In responding a fund manager said: ‘I guess just being as honest as I can be it doesn’t get priced in. There is not as much consideration on what is going to happen in ten years. And I am blaming all values are the same. We get, we’ve got almost $2bn worth of property and it has got to be valued every ‘valuation period’, so we’ve got a million and one valuations from supposedly the best in the country... and they don’t put a lot of consideration into it. Look, they put a lot of consideration into the initial yield; they put a fair bit into the discount rate. And they give the terminal rate some passing consideration.’

ii. The overall challenge relates to the whole issue of projecting a valuation into the future with the associated forecasting required: ‘Regional shopping centres and shopping as a whole is becoming such a moving target that you really don’t know where it is going to go. And for somebody to come to me and say here’s a ten year projection on income, take out value, everything I find it very very difficult to come to grips with, I really do.

iii. Valuations are rarely revisited years after the event: ‘I wonder how many people come back in eight years time and look at those projections. I wonder how many people will come back and relook at those and find out what has actually happened. It is only an issue when litigation is brought over the valuation, and such an action has yet to be brought to the Australian Courts in respect of a regional shopping centre.

iv. In reconciling the two approaches: ‘Normally we do a 10 year discounted cash flow and a capitalisation approach and we use that with every valuation. Basically the 2 methods they sometimes come out very much the same in terms of the end result, other times there is some variation. We would put a lot of reliance on the DCF approach.’

Tenant-by-tenant approach

i. Valuers do not always check every tenancy (or thus value each interest) in an shopping centre investment in detail. In taking a tenant-by-tenant approach one practice observed: ‘We make a point of looking at each lease for a number of properties. If we are on a 2 year appointment, we might sample some in the first year and sample the rest of them in the second year. We
won't necessarily sit down and read all of them individually the first year. We take the tenancy schedule provided by the owner and then cross check, perhaps randomly cross check 100 different tenancies to ensure that the data we have been given is correct.

ii. The problem of forecasting is again relevant when projecting out anticipated lease agreements: ‘...we make assumptions about what we believe the review pattern will be (for specialties). The problem there is of course that even the centre managers are not aware of what sort of lease they might strike after the 5-year lease has expired. They might go for CPI with a market in the 3rd year or they might go for predetermined stepped increases. At the moment there is a tendency for new leases to be on a step basis over predetermined steps or percentage increases, so that tends to be the flavour of the market at the moment. There are still quite a few CPI leases about. But with CPI being very low and likely to stay low for a while they tend to regard that as their best option.

iii. Major tenants also have very varied lease terms, often based on complex percentage/turnover expectations which must be projected and forecast within the DCF: ‘That has to be all be done quite accurately, because that can obviously influence income quite substantially because of the amounts involved. Again we have to do forecasts of turnover for major tenants. That is based upon, I guess, what historic growth rates have been and what we see the future competition being in the area, if any...’

---

### (2 4) Valuer/Software

*** Definition:**

Lotus, Excel, QuattroPro, ProJect

---

i. The standard spreadsheet applications adopted by practices and funds are Lotus\textsuperscript{TM} and Microsoft\textsuperscript{TM} Excel\textsuperscript{TM}. One valuation practice developed models on QuattroPro\textsuperscript{TM} whilst cross checking in Microsoft\textsuperscript{TM} Excel\textsuperscript{TM} with another using ProJect\textsuperscript{TM} exclusively.

### (2 4 1) Valuer/Software/Designer

*** Definition:**

Who designed package?

---

i. The majority view is that the valuer using proprietary spreadsheet software has individually designed the models. As a result there is commonly a lack of uniformity between valuers, in a single office and between offices, of the same company.

ii. The funds made similar commentary: ‘We have just designed our own spreadsheets over the years. And we are just now looking at buying something or having someone in to develop a homogenous
software package for us. I have got ten investment managers in my division all using slightly different styles.’

iii. The benefit of valuer designed and refined models are the flexibility: ‘it’s always being refined. There are always anomalies - the shopping centre has something different, you know or we want to add a Target or we want to put this or we want to put that in. I mean the framework is there if we want to add and subtract.’

iv. Other practices cite that they had two distinct retail appraisal programs in the same office. They didn’t want to give them up thinking each had some commercial edge.

v. Some practices built up models between their state offices, allowing transportability, whereas others were very individual - in line with commentary that funds used the services of an individual (2 1 1 xiii).

vi. Conversely, the view of the one practice adopting ProJect™ is understandable and perhaps provoking: ‘Well I just think that writing your model from scratch is a little bit like doing your own brain surgery with a mirror because from my perspective all that is just fraught with risk. We see some of the risks that emerge just in using ProJect which has been around for 25 years or something and what can occur with some sort of misinterpretation there. Why you want to take the risk of multiplying that many times by writing your own model and not knowing where the flaws are? You know, I just don’t understand it.’

---

i. There is no client specification to valuers on what model to use currently in Australia. Challenges arise when the valuer is appointed to audit a funds valuation. What is apparent is that there is currently very little transportability of thought or data due to the individuality of systems being used.

ii. Conversely, in the United States where ProJect™ is commonplace, clients proffer tenancy data to the valuer already in a suitable format, and the disk is returned to the client (post appraisal) for sensitivity analysis and external auditing.
i. The concept of client provided tenancy details was well received but was matched with a suspicion of “black boxes” which separate the valuer from the data.

ii. The funds which tested ProJect™ did not find it flexible enough for their purposes, and having sent staff on courses decided that the models were ultimately too fixed in where you had to put your variables: ‘I think that is the trouble with it, I’m glad we didn’t have to go down that line...’.

iii. The funds acknowledged that if they purchased it, all the valuers who service them would have to buy a copy also.

iv. The concept of change also deterred a few valuers: ‘I think that you will probably find that we are all a bit staid in our ways here, we understand what we are using’

v. ProJect™ was perceived by some valuers to be labour intensive, although no clarification was forthcoming as to why it was more so than entering tenancy details into a DCF model that they had designed themselves. This energy was cited as a major reason why it was not popular. As referred to elsewhere (2.4.2 ii) the situation is different in the United States where funds commonly provide the fee valuer with full tenancy details in ProJect™ format. As all the funds have data on Lotus™ or Excel™ they could be linked directly through to ProJect™ anyway, but despite this, even the users of ProJect™ prefer to enter their own data themselves as the model is ‘highly sensitive’. The endeavour is minimised ‘Because we are doing revaluation work the following year you’re really factoring the input exercise, the cost of the input, over a two year period’

vi. The limited adoption is acknowledged: ‘And that’s a dilemma we have in Australia - that ProJect is not as enthusiastically embraced here as it is in the US. In the US something like 60% of all institutional valuation work is done on ProJect. Here the usage rate is far lower; most of the major firms have decided not to use it because they don’t believe they can train their people competently, to use it competently. That is what they have told us anyway, which is a pretty devastating sort of acknowledgement’
NOTE: The grouping under “(2 5) Return” serves as an umbrella for what started as the key hypotheses relating to the issues of (2 5 1) risk/yields, (2 5 2) growth and (2 5 3) depreciation. To this the subset of “(2 5 4) analysis” was added. Because the responses (particularly risk/yields) were broken down into considerable detail, the responses have been grouped under their more focused subsets.

(2 5 1) /Valuer/Return/Yields

NOTE: This section originated as being identified as an area of key concern. For the purposes of analysis it has been further broken down into six sub categories, each dealing with an aspect of yield. This section aims to look at the wider picture and highlight the apparent confusion.

i. Confusion over the terminology is paramount. For example the naming of the “term” yield by some valuers relates to the terminal (end of DCF) capitalisation of the anticipated year eleven income for others. Other valuers commonly refer this to as the “reversionary” yield. The confusion is further compounded in that the “term” yield implies an “initial” yield for the first lease term prior to review of rental to full rental (or market) level on review within a ‘term and reversion’ simple capitalisation approach. As one fund manager succinctly put it: ‘Everyone has got different meanings on these things.’ And as a valuer said: ‘Look, I think the market is somewhat confused by all of these different terms. We like to really talk about two different yields here. An initial yield which doesn’t mean a great deal. And an equated yield… Sorry, a terminal yield as well.’

ii. The use of a “harsh yield” was proffered as relevant terminology, i.e. increasing the yield, making it higher, to reflect relative ‘riskiness’.

iii. The issue of comparison in analysis is a challenge in this sector. The question was asked: say you are looking at a ten year old regional shopping centre now - would you try and find a comparative sale of a twenty year old regional shopping centre and analyse that to get your terminal yield? The responses were all similar in confirming: ‘We do endeavour to compare like with like, but when you deal with regional shopping centres that is not always easy.’ And when you deal with a peculiar animal like “x centre” which was before its time, probably in the wrong...
place, you have got no real comparability, true comparability, to go and look at anywhere else. So you are looking at superior bodies and trying to analyse backwards. Saying that we have got this inferior product in the wrong location, and that makes analysis purely in the eyes of the analyst - it is very much a personal thing.

iv. The owners are clearly as confused as the valuers who service them. In responding to a request to define the yields adopted, one fund manager responded: ‘We try to strip it back too, for consistency, and we use different terms for it. We try to strip it back to the yield. If you are at mid-point of the year, so it is now December 1996, and if you took the income that is going to be earned between six months prior and six months forward, that becomes $X. And then, that is your numerator; and then the denominator will be the value or the sale price less any extraordinaries, like your surplus land and all those things that need to be adjusted out. Then it is straight division between these two. We find that the safest way to look at what we think a yield was on a property. Other people just use the passing (rental). And in shopping centres that is a bit hard, because the rent review cycle could be just looming up on that passing and there could be some very... we don’t bank, we have a very conservative view on reversions, and we don’t bank, we don’t look at reversions out there. It has to be right on your doorstep. Other people say it is the income from twelve months forward from this date, in fact that is the traditional valuation approach. That is the traditional, but we are a bit more conservative, we take six months back from that. And and we try to get all the data we can on a sale or on another valuation, we break it all down and we analyse it all on that basis and we can compare it with our own. That is how we do it. And when we talk amongst ourselves in the office on, you know what did “X” sell at, for instance, that is the basis we talk on. And when we talk to other owners we get bloody confused.’

v. As to publicly quoted yields in the property press, they were acknowledged as being ‘nonsense’ by the owners because the ‘published’ income bears no relation to the passing income.

vi. Investors are in a position to ‘make’ the market rather than following it by acquiring shopping centres at 1% below what the ‘market’ thinks it should be.

vii. Understanding and dealing with the advertised income is an important aspect: ‘when these sale brochures come up, they put in every dollar income that they can, turnover rent, electricity profit. I mean everything that they can find. What I try and do is strip it bare. And all that odd bloody income I cap it at 20%, 25% or something. I just strip all that stuff out and use a different cap rate. It makes a hell of a lot of difference in the end. Any percentage rent you might be getting you know all of that sort of stuff. Percentage rent is a big one too, I mean I have always looked at the philosophy of, and how to get to owners, you know - they might walk in with a Coles store, you know one of these old Coles early 80s leases. They weren’t very sophisticated. They have a turnover rent and a base rent. The base
rent at the time was very low because no one could have anticipated that you know Coles might have gone on the basis that this store is only going to do $15m. Not looking 15 years down the track when it is going to be doing well over $30m. So there you have got this base rent of - $170,000 seems to be the common one - and a turnover rent of anything up to $300,000. Very risky. It’s all risky stuff. And you have got to go to the owner and say look, you have got to get that built into that. And right at the same moment he might have a letter from Coles saying that we are about to spend $3.5m doing a refit of the store. You might go to Coles and say well give you $1m if you give us a new lease with a new starting rent. It takes all the risk out of that for your long term.

viii. Dealing with competition in respect of the demographics raised several issues: ‘...you have got to look at the area that the centre fits in. If it is a growth area, there is a very good possibility that somebody is going to come in and whack another one up the road. And he takes that one out of it.’

ix. Some valuers would reflect the turnover rent element at say 12½% whilst the base income yield was say 9½% to reflect risk, depending on the size of the centre. Whereas others don’t generally split cap rates.

x. A constant yield rate would normally be adopted for all tenancies with no differentiation between majors and specialities in either the cap rate or DCF approach. Such a circumstance would only arise if income were not secure for the whole duration of the cash flow.

xi. In the capitalisation approach, many valuers do not concern themselves about the reversionary component because the rental structures ensure that there is not a great deal of difference between market and passing incomes - and any differences are smoothed by the large number of tenancies.

xii. The picture is further clouded in a market where valuers admit to starting with a price (or answer value) for the DCF and work backwards to find a “discount rate” which fits.

xiii. Within the DCF there is a general reliance on referring back to the owner (client) to determine what their risk weighting (IRR or target rate) is. But some valuers argued that you could not buy a regional mall at an IRR of 14% or even 12% in the current market.

xiv. The sentiment from owners, in response, was: ‘you know they run their DCF, but there is not a lot of thought goes behind what discount rate they use. And what is riding the discount rate’

xv. No valuer admitted to knowing (or understanding) a formula to calculate the equated yield (target rate, discount rate, IRR). They gave a vague acknowledgement of bond rates plus risk. The sentiment being: ‘It is more what the market is saying. No we don’t
formularise (a discount rate). Essentially what it is - is keeping abreast of what’s happening in the market and continually talking to property owners. We’ll say that you have a yield rate or a hurdle that you have to satisfy and they’ll all do it, “P” and “Q” and the others. They say, yes, we would like to see X%. We have difficulty going under it. We’d love to go over it.”

xvi. Developing this theme, there are indications from some valuers that there is no finite market rate that can be utilised: ‘Target rate of course being different for you, me or “J”, if we were representing 3 different institutions. Depending on the market at the time you could, I mean I’ve done it, you ring 4 or 5 of the players and say well what sort discount rate would you require or an internal rate of return would you require on a regional, on a quality regional at this time? And some would say well, I want 13%, I want 3% over the 10 year bond, I would want 8% over the bond. What I’m saying is were not in the market at the moment. But if it was that cheap we’d buy it… Essentially after a while in the market place you can work out the players who will only buy when it’s an absolute steal. Yes, you have got buyers and sellers. And who are those that will only buy, I’m sorry, who are prepared to pay over the market because they are driven by some other factors and they have a pile of money to shift or whatever; and then there is sort of like a consensus in the middle and you can almost get a range.’

xvii. Users of valuer’s reports highlight this vagueness. Whilst a report may run to some 300 pages: ‘that made it look like they’d done their research, but as far as the really important numbers, I didn’t find any justification there’

xviii. In response to a question on definition of the yield terminology, one valuer responded: ‘It would depend a little on the most reliable comparables that we have available. And we will work with the yields, whatever yield has been exposed by the most ideal comparable. So that if we are working on a shopping centre in Sydney and there has been one sale down here and we regard the revenue profile similar then whatever the yield number that has been produced that we have available to us we will rely on that and adjust ours to suit. But initially we would work by asking income, adjusted for any sort of immediate increases or decreases and the like… The discount rate we use for the cash flow is an entirely different exercise for us to yield… We take the discount rate. The issue of the selection of the discount rate has been quite different from the yield, the yield adoption exercise. In fact we typically we produce the yield rather than to determine the yield and produce discount rate. We more actively embrace the financial risk profile of the income stream. Now that is just the nature of us, we probably were different from most of our colleagues. We come from a background of valuing businesses and we see valuation of real estate as very, very much part of an overall business valuation.’

xix. Here again, there is security (or confidence) in ‘knowledge’: ‘we have been fortunate to have been involved in the majority of transactions that have happened, obviously some of them are interstate, so someone has got handle on exactly what yield or what return that particular transaction was showing
I'm talking yield, what sort of equated yield, does that particular transaction show?

xx. However, when tackled over the difficulties of properly analysing an equated yield it was acknowledged: ‘Well, you can’t, to be honest.’

<table>
<thead>
<tr>
<th>2511</th>
<th>Valuer/Return/Yields/Initial</th>
</tr>
</thead>
<tbody>
<tr>
<td>***</td>
<td>No Definition</td>
</tr>
</tbody>
</table>

i. In using the terminology initial yield and equated yield, some argue that the initial yield does not mean a great deal. However they contradict this view in their simple definition of passing income divided by price as a key factor of analysis. In that context it provides a “ball park” figure – something to start from.

ii. Some see it as a benchmark from which to evolve a terminal yield by adding a notional ‘couple of percent’: “Well I think that you have got to put something on it. You know as I say the thing is going to be 10 or 11 years older by the time you sell it.” Some valuers simplify the scenario by adopting a mere 1% differential (i.e. increasing the terminal capitalisation rate by 1% over the initial yield).

iii. For many, the normal approach is to take an initial yield view (around 7½ - 8½%) on the passing income to approximate the capital value, then spend (considerable) time making the discounted cash flow fit. “At the moment with regional, tongue in cheek I say this - there is a mystical cap rate out there for regional shopping centres.”

iv. Whilst the initial yield is taken at 7½ - 8½%, the discount rate adopted is in the range of 11½ - 12½%… ‘Yes, see we are talking initial yield, equated yield whatever, we are talking on the static approach, on the price against the income’

v. There is confusion over terminology and relationship between the terminology capitalisation rate and initial yields: ‘Now in terms of yield, you probably find with most major retail valuations that there is not a great deal of difference really between cap rate and initial yield. They tend to be pretty close simply because there is not a lot of reversion there anyway. In fact a lot of valuers are simply taking and passing income and capitalising that and not even worrying about reversions because it is so close. We still look at the reversionary element, but generally you would find that there would probably be less than a, if I said a range of say a quarter to a half a point at the outside, difference in cap rate versus passing yield, you would probably encompass most of the regionals in that sort of area.’

vi. The DCF approach requires the valuer to be explicit: ‘The beauty of the DCF is that it makes the valuer think about the thing in more detail. But at the end of the day it is still the value at $200m
that shows the 7.9% or 8% initial return. And when they quote, they settle with the value and the initial yield. They don’t give discount rates and terminal yields and growth. It doesn’t come into it.

*** Definition:
Equate Yield (same as IRR, target rate, discount rate?)

i. The terminology ‘equated yield’ was a significant cause of confusion, being construed by some valuers to mean capitalisation rate or ‘equivalent yield’: ‘We like to really talk about different yields here. An initial yield which doesn’t mean a great deal. And an equated yield.’

ii. This was then compounded when the discussion related to the analysis of an equated yield. In qualifying ‘return’ on an investment, as in the initial yield, the response was ‘I’m talking yield. What sort of equated yield does that particular transaction show?’ But because of the relative ‘secrecy’ of lease terms it becomes impractical, if not impossible to analyse the equated yield: ‘Well, you can’t, to be honest. You know, I don’t know how much percentage rent Grace Brothers are likely to pay. You can make an assumption that they were doing such an such a million dollars, but if you have got that hard information then you know what that purchaser is actually going to receive in terms of net income.’

iii. So what goes into an equated yield? ‘I suppose it’s a fully leased income generating asset. With deductions for various forms.’ Right. So you take it on direct comparison equated yield to equated yield rather than taking the market rate as put out by BOMA plus property risk, or bond rate plus property risk, or...? ‘Well yes, you are looking at all these things. I think it is fair to say that at your regional shopping centres was to be PV’ed it would be under-rented. It is probably only right to bring them all in line. So if anything I think some are perhaps a little over-rented. We consider a market rate but I mean that comes on to overall speciality occupancy costs, occupancy costs for each of the majors and what is an acceptable range. That flows right down to looking at your demographic profile of the catchment area.’ So, you are deriving your equated yield from comparisons? ‘Yes, as I say we are fortunate in that we know there might be XYZ amount of reversionary income that comes out because of fixed reviews, fixed increases, x amount of percentage rent that is due and payable. We can make a call whether we think that the majors are perhaps going to grow a little bit better next year, etc, etc.’

iv. Other valuation practices claimed not to use an equated yield approach. This is possibly attributable to their interpretation – or lack of understanding - of the word ‘equated’. So you don’t take an equated yield approach? You don’t have any regard to bond rates and
property risk? ‘When you talk about regard, do we have regard when we actually valuing the centre as to what...’ Yes, you take an equivalent yield approach as opposed to an equated. One of the problems that I felt came out of the AIVLE DCF Practice Standard is that it didn't define the different terminology on yields. And when I say equated, I might be talking about what you use as equivalent, that's why I'm asking for elaboration on... ‘When you say do we have regard for bond rates and so forth, we certainly do when we are talking about the internal rate of return, as to where that is sitting.’

v. Another example of lack of understanding of the terminology is: ‘Not equated yield. We don't refer to it, I don't know anyone who refers to it, who would call a discount rate an equated yield.’

vi. Because of the inferred ‘mystical rate’ (see 2 5 1 1) there can be a tendency by valuers to start with the price they want and then work backwards... ‘Or look at your sale. No no, if he is talking about a sale site for instance, lets say x centre sold for $250m, lets just say, there is a starting point, and then you work back from there with your logical growth rates assumptions, etc. At a price of $250m, what would the discount rate be on these assumptions? It says it's 11.78% or whatever it is, or 12%, 13%, 14% whatever it might be. The thing is we know the bonds are at 7% and they normally want 6% or 7% over the bond. So you build it up... Turn of time then it was up to 7% then there was 5%. That’s why you wouldn’t automatically grab that because it's so volatile, it can be volatile. A 2% or 3% movement in the bond rate in the course of a week doesn’t alter the property by 2% to 3% points.’

vii. There is a lack of scientific approach. The valuation profession does not tend to calculate equated yields with formula, relying instead on a subjective gut reaction influenced by the goals of the owner/client... ‘It is more what the market is saying. No, we don’t formalise that. Essentially what it is - is keeping abreast of what’s happening in the market and continually talking to property owners. We’ll say that you have a yield rate or a hurdle that you have got to satisfy and they'll all do it, owner x and owner y and the others. They say yes, we would like to see X%. We have difficulty going under it. We'd love to go over it.’

<table>
<thead>
<tr>
<th>(2 5 1 3) /Valuer/Return/Yields/Equiv</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
</tr>
<tr>
<td>Equivalent (effective) yield - averaged by deduction from term &amp; reversion</td>
</tr>
</tbody>
</table>

This node indexes no documents (i.e. no reference made to the use of ‘equivalent yield’ by any of ‘experts’ in the analysis). However, see (i.) below:

i. One comment was overlooked (indexed under 2 5 1 4) and has been reintroduced here.
‘We bring everything back to equivalent. We analyse our sales as we value them if you like. So with sales information, if we get a regional shopping centre and we get all the relevant financial information and put that up on a spreadsheet and well allow the same things that we would if we were valuing it, to analyse it. So well allow either 1% or 2% vacancy factor, whatever, well allow something off for initial repairs and maintenance - that might be $100,000 or $50,000 or whatever. Well just use a guesstimate so that we get back to our equivalent type yield approach and then well also look at cash on cash, and just the initial yield.’

(2 5 1 4) /Valuer/Return/Yields/Reversion

*** Definition:
Reversionary or Terminal

i. In asking how a terminal capitalisation rate (the projected capitalisation of a presumed sale at the end of the tenth – or fifteenth – year in a cash flow) is selected the simple response was, ‘I think that is so tough.

ii. Valuers in funds admitted to commissioning general economic forecasts from Econtec, Syntec, MarketShare, Ivacon and Irvec to get the ‘real big picture stuff to take a ten-year outlook’. Having done that ‘research’ the terminal yield ‘ends up being a yield that is the initial yield plus some sort of a (risk) premium…’

iii. In developing the ‘initial yield plus risk premium’ point, the impact of the centre notionally being ten years older at the point of terminal capitalisation was discussed. For example a ten year old centre ‘today’ becomes a twenty year old centre at that stage and there is a need to ensure that like is compared with like. The most realistic responses included: ‘Look, it doesn’t… I guess just being as honest as I can be, it doesn’t get priced in. There is not as much consideration on what is going to happen in ten years. All valuers are the same.

iv. To summarise how valuers deal with the yield issue from an owner’s perspective: ‘…they don’t put a lot of consideration into it. Look, they put a lot of consideration into the initial yield, they put a fair bit into the discount rate. And they put, they give the terminal rate some passing consideration.’

v. Some valuers do, in some way, acknowledge the ‘added’ age impact on the yield: ‘Well I think that the first thing that one has got to say is the shopping centre is going to be 10 years older. What is likely to happen in that total trade area in terms of competition in the next 10 years? How old is the shopping centre now. How much money are we actually going to put in for capital expenditure during the period? And, with a bit of judgment, one calls on a terminal yield which is going to be
something in excess of the capitalising yield that you are using and that is going to vary from property to property. I don’t think there is any special methodology in determining a terminal yield.

vi. Subjectivity would appear to be the order of the day: ‘It is a very subjective and unscientific thing at the moment. I guess if the centre is a strong centre and perceived to remain that way through the ten years, one that just needs the usual sort of injection of capital to maintain the services and finishes and amenity of it. We’d probably typically move the cap rate out in that instance around a quarter of a point. For that specific issue. Now on top of that quarter of a point, if we perceive that due to emerging competition and other factors within the retail centre there is some argument to move the cap rate out further than that would be in addition to that quarter point. All very subjective and very hard to judge. You are making a very long term call on all the things we were talking about earlier in terms of the current retail market and where it’s headed. Those things alone would probably justify movement in cap rates.’

vii. A balancing view to adding a couple of percent to the initial yield is the argument that ‘by the same token your major players QIC, Westfield, Lend Lease are not going to allow that centre to sit there and languish. They are going to be constantly spending money just to maintain rental growth. And we talk more in terms of capital expenditure being more the non-recoverable element. X spend $100 million on a shopping centre and they probably get $70m or $80m back of it in terms of increased rental growth. But there is always going to be a bottom line tranche of $10m to $15m that they won’t get back immediately and that is just there to keep the thing going.’

viii. The consensus goes with subjectivity on yield determination coupled with the tenet that owners are not going to let centres languish. They are going to continually inject capital to keep the centre relevant and income producing: ‘I think it comes off the initial yield. You look at what initial yield you allow. But I think you also, and we have had a fair bit of discussion about this both internally and with other valuers. As an example we have done recently down in Victoria where the banks are all puzzled about the approach taken, and it seems to be that some valuers are looking at the initial yield here say it’s 7.5% or whatever, and just taking a view over this period, depending on how old the centre is, how much Cap Ex you are allowing throughout that period. Secondly, they will then take a view as to how much they soften that as the terminal yield. Now you have got to be careful as to what sort of Cap Ex you also allow throughout the period, because if you allow a great slab say here you would expect rents to pick up as well. What we tend to allow is an amount that we believe is necessary to maintain the condition of the centre and maintain the existing rents. So it’s sort of a real subjective amount, you know that can’t be guaranteed. But we’re not sort of allowing like at 7 years you might think it will require a major overdo just to bring it right up to speed and also to carry it forward for the next 10 years or 7 years. But, our argument is that if we do that we
have got to show corresponding kink in all the rents and that's fairly subjective as well. So as I said it is a little bit of a vexed question. We tend to take a sort of just a general approach, okay well allow well allow reasonable amount of Cap Ex throughout the holding period, as I said, trying to maintain the asset, in a reasonable quality to be able to maintain and show some growth on those rents. Because we are also at the same time having growth. Or some form of real growth, hopefully, if you are in the right catchment area."

ix. The potential of the shopping centre in terms of catchment and potential for expansion is also relevant: ‘It is usually fairly arbitrary. Depends a little bit on issues such as whether the regional mall is in an expanding or stable market area. It’s something to look at carefully because there must be over a period of a 15-year period, a presumption either a significant retrofit or an expansion, particularly if, say the mall is in the hands of Westfield and Westfield have got a strategy of taking regionals up to 100,000 - 120,000 square metres. And you are looking at a regional mall of 68,000 to 75,000 square metres. Then there must be a presumption at some point if the mall is located at a growth area then it is going to grow significantly. Now if we're doing that we will put a more aggressive terminal yield on than if we believe that the market area for that particular regional mall has started to stabilise or this is probably too early... Normally we add 1% to the initial yield to give the terminal yield...’

x. Then there is the argument that the reversion can be ignored, but this can be attributable to valuers not appreciating the reversion as the notional sale at the end of ten years. This is confused with the ‘reversion’ relevant in under-rented tenancies: ‘Now in terms of yield, you probably find with most major retail valuations that there is not a great deal of difference really between cap rate and initial yield. They tend to be pretty close simply because there is not a lot on reversion there anyway. In fact a lot of values are simply taking and passing income and capitalising that and not even worrying about reversions because it is so close. We still look at the reversionary element, but generally you would find that there would probably be less than a, if I said a range of say a quarter to a half a point at the outside difference in cap rate versus passing yield, you would probably encompass most of the regionals in that sort of area. Regionals I suppose as distinct from office because of the rental structures, or rather the leasing structures and the frequency of review by virtue of your annual CPI’S and overriding markets... There tends to be not a great deal of difference between market and passing incomes really.’
As was highlighted (in 2.5.1.4), ‘a lot of valuers are simply taking and passing income and capitalising that and not even worrying about reversions because it is so close’.

Certain valuers make a differentiation between ‘cap rate’ and ‘passing yield’ but are unable to vocalise their understanding of the differentiation. This confusion extends to ‘initial yield’/’cap rate’ as well. The consensus being that it is ‘all very subjective and very hard to judge’.

Whilst some valuers indicated that they adopt an ‘initial’ and an ‘equated’ yield approach, they indicate that there is a general reliance on ‘a mystical cap rate out there for regional shopping centres’. In that context, the mystical cap rate was subsequently clarified as an ‘initial’ yield.

Despite most valuers indicating that they can quickly determine a ‘ball park’ value for a regional shopping centre, there is some contention over such a ‘gut feel’ valuation: ‘We find a few practitioners, okay, the others will say the same about us, who tend to just roll with it and then equalise it with a rate that gives them the answer they thought of in the first place. And it throws it, it’s bugged, because it’s not a document the client can use well. It doesn’t take a scholar to come up with a number first by some rudimentary means and then just get a cash flow to support it. That would be almost demoralising. You know, to waste their time, what is the point in doing it.’

The consensus is that there is a strong correlation between a DCF approach and a cap rate or ‘static’ approach: ‘From time to time the cash flow and the static approach align reasonably well, reasonably closely. Sometimes they are miles apart. And often on closer examination you will find that you did something wrong in your cash flow. Say we’ll see the cap rate where are we out. We forgot to put in turnovers for the major, oh shit that shakes it a bit. But I would say within 5% to 10%, 5%, most times. The whole idea is, and once again it doesn’t take a scholar to get a tenancy schedule and dump it into a model, it’s monkey work, give them bananas. It really doesn’t take a whole lot of brain matter to do it. The brain matter comes in the collective knowledge that you’ve got over a number of years in looking at the sales, the trends in the market, both past and future, talking to the players and there is no formula around. It is a science, formulating all that information into, and all those inputs into a model. And if you get all the basic assumptions, which if they are logical, and they make sense.
and are reasonably supportable, by reasonably I mean nothing is black and white, but if your assumptions are logical 9 times out 10 your DCF and your cap approach should be within the ballpark.

vi. There is concern that because it has not, as yet, been fully tested through the courts, the DCF is being taken as a check test of the cap rate approach, whereas from an accuracy view, the cap rate should be a check for the DCF.

<table>
<thead>
<tr>
<th>(2 5 1 6) /Valuer/Return/Yields/IRR</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
</tr>
<tr>
<td>Internal Rate of Return</td>
</tr>
</tbody>
</table>

i. The internal rate of return is taken as the target rate, or hurdle rate, and thus (confusingly by some) the discount rate.

ii. In conflict with the view put forward in 2 5 1 5 (v) and (vi) certain valuers tackle the whole process with the cap rate initially and then try to match the DCF: ‘We chuck a cap rate at it at 7.5% - 8.5%, and we get a ballpark figure of $200m. And then we do a DCF which hopefully comes up at around...’

iii. So how would valuers arrive at the target rate for the 10-year DCF model? Primarily from the aspirations of their institutional client: ‘We certainly have regard to bond rates and the risks to the property and well go and ask the institutions what they’re seeking. Well, that’s the evidence. What is their target? Then we look at the sales and say right, you bought this centre, what was your target rate, what was your growth rate? The institution’s view being their ‘risk weighting.’

iv. The Property Council of Australia publishes industry-based statistics that show overall return on regional shopping centres at approximately 14%. This does not necessarily transpose to an institutions ‘target rate’ as it relates to their expectations. That is because you couldn’t necessarily buy a regional at 14%.

v. From a funds point of view the IRR is taken as a particularly useful measure in determining the acceptability, or otherwise, of a redevelopment proposal. It allows comparison against competing investment classes and opportunities.

vi. Analysis is a particularly difficult aspect for determining the IRR from a valuer’s position. Knowledge, as has already been stated, is power in such a ‘closed’ market: ‘it just depends on how much information we can get. You see some clients won’t be prepared to give their full forecasts of growth, what they anticipate or their expected IRR, so you are really stuck in a situation where you have...”
to fill in the gaps yourself, it’s not easy to get all of that information from a client who has just purchased a property - often that information is quite sensitive and confidential and they’ll only give you bits which they feel comfortable about. They won’t give you the whole lot, with it’s - on a couple of occasions I’ve got 90% of what I need, but in most cases they are not willing to have that... Even if you keep that information here and don’t put it in a report they’re not happy about giving too much away in case the competitors get their hands on it. Knowledge is power. It’s all very closed market.”

<table>
<thead>
<tr>
<th>(2 5 2)</th>
<th>/Valuer/Return/Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>Definition &amp; source/basis</td>
<td></td>
</tr>
</tbody>
</table>

Note: There is clearly a strong linkage between the ‘growth’ view and that of ‘forecasting’ (see 2.7) and both nodes should be considered in conjunction.

i. Growth is dealt with from the detailed and explicit to the implicit.

ii. The terminology becomes clouded with relationships between CPI, inflation and ‘real’ growth. For example, a valuer may take the ABS CPI annual forecasts and divide by 12 to incorporate in the model. Another figure (or CPI) may be taken for the outgoings growth. From this a ‘true rent’ may be derived from which an effective rent can be plotted in percentage terms. Then there is the rental growth to account for rent reviews in a market where tenants cannot pay even market rent as perceived by the market place - they are having to give a discount to rent to enable the tenant to trade profitably rather than to trade at a loss because the rent has jacked up so high. If it is a six-year lease we will go to market at the end of year three hoping that market will be better than we are achieving as a percentage of turnover. And that forecasting is crystal balling largely, but we can check how a particular tenant in a particular location is going to trade by going at that same type of tenancy or even the same trader, and how he is operating in other centres. Then we make the adjustments for demographics that go with that particular centre that we are looking at.’

iii. Other valuers use ‘industry’ forecasters such as Syntech and pay regard to the reports obtained from Jebb Holland Dimasi by their clients.

iv. There is an established network amongst the valuers acting for the major funds to ‘share’ market knowledge (as they perceive it to be accurate). In that context MAT (moving annual turnover) figures are shared, and the state Retailers Association are approached to obtain a balancing ‘tenant’s’ view.
v. Whilst some valuers are trusting (or naïve) in respect of figures and forecasts obtained from landlords, the indication is that it is normally the landlord who will up the figures provided to the valuer rather than the tenant suggesting artificially low ones.

vi. There is a clear advantage where valuers have other departments within the same company who are handling day-to-day management information on centre turnovers. In that situation, the valuer can balance indicated growth, which in isolation may appear strong, but is poor in relation to the rest of the market.

vii. Growth can also be a cause for concern. If a centre demonstrates very strong growth there is a strong likelihood (or risk) that another fund may optimise the demographics and build a competing centre in the locality.

viii. It was suggested that retail growth, particularly in ladies fashion, is likely to be negative in the Melbourne area due to the cash call of gambling in that (and other) state.

ix. Valuers are unlikely to take a tenant-by-tenant variation on growth, but would, ordinarily, treat it sector-by-sector.

x. Growth is relevant in the derivation of an equated yield – through comparison with bond rates, property sector and property specific risk and a ‘growth’ factor. As stated in ‘yields’ (2 5 1) no valuers admitted to rendering this concept down to a formula/equation as yet.

xi. There is an impact on growth where leases of ‘majors’ or ‘anchors’ are coming to an end – consideration has to be given within the valuation as to what to do to such spaces from an owners and a tenants view (there is a direct link to forecasting future need).

xii. From the owners viewpoint, real growth is not anticipated to be strong in the short to medium term: ‘We’ve got all the classic signs there, we see it in occupancy costs where it’s not uncommon now to look at a regional and find that occupancy costs are 14%, maybe 15%, in some cases. It is getting way beyond the traditional 12% to 13% levels that everyone was comfortable with. All those things indicate that retail profitability, particularly from specialty leases, is under a lot of pressure indicating a lack of future growth, or at least at a period of time where rents plateau. Even at best, I think in a lot of cases, a lot of the better informed people around in the retail industry suggest that rents will in fact go down. We have yet to see any definite sign of that, but it is certainly a possibility... In fact every monthly report I look at on major regionals, certainly for the last few months, turnovers are tracking down, there is no doubt about it. Across the board majors, specialties everything. So I think our big growth phase if you like is certainly come to an end. At best things will plateau. At worst we certainly could see reductions in rent. So that whole retail sector is coming under pressure at a time
when supply is still expanding and I guess those things tend to indicate we may see a bit of a shift in retail yields because of that. And particularly I guess the other reason is that we’ve been through this period where retail has been the most sought after investment because of the lack of performance in other sectors.

<table>
<thead>
<tr>
<th>(2 5 3)</th>
<th>Valuer/Return/Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition: Depreciation</td>
<td></td>
</tr>
</tbody>
</table>

i. Inflation serves, or rather has served, to mask the depreciation component. In the same context, owners have masked depreciation by rebuilding, redeveloping or remarketing the centre. When an owner expends capital, the result is a ‘different’ investment product: ‘Almost every property has to be treated on its own... there is no formula.’

ii. From the owners’ perspective, it is competition that creates depreciation. Some funds take the lead in this by spending money to purposely-initiate depreciation in the competition. The majority of owners are always going to spend money on their centres to maintain rental growth rather than allowing the centres to languish.

iii. Most valuers acknowledge a depreciation component by making some small adjustment to the terminal (reversionary) yield for the projected (hypothetical) sale at year ten. This is a token acknowledgement rather than a scientifically founded adjustment.

iv. No valuation practice can suddenly start changing their approach to dealing with depreciation for fear of being sued for negligence on previous valuations where they failed to explicitly deal with it. No practice can risk upsetting the applecart for fear of bringing the whole sector down on top of them like a pack of cards.

v. A minority of valuers make some attempt to address the depreciation issue by taking what could equate to a cap rate plus sinking fund.

vi. There is ‘real value’ depreciation but not necessarily monetary depreciation because of inflation come year eleven in the cash flow model: ‘Having read your paper (Boydell & Gronow 1997) and thought quite a bit about depreciation and the age of the building we’ve taken role of it and doing anything about it in real terms or are we just taking it for granted that a building would always grow older and therefore does it have an additional value? No. Does it have the same value? Arguable, probably not. Therefore there is in terms of the asset to the building there is a depreciation to the worth of that building but it doesn’t necessarily lose its ability to earn income.’

vii. Within a due diligence role valuers have alerted owners to the risks of depreciation: ‘We
are finding now, we as valuers have had to educate the client in many respects with regard to building depreciation. They have tended to say that the best regional centre will always be the best - and we have come along and said 'no, it won't'. Either it will get out of fashion because it is no longer a "magnetic" centre or it will get out of fashion because it has simply aged. Or both.

viii. The unpublished consensus is that over a ten year period an investor would have to inject at least as much into a development as was paid for it in order to maintain the return and thus negate depreciation: ‘I would say the non recoverable element could be as high as 15%, that’s the bit you don’t get back. So let’s say you’ve got $100m shopping centre, you know one might be thinking of putting another $100m into it but one would be hoping for rental growth, and perhaps a hardening of the cap rate because it is a new product. You would at least get, let’s say, a reevaluation of $185m so there is a short fall of let’s say $10m to $15m’. But if you chose not to spend the additional $100m your $100m valuation has already gone back to $85m and is on the way down…’. The net result is that spending a notional $100m may result in a ‘paper’ loss of capital value of 7½% compared with a perceived 15% loss in the ‘do nothing’ scenario.

ix. Economic rationalism is thus not apparently critical to the investment decision: ‘Don’t worry, on a few occasions I can assure you that the sums didn’t work but they still did it.” Reflecting this in their valuation is all but impossible for the valuer, albeit the likely scenario.

x. To account for the redevelopment (suggested in viii) would necessitate forecasting major future demand for space, rental incomes and a consumer base which does not currently exist: ‘So we would be assuming that the property stays the same, you are still getting the same basic income flow, but we are also taking out the non recoverable element of any refurbishment.’

xi. Certain valuers expressed the view that no investor would pay 7½% if they anticipated undertaking major refurbishment/expansion within 5 years. Others considered it a reasonable assumption that such expenditure would be required within that time frame, albeit that it would create a ‘different animal’.

xii. A valuer takes a micro view in valuing a centre whereas a fund takes a macro view of its ownership and overall performance in its attempt to ‘beat the index’.

xiii. ‘Depreciation is one of the most subjective areas of the cash flow’

xiv. A ‘normal’ approach by valuers is to ‘fairly simplistically’ allow a subjective $5m or $10m expenditure in the cash flow to account for some upgrade works to common areas. This capital sum will have a CPI forecast multiplier added and then will be funded out of income for that year. This would avoid putting in a ‘cost of borrowing’ element or the
problems of funding a negative income stream for a particular year, thus avoiding dealing with a ‘borrowing’ requirement.

xv. If it appears that the cash flow may turn negative they would schedule the hypothetical upgrade in “two hits – one in year four and one in year seven” instead. If they allow an upgrade in year five they will usually incorporate another in year ten, thus permitting (or supporting) a smaller yield differential for the reversion (hypothetical sale). It is acknowledged as a ‘perceptual thing’ and ‘very subjective’ which allows for an ongoing rental growth within the cash flow model.

xvi. Those valuers and funds which take a 15 year cash flow model recognise that during the duration of the model the property will go through at least one, if not two, life cycles. They suggest that they incorporate an extension and a ‘retrofit’ by factoring in a sinking fund.

xvii. There was no clear agreement on adopting comparable yield evidence from centres ten years older than the subject property to reflect the age differential and thus reflect a depreciation component. The difficulty is that there are a range of influencing factors and it is too hard to isolate the relevant component: ‘If you are analysing a sale, it’s very hard to isolate the value of a particular variable that comes out of the sale, because there are other factors that might... How can I explain this? There are so many things from the analysis side which can be very sensitive to minute changes in the variables and if you look at a centre if you are valuing a centre which is 10 years old and you’re hoping to ideally you know you want a sale of another centre which is the same age you wouldn’t have that problem but if you have something else which is 20 years old that particular property might show a yield which reflects the additional 8 to 10 years. However, there could be other factors there which happen to be influencing that deal, not the extra age of the centre. I think it’s hard to hold all the variables constant, and say okay all these things are constant, therefore we can isolate the effect of this on that. But you can’t do it because each centre can be so different in its trade area, the factors there which drive the growth can make one centre quite different to the other, although they physically might be the same, same size and similar tenant mix, the fact that one area might be a very mature trade area which isn’t doing much and the other, and has competition within its trade area, compared to another area which might be developing which has got obviously long term population, or medium term population growth. Those factors can be so important that some of the other things you are trying to derive from the sale, like whether the terminal yield is higher on an older centre compared with a newer one, they tend to fall into the background’

xviii. Two valuation practices spoke of the instructing trustees including a ‘set of rules on DCF: do not guess, try and estimate as best you can cash inflows and outflows over the term’. So they've
incorporated their requirements in their instructions. And it says if you can foresee or you think that it would be appropriate to reflect something like a capital allowance throughout the cash flow please do it and explain why. And every time we sit down, as we do, with every valuation, issued for major clients, you pay them the courtesy of a discussion and we are pleased to encourage that, to get the feedback and we are always asked about discount rate, terminal yield, the growth, the list goes on and Cap Ex.

xix. Funds fully acknowledge the need for capital expenditure to be incorporated within the cash flow. Indeed, there is a greater concern if it is disregarded: ‘if a bloke says I just don’t think it’s appropriate to have any Cap Ex, they say well you’re a bloody idiot because you can’t run these things if you don’t put money into them. So you’re disadvantaged by not having Cap Ex.’

xx. From a taxation viewpoint, ‘the use of the word depreciation is a wonderful thing if you own a centre because it means tax issue. You depreciate’

xxi. To what degree is the highlighting of depreciation a responsibility of the valuer? Whilst it may be considered a normal part of the due diligence process, there are valuers who would dissent considering it beyond their instruction.

xxii. At debate is how far to take the responsibility: ‘I think it’s incumbent on the valuer to draw attention, draw the attention of his client to a problem with his property that is going to affect it’s worth as an asset. How far we take it, I’ve think just identifying a potential problem is about as far as we need to go’ But how far to go is an issue and at the heart is the discussion of the responsibility to provide a valuation or to offer wider professional advice: ‘We’d love to do all that. We’ll do that. We’ll do anything if the client wants to pay us to do it. And maybe that’s why, we wouldn’t want the client to think we were touting for work. We would just draw their attention to it and say look, if you’d like us to run some scenarios, we would be only too pleased to do it for you. But sometimes clients, the reason we don’t push too hard is that sometimes clients don’t want to know about it. In fact they probably already know and we just highlight it.’

xxiii. Whilst the depreciation issue is topical it has not visibly detracted from the popularity of regional shopping centres as an asset class. It may be related to market ‘hype’: ‘I mean it’s so topical that you are doing this at the moment, because no one really knows... In all honesty does anyone really know the future of the regional shopping centre? I mean they’ve copped a lot of negative press. But at the other end of the scale you have a major, or the pre-eminent regional shopping centre owner in Australia still paying what would be considered by most property punter as big yields, to be pretty keen’ It may just be that the major players cannot be seen to demonstrate weakness.

xxiv. The potential for major (anchor) tenants to ‘go dark’ (an American appraisal and retail
related to an anchor tenant closing their doors and stopping trading) has not yet fully hit the Australian market. Most of the regional shopping centres still have major supermarkets and department stores on reasonably long leases. It is representative of the relative immaturity of the Australian market compared to the US counterpart: ‘some have been as probably as close as 5 years of expiry, there has been reassurances from centre managers that they have no intention of leaving. I guess if that store is performing well and there is no major threat to it you would have to take that on board, I think. I think if you had good information that Grace Brothers were going to pack up and go I think you would obviously bring that into account. Take some measure of that into your cash flow’

<table>
<thead>
<tr>
<th>(2 5 3 1)</th>
<th>Valuer/Return/Depreciation/Redevelopment</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>Refurbish (retrofit) or redevelop (expand)</td>
<td></td>
</tr>
</tbody>
</table>

i. Valuers indicated that in coming to value a (for example) 15 year old centre that hasn’t had a major refurbishment, they would refer back to the client and ask if they have plans for the centre. Such discussions allow the valuer to develop a better focus of how, when and how much capital expenditure to forecast into the cash flow model.

ii. However, in contrast, whilst most valuers are prepared to do scenario analysis on potential schemes, if the appropriate fee is forthcoming, the reticence comes from the trusts: ‘I mean trusts at the moment really don’t want to know what anything is going to be worth in the future, they want to know what it is worth now. We are finding that a lot with Property Trusts at the moment. They are not really interested in what you think five years down the track, what’s it worth now? Short-termism prevails.

iii. The fee valuer, per se, tends to become involved in the refurbishment process at ‘a pretty late stage’ given that the funds all have large teams of ‘experts’ in house and the funds are used to dealing with this sort of project.

iv. When funds are undertaking major work, they mask the refurbishment by remodelling, enlarging and relaunching what will then be a ‘different’ centre in terms of GLA, catchment and tenant mix. Such evolutions only occur after some 12 months to two years worth of research.
i. Whilst fee valuers indicate that they have all the evidence and they are close to the market, such ‘bravado’ is treated with an element of scorn and concern from the owners in terms of comparable analysis. It has already been highlighted that each centre has to be considered in isolation, with very different demographic patterns.

ii. In asking valuers in funds (employed directly by owners) if they can find commonality that they can draw upon for analysis the responses were in the negative: ‘No, not really. I don’t know how external values can possibly come up with a number for shopping centres. They just are not privy to the information. It is all very secretive. All of the owners keep everything very secretive. I really feel for them (the fee valuers).’

iii. Because many shopping centre transactions are handled ‘off-market’ there is no information for the fee valuers to analysis: ‘a lot of things get handled off the market these days. Big assets don’t get a ‘for sale’ sign put on them. People don’t even know that they are in play and the next thing that you know a new owner pops up’

iv. The funds, because often they will be invited to purchase, benefit from market data (or intellectual property) to analyse even if they do not proceed: ‘we get a fair bit of information because people come to us and they might say do you want this, are you interested in that. And we say yes we are, give us some info. When we don’t proceed we have got all of this intellectual property. But it is a close little club you know’

v. The issue of funds creating their own market by transacting ownership, or more commonly partial ownership, in centres at published yields around 7½% was highlighted. In so doing they make the market by creating the best market evidence (most recent transaction) for the valuers, upon which they are bound to rely.

vi. Analysis, from a valuers view, becomes very clouded by ‘hidden’ incentives, the details of which the valuer is not party to. Commentary was made relating to cash changing hands ‘under the table’ between landlords and tenants, which causes suspicion from the fee valuers but is difficult to prove. It does, however, make something of a joke of normal analysis techniques, or rather of reapplying ‘evidence’. Rent free periods and free ‘fit outs’ are also impossible to analyse, whilst serving to kill the market when done ‘above board’.

201
vii. Those fee valuers whose wider companies have a strong influence in shopping centre management, albeit predominantly at sub-regional level, have the benefit of comparable tenancy performance data upon which to analyse and establish turnover ‘tones’ by sector and by area as a check to discrepancies in the market. Whilst such data is historic, it also serves as a key forecasting technique for valuers in anticipating upcoming market weakness and oversupply.

viii. Whilst the philosophy ‘as you analyse, so you value’ is supported by the valuers, it is more often an ideal rather than a reality: ‘Chances are we won’t have all that information – in terms of lease details to plug into a model to analyse… So we’ll work off whatever is our most reliable information. Now if we have that reliable a source of information then yes, we will work that way. And because we have valued a lot of the regional malls within the last 4 to 5 years we have an enormous amount of data. We happen to have valued the 2 most recent regional mall sales at some stage in the near past. So we have a pretty good view on what the prices really meant… It is a case of the stronger you are, the stronger you become.’

ix. The fund valuers have a bigger call on information for potential purchases: ‘The first thing we do when we look at buying the property is call for the monthly report. If they say we can’t have it, I look at the arrears statement. And I just look at the rate of arrears if I can’t look at the turnovers and there is my answer. As to whether I should go forward or put it in the bin. There is a lot more interest at the moment on what you’ve got, on what you can buy, rather than the future.’ Again short-termism prevails.

x. The ‘as you analyse – so you value’ argument flounders under the rigours of commercial reality where the DCF approach is concerned in the view of some valuers. ‘You are not going to build a 300 tenant model to work to analyse your sale. You’re not going to do it. If you’ve done (valued) it and then it sells, you can run it back and get exactly that. Now the clients won’t afford the luxury of that sort of time consuming analysis. That is in a practical sense. We’ll do it if we value the centre and then it subsequently sells, we’ll repackage it. In an academic sense we would do it in exactly the same way as we would value the property we were looking at.’

xi. In analysis, as in valuation the oft repeated adage prevails: ‘Knowledge is power. It is all a very closed market.’
i. Anticipated lifespan falls into two main categories: (a) Main Structure and (B) ‘Retrofit’ of internal upgrade.

ii. Life of carpeting & internal finishes considered at 3 years.

iii. Need to spend equivalent of purchase price over a ten year holding period, but this creates a different product to that being valued today and launches the investment into its next life cycle.

iv. Lifespan of centre interior: 6 years classed as recycling (or ‘retrofit’) to keep centre in the market place. On major centres, funds start planning the next major refurbishment as soon as they complete one: ‘the general consensus seems to be around 7 years. Whether they in fact spend their huge injections of money every 7 years is debatable’ Others took a 5-year view or went to 7 years if it is a very big retrofit. ‘With the cash flows we tend to include a refurbishment allowance every 7 to 8 years and we take that into account in the cash flow. Which, basically, from our experience a lot of centres are refurbished every at least every 7 to 8 years, sometimes more frequently.’

v. Main structure viewed as having a lifespan of around 30 years in line with the tax depreciation of 2½% p.a. over 30 years, but this is an element of depreciation that ‘hasn’t really caught up with us yet’ given that the Australian market is less mature than its US counterpart. It will do, however, during the valuation cash flow lifespan of a centre that is already 20 years old. Other valuers perceived the ‘overall’ lifespan to be 15 – 20 years where there is a need to cement the centre as the biggest and best in the area.

vi. Plant and machinery (lifts, escalators, travellators, air conditioning) are treated as a separate item with a certain life of 10 – 15 years.

vii. A regional centre can take between 3 – 5 years to establish itself in the market place.

viii. The traditional life cycle for regional shopping centres in Australia is for them to have grown out of small beginnings: ‘they start off small, they evolve, they get bigger and bigger. They might start off with one supermarket, a DDS and sixty shops - they’ll end up with 2 supermarkets, a DDS and eighty shops - then they’ll go to 2 supermarkets, 2 DDSs and 100 shops - then they’ll go to 2 supermarkets, 2 DDSs, cinemas and 120 shops and then a department store might come into it. And they eventually grow up and evolve. And I suppose where the first run of a trial wasn’t real successful was Robina. They tried to do it all in one hit - all at once. It wasn’t successful.’
ix. Refurbishment is less relevant than redevelopment and re-launch in the current market: ‘Certainly in the last 10 years, certainly 20 years, the whole regional shopping centre experience has changed. We have been through the whole entertainment, lifestyle and leisure injection. But it seems to me it’s not so much that they are refurbishing them, but they have been actually redeveloping them, extending and making them larger. Then it is re-launched.’

x. Whilst competition is acknowledged as a key catalyst to expansion and refurbishment, the self interest of construction subsidiaries of the main owners is another aspect of the life cycle voiced by the experts: ‘Lend Lease have their Civil and Civic, Westfields have their Westfield Design and Construct - it certainly keeps a lot of blokes busy and employed. Seriously.’

xi. Other valuers took an honest view in considering the life cycle issue in their valuation: ‘The answer is that very limited thought was given to that aspect between of the lifecycle’

### (2 6 1) /Valuer/Lifecycle/Main Structure

*** Definition: Life of the main structure

Note: The analysis of this node was incorporated in (2 6) /Valuer/Lifecycle.

### (2 6 2) /Valuer/Lifecycle/Retrofit

*** Definition: Before major refurbishment (retrofit terminology)

i. Historically replacement was not planned for in any of the regional shopping centres. ‘It is now. But it wasn’t twenty years ago’ Future growth was not an issue when centres were first inspired, ‘So we are having to grow a centre by other means - which is to either grow it upwards or move its boundaries outwards to allow it to grow’

ii. Some funds are big spenders on capital expenditure (Cap. Ex.) whilst others are very low. Some of the low spenders ‘spend the money, take the yield, wind the yield up as high as they can and as they detect a retardation in rental growth that’s when they make their next Cap Ex. Usually they try to get that to coincide with as many lease renewals as they can as well. I think they are more astute. That’s how I would describe them’

iii. Information remains the problem for the valuer: ‘I think it’s because not so much that they don’t want to give the information, it is because they don’t actually have it themselves. A major refurbishment may not be identified that far in advance but I’m saying putting a time on it I guess, ten years they obviously won’t know any information in terms of what they are going to do. If a
refurbishment appears like it's necessary within say 3 to 4 years, they will probably have some preliminary information on it. All that information can also change the nearer you get to the actual time when they decide to do it, with different scenarios all the time and it's all quite fluid, until you get probably within 12 months of it actually happening.

iv. Timing of major works is also challenging: 'It also depends on certain things, like lease expiries and if they have the feeling that they want to refurbish this part of the mall say in 2 years time they might be: you know you have to look at lease expiries, you can't just throw tenants out, you have demolition clauses in and you've got to work around your tenants to some extent. It's not that straight forward where you have a fully tenanted centre. If it's empty you can go ahead and do what you want to do, but when you have leases involved, relocating tenants and all these sort of things, it becomes a much more complicated exercise.'

v. Uncertainty, lack of advance detail of future works, and variation of proposed timing are open to significant subjectivity by the valuer – all of which results in potentially significant impact on the final value figure.

(2 6 3) /Valuer/Lifecycle/Funding
*** Definition:
How the scheme is funded and spread in DCF

i. Funding of potential (often hypothetical) refurbishment work can be treated in a number of ways – by taking, amongst others, a NPV at the cost of borrowing, the discount rate or the term (or terminal) yield: 'We use the true cost of money'. Which when clarified meant a bank lending rate.

ii. Some valuers take the refurbishment cost out of annual income (assuming that it can cover it) whilst others take it out as a funded item, spreading that funding over three or five years: 'We think that is a far more realistic way as to what a real person in the real marketplace would do.'

iii. However, the funds are not in a position where they need to borrow capital from the bank as they can utilise inflows of portfolio and investor income. They can use the shopping centre as a vehicle to invest the capital and then 'on-sell it within the trust – there is a ready market for it at the end'. This is a facet of the funds being able to take a macro view of the portfolio rather than focussing on the micro return on a specific centre. It must be recognised that 'it's still going to be yield driven. The decision as to where to allocate the funds is going to reflect probability of the yield, a probability or return on that money. You are getting far more
predisposed towards spending an extra $100m on something that is going to give you a 6% return than you are on spending $100m and getting a 5% return. So it helps you prioritise where you are going to make that Cap Ex commit.

iv. Dealing with costs out of passing income results in the fund showing a ‘bad year’ in the cash flow, thus prejudicing annual return figures – conflicting with the reason for investing in the shopping centre originally.

v. In distinct contrast to this certain trusts are using commercial capital from other funds to spread the risk in undertaking development work on centres.

vi. Plant can be treated differently to the main building: ‘if we have got a brand new shopping centre today, most owners tend to enter into maintenance agreements for plant and machinery such that it is maintained as new, lifts and air-conditioning are kept as new, escalators and travelators are the same.’ It is therefore essential to check maintenance contracts and other documentation to ensure that everything is thoroughly maintained.

vii. The percentage of purchase price that would have to be reinvested into the centre over a 10 year span: ‘the non recoverable element could be as high as 15% that’s the bit you don’t get back. So let’s say you’ve got $100m shopping centre, you know one might be thinking of putting another $100m into it but one would be hoping for rental growth, and perhaps a hardening of the cap rate because it is a newer product. You would at least get a revaluation of $185m so there is a shortfall of $10m to $15m’ Whereas if the fund did not spend capital on the centre: ‘your $100m valuation has already gone back to $85m and it is on the way down...’

viii. There is concern from valuers in taking too much of a hypothetical approach regarding future capital expenditure. Some are not prepared to anticipate major work which would transform the centre from what currently exists in GLA terms: ‘I think it would be hard to defend that valuation in court. It would be torn to pieces, I would think...’

<table>
<thead>
<tr>
<th>2 6 4</th>
<th>Valuer/Lifecycle/Yieldimp</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition: Impact on yield of refurbishment</td>
<td></td>
</tr>
</tbody>
</table>

i. There is a potential ethical conflict and a balance to be struck in relation to accounting for the capital expenditure works. The fund wants to be able to demonstrate current and short-term competitive returns on its investments. For a valuer to take significant account of what has been stated as very subjective and hypothetically based future capital expenditure in the later years of an investments ownership horizon can be prejudicial to
the funds reported performance.

ii. Due to the proximity to the coast, one centre was identified as ‘one of the few regional centres that is going to be damaged by salt’. My yield in ten years time will not only reflect the ability of the building to earn money, but it will also reflect the fact that there has to be capital put back into that building very soon after a 10 year cash flow period because of salt effect on roof, gutters etc. Such a risk would have to be recognised by deteriorating (increasing in percentile terms) the reversionary yield. The valuation conundrum is that the reversionary yield would be ‘unquantifiable at the moment’. Ultimately such a centre would require major expenditure, even on the core fabric, within twenty years because of the impact of salt.

iii. Some valuers attempt to gauge capital expenditure at a level which will retain an effective ‘status quo’ in terms of rental, growth and yield levels. This is justified on the basis that capital expenditure could result in a change in GLA and a potential increase in rentals during the term. This would mean the centre would be materially different before the end of the cash flow projection with all the valuation ramifications that would cause.

iv. Therefore the norm is to ‘allow an amount that we believe is necessary to maintain the condition of the centre and maintain the existing rents. So it’s sort of a real subjective amount that can’t be guaranteed.

v. The role of the valuer is ‘to get the figure right’ in a micro context. Whereas the fund takes a macro view looking at it's overall portfolio and it can afford for one to go down and one to go up as long as the fund itself is seen to be increasing in value from year to year to report to the trustees that it is beating the index.

vi. When valuers talked of creating a ‘sinking fund’ within the cash flow to account for future capital liabilities, there was disagreement over the yield selection. Some were content to use a ‘traditional’ and secure 3% - 4%; others applied the overall discount, or target, rate or alternatively used a money market, or borrowing, cash rate.

vii. The ‘sinking fund’ view conflicts with the other philosophy that taking the macro view of the portfolio, funds would use their own capital. Remembering that, even in the macro context, ‘It’s still going to be yield driven.’
Regional shopping centres are seen as a ‘moving target’ shrouded in uncertainty.

Forecasts are rarely reconsidered after several years have passed to check their relative accuracy, or otherwise.

The ‘norm’ is simple usage of CPI forecasts and applying them to anticipated rental and outgoings for the duration of the cash flow. Some valuers moderate this with projected lease variation.

The three main ingredients of income (rental) growth are seen as CPI, population growth and retail expenditure growth.

The area of projected lease variation forecasting is acknowledged as ‘crystal balling’. This is balanced by the ability to check traders and trader ‘types’ against the competition, then adjusting for demographic differentials.

History is taken, by some, as the main forecasting technique. Sales and trading figures, when available and analysed, enable the valuer to anticipate which traders in a centre at a micro level, or which traders in the market at a macro level, are under or over performing and thus a potential risk. This can only serve as relevant for short-term forecasts in determining rationalisation.

In addition to using CPI projections, many valuers rely on other econometric forecasters such as Syntech, Jebb Holland Dimasi, Property Council of Australia, URBIC, BIS Shrapnel, and JLW Corporate Advisory. Some viewed AMP as ‘having a big enough resource base in property to do their own market research which nobody else has the luxury of doing’.

Valuers are challenged by ordinarily only having about a month to prepare their reports. Some of them see it as essential to rely on other forecasters. There may be a perception of passing on responsibility, but in several cases the independent forecasters/analysts reports are included as part of the instruction. There is a due diligence consideration as to how much reliance the valuer then chooses to place on them: ‘I suppose that you don’t get
a great deal of time to value some of these shopping centres, you might get a month to really to understand every intricate part. To go and do all your own research is a big job. And, ‘there is usually a restricted time frame permitted to do these major valuation exercises, so we have to fall back on quite a lot of their information because quite physically you haven’t got the time to do a full retail study. It will take just as longer longer than that to do a valuation.’

ix. Some valuers identified the inherent weakness of their in-house research departments being under-resourced. It is easier to rely on the external reports provided by the client. It is unusual for a valuer to contract out to an econometric forecaster because the fee (cited at upwards of $40,000) is comparable to that charged by the valuer for their advice (circa $50,000). The valuers are quick to acknowledge that the external advice is good, but that as it is purely based on ABS data it is something they could do internally given the time, staff and remuneration. ‘Why replicate it. If the client is giving you the report... I’m not saying I agree wholeheartedly with everything he says, but sure, just like some valuers are leaned on by the client to say different things at times, but perhaps he doesn’t necessarily think that they are totally true. You know. squeeze this up a bit or...’

x. Population and anticipated demographics is the major determining factor: ‘valuers will certainly have a lot of regard to the demographics when valuing a centre’

xi. Jebb Holland Dimasi ‘are one of the driving forces behind demographic studies, we rely on a lot of their information.’

xii. Accuracy is a major issue. Valuers have been criticised for taking an historic rather than a ‘futures’ view. Valuers are prepared to defend the criticism of ‘conservatism’ as you can’t be ‘bullish’ when considering a 10-year time frame: ‘You just can’t take that approach that everything is going to be rosy.’

xiii. There is criticism of the economic and demographic forecasters, ‘look at the experts - they are just shocking.’

xiv. The underlying nature of anticipated future growth – the catchment and the nature of the growth - is seen as critical: ‘You’ve got to know what that catchment area is actually physically doing in terms of its growth. And importantly look at what type of growth that is, whether it’s housing commission growth or whether it is... and look at what sort of competition is likely to come into the area. Because quite obviously if its got a lot of growth, then sure as eggs there is going to be another shopping centre built.’

xv. Experience is history – growth is future. ‘Sometimes you have to look back to look forward.’
xvi. How the information is interpreted is critical and at the heart of potential negligence claims: “There wasn’t a problem with forecasting, it was the way the information was used by the people it was provided for.”

xvii. The ‘flock mentality’ has a significant impact. If one or more of the major funds make a break into a property type, or a property sector, there is a tendency for others to follow.

xviii. There is a consensus that there is a need to pay more for research, particularly external research. This would enable people to stand back and look into the market whereas most commentators are too submerged and also run a risk with conflict of interest.

(2 8) /Valuer/Future

*** Definition:
Directions indicated

Note: The summary in this section ‘future’ is very closely related to the summary findings in (see 2 7) ‘forecasting’ above. Where appropriate, commentary and views relating to anticipated or potential changes in the marketplace have been placed in the ‘future’ summary. This is a product of the nodal referencing which served to allocate expert statement to both nodes in some cases. As the conceptual frameworks evolved through the analytical process, the miscellaneous section was developed and incorporates complementary sections on relevant ‘futures’ aspects including cinemas (2 9 1), the impact of the Marks & Spencer phenomena (2 9 2), service (2 9 4) and gambling (2 9 5) – the latter two also being mentioned in the summary below.

i. The future, and the whole issue of forecasting is very uncertain.

ii. Given the lack of regional shopping centres and their high investment worth, an increase in joint ownership is anticipated.

iii. Melbourne has been affected by ‘fashion speciality overgrowth and gambling are taking money out of the market.’

iv. Service is taking over a lot of the retail market. ‘The service you get. The service that you use’

v. The use of mobile phones is ‘taking money out of the market.’

vi. Street front dining has only evolved in Brisbane in the last four years – a ‘Café Society’ mentality is developing.

vii. Regional shopping centres in ten years may have no food in them as convenience centres
are capturing a large market share. Convenience centres with just a supermarket and a DDS. It is relevant that this is the basis from which some of today’s regional malls evolved. Twenty years ago it was a supermarket and a DDS, then came a bank and a couple of fresh food outlets.

viii. We are moving into the next stage of supermarket withdrawal from regional centres which will have a major impact on centre viability – the ‘going dark’ as anchors relocate to more beneficial locations on lease expiry, ‘If planners allow the supermarkets and then grant planning for supermarkets to effectively pull out of shopping centres, they are aiding the depreciation and obsolescence potentially of the inertia which has been going on in the last several years in the shopping centre’ There are already several examples of this occurring. Many majors were originally on 20+ year leases and there are many Coles and Kmart leases expiring around 2000. The relevance is highlighted by the safety angle coupled with 30% of grocery shopping now being completed outside ‘core’ hours (Note: ‘core’ hours relate to the principal operating hours of the shopping centre as prescribed in the lease).

ix. Flexible and longer trading hours will be put in place to match perceived consumer demand.

x. Whilst vacancies are not common at regional mall level, there is a tendency for owners to ‘throw money at tenants to have them renew. There is going to be quite a bit of that coming up in the next few years’

xi. Ownership is destined to vary with centres becoming securitised: ‘I think purely from a value point of view $0.5 bn is just too much money to have wrapped in one project. We will see a lot more of the joint ownership, maybe even some 25% interests. Breaking it down’ This will also facilitate a continuity of beneficial transactions to provide the yield evidence to the valuation profession which the owners need to have adopted.

xii. The AIVLE DCF guidelines, ‘will, force some of the older skilled valuers to significantly re-appraise the way that they look at the DCF. Hopefully the courts will start to better reflect an adoption of the DCF methodologies, being a better reflection of how the market will behave.

xiii. GIS techniques will be optimised to assist in demographic and competition forecasting.
i. **Education:** Valuer’s are educating their clients about building depreciation. ‘They have tended to say that the best regional centre will always be the best - and we have come along and said ‘no, it won’t’. Either it will get out of fashion because it is no longer a magnetic centre, or it will get out of fashion because it has simply aged. Or both.’

ii. Some owners are attempting to pre-guess future competition by acquiring and **holding other sites** that they perceive as being potentially prejudicial to the main centre, e.g. the case of potential cinema sites. It is a capital-intensive view ‘if you are going to take something out of the market that could affect your business you have got to spend capital now, not later.’ This raises an interesting dilemma, and risk, for valuers. Knowing that an owner is holding other land may have an impact on the development appraisal, but has no financial consequence at a micro level when subsequently valuing the centre. Knowing that there is, perhaps in a separate portfolio for the same owner, land holdings that prevent prejudicial development increases the security, thus firming the yield of the primary investment.

iii. The **smaller floor area requirement of department stores** in regional centres: many 30,000m² stores are now too large to be viable/workable and most new department stores are 15,000m² - 16,000m².

iv. **Modelling/forecasting beyond lease expiry.** Within a 10-year cash flow model, valuers are having to model out the leases a lot further than they go. Average leases are three to five years and ‘as a result of that, you’ve got a problem coming up with these renewal premiums twice in the cash flow rather than just once’

v. **Target returns.** The Property Council published data is based on the big funds. The results indicate that the shopping centre sector is the highest performer, the regionals are best and the refurbished regional is the optimal. However, there are very few players contributing to the data at that level: ‘It is called forming conclusions from a small sample’

vi. The **perception of DCF and expectations for forecasting remains very topical:** ‘now their lectures say DCF’s are a load of sh*t. It’s fraught with danger.’

vii. ‘**Bulky good retailing**’ is growing rapidly at the moment.
(2 9 1) /Valuer/Misc/Cinema

*** Definition:
Influence & Impact of Cinemas

Note: The impact of cinemas has been addressed in earlier Valuer nodes, notably (2 9 ii) Miscellaneous. No additional relevant issues were recorded against this node.

(2 9 2) /Valuer/Misc/M&S

*** Definition:
The Marks & Spencer enigma

i. Insularity of the market: ‘The retailers are tending still to be very insular. They are tending to just be looking at Australia. They don’t think that the advent of a Marks and Spencers in Sydney with Marks and Spencers nous to develop business in the world market means that when Marks and Spencers come to Australia they intend to stay. They (Marks and Spencers) don’t intend to come and tickle the market and see if it gets a reaction and then go away. Marks and Spencers will become a player in Australia in the next twenty years. And it will become something that the Australian shopper has never had to deal with before. They have always had Coles, Kmart or Woolworth’s. Now they have got, in my view Coles, Woolworth’s and Marks and Spencers. It will influence the retail market because in terms of Marks and Spencers they are not just dealing with a product, they are dealing with manufacture and they are also dealing with being owners of the business. They own not only the manufacturing business but they own the retailing business and the petrol station and the oil supply that goes with that as well.’

ii. Underwear: ‘you know that if you have bought M & S underwear it will last. If you buy Australian manufactured underwear you are going to have to replace it… And that is a hype thing the Australian Valuer has got to be educated about.’

(2 9 3) /Valuer/Misc/Internat

*** Definition:
International perspectives: AIVLE/RICS/MAI

i. Criticism was levied at Australian valuers by UK trained Chartered Surveyors: ‘There are too many factors that are overlooked by the purist valuer produced by the Australian academic system – that valuers are not trained to look outside. That valuer is only trained to look at Australia.’

ii. The role of the Australian valuer as ‘just a valuer’ was acknowledged by the Australian trained players. There is need for the Australian property professional to have a broader advisory role. Such a function would increase perception to ensure that the valuer be
involved as an adviser from an earlier stage in the decision making process rather than, as has been the practice, being presented with a finished product to ‘rubber stamp’ the value on.

(2 9 4) /Valuer/Misc/Service
*** Definition:
As in the service customers expect

Note: The ‘service’ implications were covered on (2 8) ‘future’ and (2 9) ‘miscellaneous.

(2 9 5) /Valuer/Misc/Gambling
*** Definition:
Impact of gambling on consumer $

Note: The ‘gambling’ implications were covered on (2 8) ‘future’ and (2 9) ‘miscellaneous.

(2 9 6) /Valuer/Misc/Investment Vehicle
*** Definition:
Redevelopment allows opportunity income to market, build, architect, lease

i. The large owners can undertake major capital expenditure whilst realising a superficial short-term capital loss. As has been stated, if they failed to undertake the work their percentage depreciation could be greater. They also require a vehicle in which to invest and in certain sectors, such as regional shopping centres, opportunities to invest can be limited by availability of stock. Furthermore, the big funds ‘use it as a vehicle to use their management company, their development company, the shop fit company… They make the profit all the way through… it certainly keeps a lot of blokes busy and employed.’

ii. Project development subsidiaries are a lucrative arm of the regional shopping centre business.

iii. There is a significant level of on-selling to other trusts within the same overall ownership to balance portfolio mix and spread risk: ‘It is not a case of us having to go to the bank to see if we can borrow $50m to do a refurbishment or an extension. It’s a case of which $50m will we use, Which vehicle will we park this thing (property investment) while we do it and who will we on-sell it to within the trust group?’

iv. There is a school of thought that suggests that the main funds make their own market and support their own market – the standard report 7½% initial yield is common. The funds ‘have got a vested interest to maintain the value of their portfolios, they can’t afford to sell
something 9% or 10% or whatever. They just won’t sell it because someone is going to come along and
 downgrade the whole portfolio because of that one transaction.’

v. It is hard to qualify a ‘true’ sale because funds will acquire, develop and then trade up
 and down through the trust with yields for each transaction being publicly cited in the
 press, albeit that there is a strong internal element and clear vested interest inherent in
 the transactions.

vi. There is also the desire by funds to own ‘statement’ centres because of the kudos that
 can be gained from them. Moreover, for some owners, whilst the apparent return may
 not be as good as from other investments, a significant amount can be earned from
 managing statement centres.

vii. There are obvious economies of scale from owning a larger number of centres from all
 the profit base viewpoints.

viii. There is an increase in joint ownership ‘I guess it allows them to keep expanding it brings in
 some much needed capital from time to time’ Once capital is in the trust side of things, it is
 easier to trade in and out.

ix. There remains a strong flock or herd mentality amongst investors: ‘you find you get a few
 major changes in shopping centres and there is a lot of good publicity about the sales and then institutions
 say gee I have got to get my weighting up in this particular area, we are a little bit low here. There is a
 herd mentality and I guess in some ways that tends to drive the market up and makes property quite
 expensive so yields tend to suffer from that and then everyone switches to industrial instead, let’s get into
 industrial now. I think there is lot to be said for counter cyclical investment.’

(2 9 7) /Valuer/Misc/Robina

*** Definition:
The New (1996) Robina Town Centre Super Regional

Note: Robina Town Centre is ‘one of a kind’ in Australia. It opened in the Gold Coast
hinterland of Southeast Queensland in 1996. SE Queensland has the highest population
growth rate in Australia in an area whose economy is supported by tourism. Unlike other
centres that have evolved over time out of a supermarket and a DDS, Robina is an 80,000m²
‘finished’ product, albeit that it has potential to expand by another 100,000m². It is akin to the
super-regionals of Meadowhall, MetroCentre and MerryHill in the UK, only without the
demographic base to support it. A lot of heated discussion ensued about Robina by the
experts, and as such it is considered inappropriate to develop this section in isolation. In the
interests of confidentiality, relevant commentary supporting the wider picture has been cross-referenced back into the framework through other nodes.

<table>
<thead>
<tr>
<th>(298)</th>
<th>Valuer/Misc/Corrupt</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td>The grey area (possibly corruption)</td>
</tr>
</tbody>
</table>

i. Hidden incentives are very hard for a valuer to find.

ii. One centre attempted to undertake ‘above board’ negotiations in offering ‘a fit out, a rent free period, an out clause - if they didn’t reach a certain turnover after two years they had the right to walk out if they wanted to - and you start leasing something and they put this offer to you across the table, it’s bloody ridiculous.’ Whereas deals such as this are actually going on all the time in the industry, but ‘very quietly.’

iii. What a valuer is presented with (as lease data) is not necessarily accurate ‘because it will show on the books that they are notionally receiving a certain level of rent, but they have actually forked out an awful lot more to make life comfortable for these people (the tenants). And the anchors are paying next to no rent anyway.’

iv. Insider trading: ‘This is the only sector where insider trading is not only legal but positively encouraged’

v. Pressure on valuers to make rather than follow the market ‘especially in this market again, because the growth is starting again.’

vi. Intimidation of valuers by funds is acknowledged. The situation is compounded by the tendering process which requires an indicative yield to be added to the fee proposal: ‘X fund sometimes ask me to value their stuff and I speak to the valuers around the traps who value stuff for them and I can tell you what happens to them if they don’t come up with the bloody numbers. They get wiped. They’ll get wiped for a couple of years, they won’t even get on the bloody list again. And X will, they will literally hop on a plane, fly up, get the valuer in a corner and hold him up against the bloody wall and say this is not what we wanted. We want you to come up with this. I have seen it. I have seen it happen. I have sat there and tried to act as a mediator. I’d try and say to X, look, calm down a bit, the blokes following the market, that’s how he sees it, you asked him to do it and that’s what he did. And that’s what started these bloody letters that go out now calling for fee proposals together with a little bloody one liner that says ‘and also your indicative cap rate…’ ‘

vii. Business pressure and market forces cause valuers to succumb: ‘Imagine if you were a valuer and all of a sudden you started shifting yields out on Y fund centres by half a percent, how long would
you have a job for? You'd only do it once. They would find another one.' And $50,000, or whatever the valuation fee is finds someone... 'you can talk about all the theory and do all these things, but there is market forces that force valuers to do things they shouldn't be doing.'

viii. So can a valuer detach himself or herself? Answer: 'Too hard.' There is a view that valuers (the limited number who operate in this arena) should get together and say 'we'll give you the fee, our fee proposal but we are not going to give you the answer before we start. If everyone banded together and said this is how we are going to do it, wouldn't that have some bearing on the final answer, the final result that comes out?

ix. Why would some funds put such pressure on? Because the individual fund staff are on performance related salary packages: 'if they perform and they get a certain growth out of their properties they get a bonus or something - at Christmas they get a bloody handshake. They are on performance bonus, they are on all sorts of incentives to get those values, those values up and they don't care how they do it.'

x. There is the school of thought, previously referred to (2.9.6) that says that certain funds make their own market and support their own market. This is the publicised 7½% yield example, creating evidence for the valuers by partial sales or acquisitions.

xi. How honest is honest? Valuers feel that they need to be 'as honest as possible.' This raises concern of the 'possible' word. It comes down to what is 'reasonable' under the circumstances: 'I would be lying if I said pressure didn't come to bear at some stage or sometimes. It is better than digging your heels in sometimes. If you genuinely believe that the yield has moved from 7.5% to 7.75% and you have the evidence. Why pay me $40,000 to pay you lip service. You are paying us to value your asset for you. And I mean these guys look at it from a, they don't look at it so much from an individual basis, it is a portfolio. Okay one has gone down so they will probably delve into the pot and find one that they think has probably gone up. That is outside the gambit of my area. You are looking at an overall performance.'

xii. The investment vehicle issue of management fee, development fee, fitting out fee, marketing and sale fee has been developed in (2.9.6).

xiii. Certain funds have been known to supply valuers with a pro-forma of the valuation layout at the time of instruction with only the final numbers left out. The payment of valuation fee was merely to validate (independently) the valuation: 'It wasn't just a letter, it was a submission - how you go about the valuation.'

xiv. As has been described above, clients rarely pass all the information on to the valuer.
(2 9 9) /Valuer/Misc/Negligence

*** Definition:
The potential litigation for current and past approaches

Note: No additional data was forthcoming in respect of this node. All comments and concerns expressed by valuers have been covered though the other nodes. To date, no major DCF appraisal has been fully tested through the courts and it remains a contentious issue, albeit a mandatory requirement that valuers now prepare full DCF models when valuing an asset such as a shopping centre.
4.5 Analysed Owner Interviews

In this section the evolved conceptual framework for the ‘Owner’ (summarised in Figure 4-2 with subsequent categorisation and analysis) is presented in the same self-contained style as that for the ‘Valuer’ (section 4.4) above. The same analytical process has been applied.

Figure 4-2: Evolved Conceptual Framework: OWNER

Source: Matrices evolved from analysis of interview data, developed from research in Chapter 3.

Q.S.R. NUD.IST Power version, revision 3.0.4d GUI.
Licensee: Spike Boydell.

PROJECT: SBPROJ01, User Spike Boydell, 8:12, 6 Sept 1997.
*** Definition:
Expert Owners (3 or more regional centres) NB. Strong valuation background

i. Whilst defined as the “owner”, the role of the owner can spread across management, development and project management, design (architecture), shop fitting, marketing, leasing and valuation. In many cases the “owner” is involved in four or five of the roles (of the other conceptual frameworks).

ii. Other experts interviewed as ‘owners’ were keen to clarify that they were managers acting as owners representatives – the owners being investors in a trust, syndicates or shareholders in a portfolio: ‘We act as if we are royalty.’

*** Definition:
Investor motivation - nature of fund

i. Owners differed on what portfolio mix they considered appropriate, with Westfields holding 100% in retail. The wider view was that between 8% – 12% exposure in
property represented a balanced fund. Within the asset allocation the retail component varied between 40% - 60%. This allocation (by $ value) in retail was distributed amongst regional and smaller centres with considerable geographic spread.

ii. It is not easy for new funds to enter the sector because of the cost to acquire regional centres and their limited supply.

iii. Smaller funds have only had access to the regional level by virtue of the larger funds selling a percentage of their ownership in the large centres.

<table>
<thead>
<tr>
<th>(3 1 1)</th>
<th>/Owner/Motive/Knowledge</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>Fund knowledge over and above valuers and managers</td>
<td></td>
</tr>
</tbody>
</table>

Note: all parties acknowledge the economic analyst company, Jebb Holland Dimasi, as being one of the most utilised forecasters. Hence their name has been left in context in the analysis.

i. The larger funds tend to have management subsidiaries to deal with day-to-day operational management, whilst other funds use the services of property consultants. It is the strategic asset management role that is the domain of the funds.

ii. A view was proffered that the valuer has a better understanding of the market than funds on the basis that ‘their view on the market more or less becomes the market’s view on the market.’

iii. The conflict is in the way the valuer looks at the market: ‘they are more historians than forecasters. Whereas we prefer them to be forecasters rather than historians... But the value we see from them is not telling us what happened. It’s telling us what they think is going to happen... they inform what they think is going to happen from what has already happened’

iv. The owners are the main catalysts for research: ‘we would always endeavour to get external advice as well as our own internal advice as to just where the centre is situated in the market, how it’s trading performance may run and what have you.’ It serves as a reconciliation and there is a requirement at senior level that due regard has been given to external advice.

v. There is a need for more retail analysts/forecasters in the market because there is a perceived conflict of interest ‘in terms of reporting to one owner on the expected outcome of another’s performance and vice versa in relation to regionals. The structural changes that are taking place in the property market, for example the low inflation issue and other things, all indicate that working off historic data is probably becoming more dangerous by the year. There is a real need for people with expertise who can look at how things might evolve over future years and certainly a need for
that sort of input in investment decisions. I don't think we are really seeing it from the valuation profession or for that matter the Jebb Holland and others, at this stage. It's a difficult call to make on anybody to ask them how things might be in five years on any issue given that the rate of change that is in our society these days, particularly in investment markets.

vi. The ‘valuers’ are potentially missing out on being an advisor on the overall viability of a scheme.

vii. Inherent in the taking of advice by owners is a sense of ‘passing the buck’: ‘I'll be first to admit that there is a real need to get into the comfort zone and to be able to demonstrate that at any time you have actively consulted the best people available to give you advice. There is certainly the quite reasonable element of simply taking as much and the best advice you can to make decisions.’

viii. Whilst valuers express concern about funds placing value and yield expectations on them, the owners criticise valuers for approaching them seeking advice on target returns (IRR’s): ‘We frequently have valuers come to us and ask us hypothetical questions. For example, if you were in the market for a regional today what sort of IRR would you be looking at - would you do it this way, what would you include in your cash flow. So in effect they are asking of us how we would go about valuing the centre. They are doing it because they know that if we do buy a centre we’ll employ various methods and they want to try to mirror those in how they do valuations. Which is fine - all they are doing there is, I guess, reflecting how the market would read and interpret various things and then carry out valuation in relation to it.’

ix. In the context of (viii) the owners expect valuers to appreciate the market, and be aware of research from Jebb Holland Dimasi and others, but to proffer an individual view of the market and the trading performance of the centre. The valuer ‘probably would have taken on board our views, but at the end of the process we would expect he has balanced all these various views and come to a reasonably well-based decision on what he's actually done. In other words there we wouldn't expect to see just an imprint of our own thinking on any valuation he did, nor an imprint of everything that Jebb Holland said for that matter, either.’

(3 2) /Owner/Rationale
*** Definition:
Rationale for property investment

i. The data, which the market creates and supplies to the Property Council, forms the basis of targets, or indicators, which the owners then strive to match or better. Those funds with a high asset allocation in retail over the last six years have performed very well,
comparatively.

ii. How funds have been able to develop depends, to a degree, on them being life funds or superannuation funds. Life funds have been diminishing as people cash out of insurance products whereas superannuation money ‘has been growing like topsy’s hat.’

iii. It can be difficult for superannuation funds to find suitable properties into which they can allocate adequate funds. The following example illustrates the point, and in part, explains why large high value assets like shopping centres are popular with superannuation funds: ‘if there is a $13bn fund and you get 10% on your money, well then it becomes a $14.3bn fund plus all the new investment money less the net outlays. So all of a sudden it is 13bn one year and it is $15bn the next. And if you have got to invest another $2bn and if you have got to invest 10% of that in property, well that means that every year you have got to spend $200m. So our problem has been more keeping the funds going out... It’s hard. I mean people laugh but it is extremely difficult. This is a very tightly held market, the top end institutional market. People don’t trade in and out all that often.’

iv. Economies of scale become an important rationale supporting large high value assets: ‘we can’t get into smaller property, otherwise we would end up with 100 staff. We are a funds management company and we (the team) have got to stay fairly small, keep our overheads down, so you have got to invest in big unit sizes, big lot sizes. In fact anything under $100m and you have got start thinking is this worthwhile?’

v. Most institutions rely on asset allocation committees to determine where the bulk of investments should go: ‘in the last few years property has come under a lot of pressure in terms of the availability of funds for both purchasing new investment buildings and also development of existing ones, or redevelopment of existing ones.’

vi. Infrastructure investment (major roads, privatisation of electricity supplies) has put pressure on property in terms of asset allocation: ‘most of the people involved in asset allocation tend to look upon infrastructure as something similar to property. They tend to compare the returns that they are getting which is why we are told frequently that the IRR’s on infrastructure are around 15% plus. So that is a benchmark that is starting to emerge for property. In the present market, and the foreseeable market, we are not really able to match those sort of returns with property - all be it from standing investments or particularly redevelopment of existing property. So we are coming up against a lot of pressure in terms of asset allocation, particularly from infrastructure.’

vii. There is a perception, or an expectation, by many funds that the commercial sector is the area that is most likely to experience growth in the short term. As a result it is most likely to see greatest property asset allocation: ‘the recovery will be a lot longer coming through...’
and I don’t expect the level of rents that will ultimately emerge will be anything like we saw in the late 80’s. I think those days have gone because of the structural shift that has taken place particularly in the commercial office market.

viii. Remaining in retail is not seen as a problem, following on from (vii) above: ‘for a fund to remain reasonably heavily weighted in retail, all be it that the retail sector itself is expecting a bit of a turn down in rents, may not be a bad move because the office market is really not performing’

ix. There is a wider view that property, as an asset class, is arguably under yielded across the board: ‘because we now have lower inflation and there is every sign that, politically anyway, it will be a lot of effort to maintain a lower level inflation - I think because of that property investment would not have the same attraction and it won’t produce, in other words, the same levels of growth that we are historically used to and have become aligned with.’

x. Diversification and the “smoothing” effect of infrequent valuations, coupled with the additional quality of showing growth are given as main investor, or owner, rationale for property (and retail) investment.

---

(3.3) /Owner/WhyRetail

*** Definition:
Rationale for Shopping Centre Investment (cf. other property)

i. Whilst property represented between 25% - 30% asset allocation in some portfolios in the late 1980s, a range of 8% - 12% is now seen as a norm. Within that, most funds are now holding between 30% - 50% in retail. How this component is further distributed depends on the nature of the owner. For some, economies of scale ensure large value assets, whilst for others it can range from regional centres, to sub regional to convenience with a wide geographic spread.

ii. For some funds, it would be very difficult in the Australian market to invest only at regional level because of problems of supply. AMP, Lend Lease and Westfields dominate the market. Smaller funds have been able to gain exposure at regional level through the risk management and cash raising of some of the big funds to float part of their ownership.

iii. When the property market crashed at the start of the 1990s, many funds were over allocated in the commercial market. It coincided with an oversupply of retail which many were slow to identify: ‘shopping centres had performed really well without a lot having been done to them through the 80’s. There hadn’t really been a lot of research into the market in terms of:’
knowing when there was under-supply, knowing when there was over-supply, knowing how big shopping centres can be, knowing what the critical mass is, how to define the trade area, what the retail hierarchy should be within a defined trade area. All of that sort of stuff, was pretty much in its infancy. So when the commercial market crashed, retail had performed well, was continuing to perform well, we sort of got into, sort of switched away obviously from commercial development because there was none and the next growth sector appeared to be retail.

iv. The early 1990s offered an opportunity to divert funds into centre expansion to enhance returns as research indicated that centres could be bigger and perform at a higher level because there was latent demand, which was not being serviced. Funds, also acting as developers, were looking for things to develop when the commercial market crashed: ‘and it was clear that retail offered some very strong returns for both developer and investor.’

v. There is a high level of ‘hype’ in the market in respect of retail which results from the dominance by a few. It is self perpetuating in so far as the funds provide investment return information to the Property Council (formerly BOMA) and then attempt to match or beat the index which results from the data: ‘I think, because we are so big in the market, that yes we do certainly influence the results. But we certainly take into account the BOMA results. We use them as benchmarks to see how our properties are performing so I guess there was a lead taken where clearly retail was going to perform better than commercial, three to four years ago. It was with a view that we should certainly be heavily, more heavily weighted into retail, away from commercial, although there were some commercial properties that we wanted to hold onto because in the long term they are going to perform better.’

vi. The eastern seaboard is perceived as the area of greatest potential growth. There is a need for geographical, sectoral and yield diversity. Whilst many sub-regional centres could be acquired for the asset value of one regional, ‘smaller centres are more prone to competition and more volatile, with a lot more risk. So we are weighing up the risk with the return.’

vii. Much of the current high allocation in retail occurred because the office sector was hit hardest at the onset of the recession. At the same time: ‘we were caught in the classic situation of investors having funds available for not only property investment, but all the other asset classes. Mainly for reasons of portfolio balance there were always funds available for property investment. There was almost a need to continually invest in property to maintain portfolio balance in between the sectors. Retail offered the best avenue. It had a good steady performance. It was a market, I guess, that had sufficient sub sectors to cater for a whole range of investors, be they large or small. You could range from regionals right down to small neighbourhood centres and there was a position for everybody to take. And the smaller centres offered really attractive yields for a while, particularly for smaller funds.'
who arguably did quite well out of it at the time.

viii. Regional shopping centres offered firm yields which have underpinned the performance of the property portfolio: ‘we saw yields hardening particularly for the regionals, they have come down to probably around 7% for a top-flight regional centre. Ranging from say 7% through to 8.25%, 8.50% maybe for a centre that is under a lot of pressure or perhaps needs remodernising or what have you. Certainly there is no question in my mind that the major impetus for retail investment in the last few years has been because it has been seen as probably the only sector of property that was a solid performer. And indeed it has worked out that way and performed very well. And certainly from a, if we look at our total portfolio, if we hadn’t had that significant retail weighting on regionals, the performance would have been abysmal.’

<table>
<thead>
<tr>
<th>Definition:</th>
<th>Observations over Property Council view that shopping centres are the best performing investment vehicle</th>
</tr>
</thead>
<tbody>
<tr>
<td>i.</td>
<td>There is a view that owners (or fund managers) can sit back and relax if they are seen to ‘beat’ the Property Council (formerly BOMA) index: ‘it is about relative performance rather than absolute performance. It seems a bit odd, but that is how you are measured amongst your peers.’</td>
</tr>
<tr>
<td>ii.</td>
<td>The Property Council is considered the most reliable index: ‘There are other indices that you need to compete with. BOMA is emerging as a very reliable index by virtue of its size, so it is going to be good. But in the past, the Mercer index and an index called the PGE have been the measure of performance for fund managers.’</td>
</tr>
<tr>
<td>iii.</td>
<td>It is seen as essential for funds to be in the first (upper) quartile in relation to the index.</td>
</tr>
<tr>
<td>iv.</td>
<td>It is reasonably easy for some of the bigger funds to match the index because they are, effectively, the market.</td>
</tr>
<tr>
<td>v.</td>
<td>There is now a wider reliance on indices, not just by owners and valuers, but by other parts of the financial industry, particularly the superannuation area. As a result ‘there are more and more questions being asked about just how valid is it, who contributes, what’s the weighting within the index and so forth. I think out of that there has certainly been a recognition by ourselves and a number of other institutions that we ought to be looking at a more sophisticated and better updated index.’</td>
</tr>
</tbody>
</table>
| vi.        | There are some calls for more frequent valuations, but that is only likely to make the index more hypothetical because of the lack of movement in the market: ‘there are a
number of institutions interested in looking at a better defined index and particularly one that looks into a common date for revaluation’s to give it a lot more kudos as an index.  BOMA is probably something that has served the industry reasonably well.  Before that there was nothing at all anyway.  It’s really just been an initial stick along the way of developing and defining indexes and what have you.  Certainly industry wise it is still accepted as the one to watch we certainly contribute very significantly to the BOMA index and our own promotional material is fairly reliant on comparison of our performance to the index too’

<table>
<thead>
<tr>
<th>(3 4)</th>
<th>/Owner/Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>Goals of Shopping Centre investment (Macro/Micro)</td>
<td></td>
</tr>
</tbody>
</table>

i. Whilst it is seen as important to match the index, it is important not to beat it by too much as that causes paranoia at the other extreme: ‘Not by too much. Yes that’s right. The analogy is that you never want to be top of the pops because it is a long way to fall. By definition if you are top of the pops, sooner or later you are going to become bottom of the pops. We can’t cope with that. We aim for a position at the entry point to the top quartile of fund managers. Sometimes we find ourselves right at the sharp end’

ii. Boards are only interested in the macro view: ‘Total (composite) return is the only measure’

iii. Owners try to position the fund for growth – that is the objective: ‘growth only comes as a function of income, so we never lose sight of that. We don’t go looking for the easy growth through inflation. We don’t go looking for unearned growth, the unearned increment, because that is very hard to come by.’

iv. Investment time horizons are mainly 10 years although some owners take a 15-year view. It is a sector (e.g. retail) view rather than shopping centre specific. The challenge of forecasting beyond 3 - 5 years is acknowledged: ‘Our role is really focused on a 10 year time horizon and after the first 3 to 5 years it is hard to think of how properties are going to perform. You take more of a view on the retail sector as an industry, rather than a specific shopping centre. But our role is to take the property management groups first year income forecast and then extrapolate out over 10 years and overlay on that 10 year time horizon what we think is going to happen in the market.’

v. In taking market projections the following are considered: CPI, population growth, income growth, variations in trade area, how the market is going to evolve, and how the property is likely to perform.

vi. At a micro level, in the light of projected performance the owner can identify if the
property should be developed (refurbished or extended) and to what extent: ‘If that 10 year forecast shows an IRR which is very acceptable to the trust and where it is unlikely that any major competition is going to come into the market, we might do a little bit of refurbishment or something. And we probably wouldn’t do that much with the property. We would review it pretty regularly, but we probably wouldn’t do that much. If it’s a very competitive market and we are threatened by a loss of market share from competitors, then it becomes more or less a defensive strategy to expand and take market share.’

vii. Shopping centre investment is a ‘market share game’ with little opportunity for further development: ‘The markets are pretty much fully serviced by retail, there is not a lot of markets that are under-serviced on say a floor space per capita kind of measure. So it is really just grabbing market share from your competitors and to do that you have just got to keep the shopping centre relevant, the most relevant you can make it to the customer. So it’s refurbishing, it’s remixing and it’s doing a little bit here, doing a little bit there, rather than a massive expansion.’

(3 4 1) /Owner/Goals/Macro

*** Definition:
Macro view of investment (holistic)

Note: Much of the data for this (and the subsequent ‘micro’) section is commonly dealt with under (3 4) above. That section should be read in conjunction with this.

i. ‘I think we always say that we take a wider view because we would hate to leave anything out. It’s an investment and as we said, the opportunities are really so thin on the ground. To use a cricket analogy, you play the ball on its merits.’

ii. A ten-year view is taken as the norm.

iii. The 10-year view is extended to ‘period of redevelopment plus 10 years’ when a refurbishment return is being considered.

(3 4 2) /Owner/Goals/Micro

*** Definition:
Micro view (property specific)

Note: No additional relevant commentary to add to coverage in (3 4) and (3 4 1).
i. Regard is had to the comparative property indices, particularly PCA (formerly BOMA): ‘Frankly it is about relative performance rather than absolute performance. It seems a bit odd, but that is how you are measured amongst your peers.’

ii. Fund managers/owners strive to be in the upper quartile rather than necessarily at the top of the return index: The analogy is that you never want to be top of the pops because it is a long way to fall. By definition if you are top of the pops sooner or later you are going to become bottom of the pops. We can't cope with that.

iii. Whilst the property portfolio managers for the fund/owner deal with property at a micro and macro level, total return is the only measure by which they are ultimately judged by asset allocation committees and the board of trustees.

iv. The only way to enhance the return on an investment is through income growth. Unearned growth (through inflation) also benefits the competition, so the income enhancement becomes the critical indicator/benefit. This is inflation risk free growth, or non-systematic growth.

v. Within the management plan for the investments cash flow, allowances are often made to acknowledge (but not fully reflect) the cost of capital works and their impact on the return: there is a view which supports making some allowances... over the next five years allow $10m or something like that, to keep the shopping centre sharp.

vi. Capital allowances are made at less than ‘real’ cost. From the above example a $10m capital allowance may be incorporated in the full knowledge that it would really cost $25m. The $10m is accepted as a paper commitment which may not prejudice the investment return overly. There is a school of thought that suggests the future cost is already priced into the capitalisation rate.

vii. The notional capitalisation rate is not treated scientifically, particularly when shopping centres are valued with a ‘riskier’ yield than offices: commercial offices being valued at 6%, 6.25%, 6.5% when they are the inferior asset class in terms of performance and shopping centres are valued at 7.25%, 7.5%, 7.75%. Shopping centres have lower volatility so you can’t say it’s risk. So people say it’s to take account of the capital... But it’s not very scientific.

viii. The Property Council investment return data is considered historically accurate but from here on in it will be irrelevant. The ‘irrelevance’ is on the basis that, for example, there was an
enormous amount of growth and expansion in the 80s, an enormous consumer boom. And in fact retail property in Western Australia showed a compound return over the last 30 years of 19% - 16% which was top of the tree. It could be a smidgen higher. If you actually reflect on supply of retail in Western Australia over the last two years, they have had the greatest increase of opening another 400 shops so there isn't the remotest chance of that sort of history repeating itself. It's going into decline.

ix. The target 'raw' return lies in the range of 6% - 8% above inflation. In considering return figures over the last 20 years 'the returns range somewhere between 12% - 14%. I would argue when you recognise the position that property has within the market and when you have inflation of 2% to 3%, then getting raw returns of getting close to 9% and 10%, there is nothing that will give you 20%.'

x. An impact on returns is that both the retailers and the retail formats are changing and thus are very different from 10 years ago.

xi. Supply of retail space has not been moderated by planning legislation within Australia: 'the capacity for local authorities and the state governments the length and breadth of the country to acknowledge the over development of retail space to allow almost without exception an extension or oversupply of retail space.'

xii. Short-term returns are the prime focus: 'There is a lot more interest at the moment on what you've got, on what you can buy, rather than the future.'

xiii. Infrastructure works are starting to compete for asset allocation with property: 'the returns there (from infrastructure) are often looked upon as something that can do a property return, they're usually fairly property intensive investments, pretty illiquid investments. So most of the people involved in asset allocation tend to look upon infrastructure as something similar to property and because of that they tend to compare the returns that they are getting - the IRR's on infrastructure are around 15% plus. So that is a benchmark that is starting to emerge for property. In the present and the foreseeable market, we are not really able to match those sort of returns with property - all be it from standing investments or particularly redevelopment of existing property. We are coming up against a lot of pressure in terms of asset allocation, particularly from infrastructure.'

xiv. Initial yield (or initial cap rate) on regional centres lies in the range 7% - 8¼% with limited reversionary variation: "with most major retail valuations that there is not a great deal of difference really between cap rate and initial yield. They tend to be pretty close simply because there is not a lot on reversion there anyway. In fact a lot of valuers are simply taking the passing income and capitalising that and not even worrying about reversions because it is so close. We still look at the reversionary element, but generally you would find that there would probably be less than a range of a
quarter to a half a point difference in cap rate versus passing yield. You would probably encompass most of the regionals in that sort of area.

xv. Because of the multiplicity of tenants, the nature of the leasing structures (frequency of review and impact of CPI): ‘There tends to be not a great deal of difference between market and passing incomes’

<table>
<thead>
<tr>
<th>(3 5 3) /Owner/Return/Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
</tr>
<tr>
<td>The impact of depreciation</td>
</tr>
</tbody>
</table>

i. Depreciation has historically been overlooked: ‘the whole Australian market has always neglected the depreciation side of property’.

ii. Whilst depreciation has been masked by expansion (refer 3 5 3 1) certain centres are reaching their limit in terms of maturity: ‘Land locked, definitely. And they have become a CBD by accident. And they have been overtaken by their own success. So that now you can’t go anywhere with it. So I think having reached that size then as owners we have got to start thinking ‘well, this is now a mature asset. I can’t pull a rabbit out of a hat every five to ten years and grow it. I am going to have to refit it and refurbish it. I am going to have to start making adequate allowances’

iii. Whilst a fund may budget for $10m in the cash flow in the knowledge that $25m may be more realistic for capital expenditure, they rely on hiding behind an initial yield of 7½% rather than 6%.

iv. Whilst not reflecting depreciation and obsolescence in shopping centres, some funds have been influenced into looking hard at the issues for their office buildings as a result of UK research: ‘we are really starting to think about it (in office buildings) because you can’t mask the obsolescence and depreciation in an extension as you can in a shopping centre. When it opens it is fully developed’

v. Whilst the shopping centre has historically had room for remodelling and expansion, office buildings are more constrained by their frame and are thus mature assets from the day they open: ‘Say the slab to slab height is insufficient, the floor size isn’t right, the distance from the core to the perimeter wall isn’t right, sill heights are too high. So what do you do? Well you have got to knock the sucker down... Where you can’t knock them down, they are functionally obsolete... And that is why we are really starting to think more about obsolescence. We have not yet turned our mind to it in shopping centres. We will as our shopping centres mature. You see with office buildings, as soon as it is built it is mature. It is at its very best on the first day you built it and it goes steadily downhill
because the new pins pop up all around you.’

vi. So far as competition is concerned: ‘All they have to do is add finance and you have got a problem. And shopping centres, I can tell you as an owner, it might look easy but it is a lot harder than that. You know the zoning restrictions, the demographic restrictions, the traffic network problems, the major tenancy costs, all make all put pressure on the supply side. There is a greater pressure on the supply side restricting the supply side than we find in the CBDs.’

vii. Owners are turning their minds to depreciation: ‘we are turning our mind to it most definitely. There will be a point where we are going to do a little bit more. We are going to have to get back into the theory and the mathematics of property investment when we look at our shopping centres’

viii. So far as future capital expenditure is concerned: ‘we don’t fret about it, but we certainly make an allowance. It’s not enormously scientific because we can’t second guess the future’

ix. There is no clear pattern or time scale in relation to refurbishment, expansion and capital expenditure. Much expenditure has been initiated by new retail formats: ‘if you get hold of a BOMA directory and had a good look through you would actually see where some of the centres have been extended more frequently, if you get behind it all you will actually find that it is in relation to the new formats of, for instance, that supermarkets have gone from 2,000 square metres to 4,000 square metres. Kmart in the last year have gone 120 to 144 DDS’s. Target has gone up by 18 - 20. So Target has gone along to ‘owner x’ and said look we are going to set up this approach against BigW or Kmart. And they will say, okay, we will extend our shopping centre and make this a discount end. And a whole range of things. So you’re never too sure what initiated it. But I think my money would be on consistently new retail formats’

x. Competition and keeping the centre relevant are key issues: ‘you don’t really need to do anything if there is no competition, and if you do then you are consistently refurbishing. The market has certainly become more competitive in the last 5 years. Our rule of thumb is that every 5 years you need to do something reasonably substantial to a centre to keep it relevant, to keep the aesthetics up to date with your competitors. The customer is very disloyal. It depends very much on where they are going to get the best offer at the best price, and the marginal things can often be the environment, the ambience, the amenities, the car parking, the convenience you know. That’s what you really need to keep improved. Yes, it’s a consistent program of refurbishment now’

xi. Certain owners take a proactive view, spending capital with the intent of depreciating the competition. The competing owners, in contrast, take a ‘knee-jerk’ view, reacting to the (potential) lost revenue.

xii. There is a ‘cycle’ to the depreciation which has been monitored by some owners: ‘we used
to try and look at a shopping centre on a cycle primarily through its turnover performance to establish
down was peaking. We had a view that following the refurbishment you naturally get into
growth and turnover. After 2 to 3 years that probably peaks and then starts to fall off again.
There is a point on that cycle where, arguably, you should probably look at extending the centre again or maybe
trading out of it. That, I guess, worked reasonably well."

xiii. Recently there has been a tendency to respond to competition above and beyond
anything else: ‘if we see our catchment area for a centre as being under threat from an adjoining

xiv. The defensive/reactive capital expenditure can occur without regard to return
rationalism: ‘It is totally reactive in fact. We have now reached the stage where a lot of the extensions
to centres in themselves are not economic. But they are still being done and the justification is the
defensive spend. In other words I will invest X additional million purely to defend my position with full
knowledge that the marginal return on that investment is much lower than I would normally accept.’

xv. Asset allocation committees have to go along with the argument for a poorly returning
defensive spend because the alternative is too nasty to contemplate: ‘they get hit with a
whole range of views. They are told that here’s our centre, the turnover is declining, we have a nearby
regional whose trade is influencing what we can obtain out of our trade area therefore we have to spend.
To do that we are going to include a second department store and a whole lot of additional speciality
shops. At the end of that process we think our position will be XYZ. If we don’t do it, we see that the
yield will blow out and turnover will continue to fall and so on. And there is usually some endeavour
made to quantify what that fall in value maybe.’

xvi. There are multiple pressures on the owners/funds in respect of retail in the present
economy. Equilibrium has been surpassed, there is an oversupply of retail and centres
only work if they can pinch turnover from the competition. It is also unreasonably
challenging to quantify the ‘perceptual fall in value’ from a do nothing scenario: ‘the
mechanics if you like of assessing those two positions (1) the fall in value if you do nothing and (2) the
position you’ll be in if you do spend the money, are highly debatable. A lot of the thinking and research
and processes that go into those decisions I think are very questionable. I’m not criticising it or inferring
that it is corrupt in any way, but to my mind it’s frequently not research based and it should be. There
is a lot of knee-jerk reaction. A bit of ownership pride in there. We aren’t going to stand by and let X
in, or be demeaned by another development elsewhere. We’ve got to defend our position and well do it.
It’s a sign of a market that is probably adequately supplied, the only way you can make your centre
work is if you expand it in a way or manage it in a way whereby it actively pinches turnover from somebody else’s trade area. And that is what is happening right through Australia now. We have reached a point probably where equilibrium has been surpassed. We’ve got more retail than we need and we’ve still got a huge development industry and the BOMA expectation of being able to continue investing in major centres.

xvii. Taking the defensive view some funds will not consider capital expenditure without an external ‘trigger’: ‘I’ve never seen us review the position of a centre on a purely independent basis. In other words without any impetus from competition to just go to a centre and decide that perhaps it’s physically or economically obsolescent in some area, obsolete in some area rather, and we should upgrade it or do something else. I’ve never seen us do that as a one off project. The only time we ever do that work is when we are responding to either actual or perceived competition. That’s the only thing that really triggers a serious look at a centre. Admittedly once it’s triggered we then go on to it and say this is obsolete and that’s obsolete. We need to upgrade this, the design is old hat and we need to do this, that and the other thing.’

<table>
<thead>
<tr>
<th>(3 5 3 1)</th>
<th>/Owner/Return/Depreciation/Masking</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td>Masking depreciation through refurbishment or redevelopment</td>
</tr>
</tbody>
</table>

i. Depreciation has been masked by the ongoing expansion of the centre: ‘I think we always neglected the depreciation side of property... Typically the shopping centre has been expanded and there has been a major capital undertaking in there to add to it at around the time that you would have had to do a refit.’

ii. There is, currently, a perceived limit on the size that centres can reasonably expand to around 100,000m². Thus the masking through refurbishment maybe a thing that will not be replicated when centres reach a certain size: ‘The development profit is diminished by the need to go back and tie the existing shopping centre into the new so that they look alike. That is what has been happening. That is a finite thing because shopping centres, I think, have approached the size around that 100,000m² mark, where it starts being counter-productive to go beyond it.’ In contrast, it is only some 15 years since 50,000m² would have been taken as the maximum floor area. The consensus is that at 100,000m² the supply of available major tenants currently available in Australia is exhausted.

iii. Owners regard the shop fronts to be a critical aspect of the remodelling of a centre: ‘All that happens, when you look close at the retail property, all that happens is that the shop fronts change.
There is no big injection. Generally speaking when you see the centres in the States they hardly spend anything on the internal common areas. The real action is with retail is the quality of the fronts, I mean they are the stars. Nobody goes shopping and says what a lovely mall, don't you think the lighting is special? There is generally less money to go in but in fact there have been a number of studies to say that if you refurbish and do your research, the customers don't know what colour the centre is.

<table>
<thead>
<tr>
<th>(3 5 3 2)</th>
<th>/Owner/Return/Depreciation/%reinvest</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td>What percentage of initial cost would need to be reinvested to maintain income flow</td>
</tr>
</tbody>
</table>

i. There is a need to reinvest approximately the same capital amount as the purchase price over the first ten years of ownership to maintain returns. However, the final product is likely, as a result of the capital injection, to end up considerably larger and a different centre during that time span: ‘Shopping centres are like that. It is really like just signing a blank cheque’

ii. Most funds, however, do not concern themselves with such issues at date of acquisition: ‘No, we don’t fret about it, but we certainly make an allowance. It’s not enormously scientific because we can’t second guess the future’

<table>
<thead>
<tr>
<th>(3 5 5)</th>
<th>/Owner/Return/KneeJerk</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td>Pro-active or re-active in refurbishment/redevelopment plans</td>
</tr>
</tbody>
</table>

i. The funds/owners interviews ranged from the aggressive to the passive in their approach to undertaking enhancement works to centres. Some funds actively undertake capital expenditure works with the intention of causing a depreciation of the competition.

ii. The mildly aggressive and passive funds reflect on the actions of the aggressive funds as having multiple motives – notably the promotion of subsidiary family companies: ‘If I could put forward my view on the reasons why... their motives are far from pure. They will argue that they are driven by the need to be on the front foot and to capture the market and reposition the asset and stay ahead of the game and all of that sort of stuff. But frankly most of it is to do with the fact that the assets are held by the public and the management company, and the development company and all the service providers are owned by the family or by another entity – and they need to generate fees and profits.'
And that is what drives their actions.

iii. The greed of councils and the granting of benevolent planning permissions for new or expanded centres also damage the industry: ‘it dilutes the business. I mean what these idiots don’t understand, I am talking here of planners, councillors, is the fact that they actually destroy small business. It is as simple as that. There’s a guy paying a rent of $80,000 a year and he has got to turnover $800,000, so you have got a 10% occupancy rate, so that sounds about right, it is adequate. Then now allow another shopping centre in, he’s paying $80,000, but he turning over $400,000. The developer has done his own part and already sold it on. And so this dilution of trade means you have got a lot of tenants who can’t pay their rent. Franchise businesses are going to be sunk overnight, so you have a lot of retrenchments taking place. So you have a lot of retail properties that are very uneconomic. That’s the case in the States as well.’

iv. Conversely, whilst acknowledging that adding $100m to a $100m centre may only realise a revised capital value of $180m, some fund managers argue that they will not tackle ‘uneconomic’ schemes: ‘That exact scenario is what we are facing today more and more. It is often difficult to get a development to stack up so that it adds value rather than going backwards in the market share, and we just won’t do development work where we don’t believe that it is going to add value. It has got to satisfy the returns that the trust needs in terms of marginal yield and also total return, and we use a ten-year time frame. There has got to be profit for the trust, so all the work is generally now done by the trust fund ‘x’, and so it has to be profitable for the trust. And if we can’t put up a commercial assessment which satisfies those objectives then the board just doesn’t approve it.’ If the figures don’t balance, the managers would make a case to dispose of the asset instead.

v. The view of only undertaking the ‘economic’ course is not applied by all funds: ‘It is totally reactive in fact. We have now reached the stage where a lot of the extensions to centres in themselves are not economic but they are still being done and the justification is the defensive spend. In other words I will invest X additional million purely to defend my position with full knowledge that the marginal return on that investment is much lower than I would normally accept.’

vi. Competition is the key issue for the reactive funds: ‘I’ve never seen us review the position of a centre on a purely independent basis. In other words without any impetus from competition to just go to a centre and decide that perhaps it’s physically or economically obsolescent in some area, obsolete in some area rather, and we should upgrade it or do something else. I’ve never seen us do that as a one off project. The only time we ever do that work is when we are responding to either actual or perceived competition. That’s the only thing that really triggers a serious look at a centre.’
### Owner/Lifecycle

#### Anticipated lifespan

Note: These issues have largely been broken down into the subsections (children) of node (3 6).

i. On the basis that shopping centres are evolving, immature asset owners would not be drawn as to asset life. This is better broken down into life span of the main structure and time between major capital injections. ‘*it's a consistent program of refurbishment.*’

ii. Turnover performance is a key indicator of the need for capital injection: *following the refurbishment you naturally get into growth and turnover.* After 2 to 3 years that probably peaks and then starts to fall off again. There is a point on that cycle when you should look at extending the centre again...’

### Owner/Lifecycle/Main Structure

#### Anticipated lifespan of main structure

This node indexes no documents.

### Owner/Lifecycle/Retrofit

#### Lifespan before major refurbishment or lesser retrofit

i. The principle is that a capital allowance is made during the projected 10-year ownership period of a DCF: ‘*we do some capital forecasting which would allow at about five yearly intervals for a significant capital upgrade of the shopping centre.*’

ii. A five yearly projected allowance is the ‘norm’: ‘*Our rule of thumb is that every 5 years you need to do something reasonably substantial to a centre to keep it relevant, to keep the aesthetics up to date with your competitors. Because the customer is very disloyal... Yes, it's a consistent kind of program of refurbishment now.*’

iii. It tends to follow a ‘rule of thumb’ rather than any scientific process of formula on the part of the owners: ‘*we don't fret about it, but we certainly make an allowance. It's not enormously scientific because we can't second guess the future.*’

iv. The capital expenditure within the 10 year horizon is for a cosmetic upgrade rather than a major refurbishment/expansion and may bear no relation to the actual costs incurred if
market forces demand strategic enhancement: ‘We make capital expenditure forecasts on a 10
year basis. And what we normally do is have an audit done of the centre in terms of maintenance
upgrade and cap ex works and that kind of fits into a line on what we call our asset mode for the 10
year forecast and then we’ll put in estimates every 5 or 10 years on how much we think we need to spend
on say a cosmetic upgrade.’

v. Some owners suggested they were more scientific than the valuers in their own
projections. This was not then supported by an explanation for a ‘do nothing’ scenario
which included a ‘do nothing’ $5m cosmetic upgrade: ‘There is a lot more science because we
are obviously closer to property than the valuers are. But what we what we generally have is what we call
our base client asset plan. It’s a do nothing scenario which is probably a little bit of a misnomer because
you can’t really do nothing but it demonstrates how we think the property is going to perform over 10
years if we really don’t do much to the property. So that’s really like a cosmetic upgrade which might be
$5m or something like that, to give it a coat of paint, do some aesthetic works and make it look a little
bit fresher.’

vi. The assumption is that if owners spend more than, say, $5m they are going to achieve a
better return – albeit that no historic evidence was proffered to support an example of
this.

vii. Capital expenditure allowances of $5m or less over the 10 year ownership horizon are
accepted as an ongoing maintenance allowance to maintain the status quo: ‘If we had a
centre say with a value range of $140m to $150m you might just address some finishes and repainting
and generally improving the overall appearance without any structural work or without actual design
changes. We might spend $2m to $3m in one hit just doing that. It’s very expensive, but that wouldn’t
be regarded as a development move in any sense, or a defensive move or anything else. It would just be
seen as ongoing repair and maintenance work in order to maintain the centre in terms of its finishes and
general appearance. Just in order to maintain its present trading pattern.’

viii. In addition, a reflection is made in the cash flow of how the property ‘looks’ in the
market at the end of the 10 year cash flow: ‘We would value the centre today, with a normal 10
year cash flow. Within that 10 year cash flow depending on the size of the centre and what have you
and what it’s present condition is, we would expect in the next 5 years to spend $4m on it. And I think
perhaps another $4m in the 5 years following that or maybe we have just done it up and we might say
well we are good for another 6 to 7 years without any major expenditure. We do make an assessment
and certainly try to build into the cash flow an allowance to maintain the existing centre. The only other
thing we do in addition to that is at the end of that 10 year cash flow or by the redemption date we
endeavour to reflect what we think the centre might be at the end of that 10 year period. How it might
Funds have a conflict when considering major capital expenditure. They want to present property as a competitive asset. Acknowledging that extraordinary levels of expenditure are required to maintain growth can, ultimately, prejudice returns: ‘It is not a deliberate agenda. I think that there is a view that ‘yes, let’s make some allowances... let’s over the next five years allow $10m, or something like that, to keep the shopping centre sharp’. In the full knowledge that it would really cost $25m’

How this ‘hypothetical’ $10m is funded then becomes an issue. Within the cash flow there is a conflict between funding capital expenditure out of (rental) income or paying money market rates to fund work: ‘we would love to get away with a cash rate, because we can buy our money cheap, but we can’t get away with that, it’s the hurdle rate so...’

Because funds can find it challenging to allocate large tranches of capital in the property sector, an opportunity exists to invest income receipts into development work. Most funds/owners acknowledged the existence of a ‘slush fund’ that they could periodically ‘dip’ into without prejudicing their distribution: ‘We use slush funds. You know I mentioned earlier that we are underweight, compared to our neutral position. And we would always try to remain a little underweight our neutral position so we create that slush fund to accommodate development projects. We don’t want to find ourselves in a position where we have to go forward with a project but we can’t get the funding or we have to liquidate another asset to do it. So we always stay on the skinny side’

Such an approach enables a positive return to be generated on cash in-hand: ‘Through working that cash portfolio they may get 9% on it.’

In contrast, other funds borrow, or have a share ‘issue’: ‘we look at the cost of capital and the return. Generally the benchmark is that the return has to exceed the cost of capital. Generally we either fund through equity yield or fund through debt.’

The balance on major works would ordinarily be to ensure that investment return exceeds the cost of capital, but this is not always the case, with funds prepared to make uneconomic expenditure in certain circumstances: ‘The issue is that it is delusional if it doesn’t cover the cost of capital. The aim is not to have any delusional expenditure. However, if there is a good store in the development on a regional, a growth area which has all the right fundamentals.
maybe an under supply of retail space in the area, shows an IRR of 12% to 13%, not a lot of competition, then I think it is probably the story that the market would accept as being appropriate for the fund to invest and get a return that is going to be delusionary.

(3 6 4) /Owner/Lifecycle/Yieldimp

*** Definition:
Impact of refurbishment on yields

i. In considering, for example, a ten year old centre – the centre will be twenty years old at the end of a 10 year cash flow, but no recourse is taken to comparable twenty year old centres in determining the terminal yield: ‘a big generalisation, but the terminal yield ends up being a yield that is the initial yield plus some sort of a premium’

ii. Several owners just ignore the ageing process on the terminal sale yield: ‘being as honest as I can be, it doesn’t get priced in. There is not as much consideration on what is going to happen in ten years’

(3 6 5) /Owner/Lifecycle/OrigLife

*** Definition:
Original planned lifespan

No additional aspects are factored into the analysis of this node.

(3 6 6) /Owner/Lifecycle/Horizon

*** No Definition

i. Funds look at property in different ways, some being in for the long term, others looking for a reasonably high turnover: ‘We see commercial property as more trading stock than call stock in the portfolio. So we would need to enter the market and exit the market probably within the old seven year cycle, because the peaks and troughs are just too severe for us to deal with. We are funds managers and we need fairly homogenous returns, because people are retiring and they need to know….’

ii. Ten years is proffered as the ‘normal’ investment horizon, although no scientific data was suggested to support the assertion: ‘Ten years is our horizon.’

iii. When developments (and refurbishments/expansions) are considered the horizon is either development period plus 5 years or development period plus 10 years: ‘In our developments we normally take the period of development plus 5 years. One feels uncomfortable about going any further - but then there are times when one feels uncomfortable about really going more than 5.’
iv. Some funds look at a shorter time span than valuers look at within their discounted cash flows: ‘I mean most of the valuers I’ve dealt with in recent times, I think are in a different world, but it’s the world they’re are required to be in. They take ten years. I mean we take ten years sometimes as a discipline 10 years. Actually you’re more likely to get the right answer on acquisition if you take a 10 year cash flow simply because of the multiplier effect you’ve got a better outcome. You’ve got a longer period to defray the expensive acquisition cost, or get more returns back on every capital injection you might make by way of refurbishment etc. etc.’

v. Some owners look at retail market performance rather than shopping centre performance in making their 10 year projections: ‘Our role is focussed on a 10 year time horizon and after the first 3 to 5 years it is hard to think of how properties are going to perform. You take more of a view on the retail sector as an industry, rather than a specific shopping centre. But our role is to take the property management groups first your income forecast and then extrapolate out over 10 years and overlay on that 10 year time horizon what we think is going to happen in the market.’

vi. Several ‘experts’ (valuers and owners) advised that a particular owner took a 15-year horizon, but this was not confirmed as the said owner stated that they took a 10-year investment horizon.

<table>
<thead>
<tr>
<th>(3 7) /Owner/Forecasting</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
</tr>
<tr>
<td>Research approach</td>
</tr>
</tbody>
</table>

i. Owners and funds admit to passing some of the forecasting responsibility on to external companies such as Jebb Holland Dimasi for particular properties (micro) using Econtec and Syntec for the ‘real big picture stuff. We commission them to take a bit of a ten year outlook.’ Together with MarketShare, Ivacon & Irvec.

ii. Some owners/funds see the expenditure on external econometric advice as a reconciliation: ‘There is a requirement or an expectation at senior level to see that there has been external advice requested and taken on board’ It is a form of due diligence.

iii. Some argue that there is a need for more providers of econometric forecasting to overcome the perceived conflict of interest that may occur because there are currently a limited number of players.

iv. The role of the valuer comes in for some differing views: ‘There is no doubt the values are probably too far out of it in a number of instances because they report on the past and we spend the whole time talking to people about the businesses and the future.’ And ‘...there is a lot more science because
we are obviously closer to property than the valuers are’

v. Conversely, an alternative view of the valuer is: ‘Well they have their own internal research groups. I am not saying that our view on where the market is going is worse or better, well it is probably better than their view. But I guess what I am saying is that their view on the market more or less becomes the markets view on the market.’

vi. Valuers ‘are more historians than forecasters. Whereas we prefer them to be forecasters rather than historians’. However, ‘the value we see from them is not telling us what happened. It’s telling us what they think is going to happen... And then they inform us as to what they think is going to happen from what has already happened’

vii. Criticism of the valuers runs deep: ‘I’m not being overly critical of the valuers, because I think generally they are way close to the market in terms of what somebody is prepared to pay. I’m critical of their ability to argue that on a more theoretical, say ten year, time horizon.’

viii. But, if valuers are to forecast, where are they expected to obtain their data on the workings of the market and owner expectations? The owner: ‘We frequently have valuers come to us and ask us hypothetical questions. For example, if you were in the market for a regional today what sort of IRR would you be looking at - would you do it this way, what would you include in your cash flow. So in effect they are asking of us how we would go about valuing the centre. They are doing it because they know that if we do buy a centre we’ll employ various methods and they want to try to mirror those in how they do valuations’

ix. What value are forecasts? ‘there is no doubt that the majority of the market research reports that have been prepared in the last five to ten years have been absolute works of fiction. I don’t think that there is any doubt whatever. I don’t think that there are many that would stand scrutiny of the outcome matching the forecast. There may be other reasons, other developments that have come up but I think that those reports have been extremely questionable’. The rationale behind such a conclusion is that the market has been hyped.

x. Whilst the long term credibility of forecasts is under fire, there is still an expectation by the owners for someone to make the risky long term call into the future: ‘The structural changes that are taking place in the property market, for example the low inflation issue and other things, all indicate that working off historic data is probably becoming more dangerous by the year and that there is a real need if you like for people with expertise who can look at how things might evolve over future years and certainly a need for that sort of input in investment decisions. I don’t think we are really seeing it from the valuation profession or for that matter the Jebb Hollands and others, at this stage. It’s a difficult call to make on anybody to ask them how things might be in five years on any issue
given that the rate of change that is in our society these days, particularly in investment markets.

xi. Forecasting advice is essential: ‘there is a real need to get into the comfort zone there and to be able to demonstrate that at any time you have actively consulted the best people available to give you advice and what have you. There is certainly the quite reasonable element of simply taking as much and the best advice you can to make decisions too’

| (3 8) | /Owner/Future |
| *** Definition: | Future Directions |

i. With shopping centres, investors are locked into their own inertia: ‘They are really just like signing a blank cheque’

ii. Owners are likely to reach the stage where it becomes physically impossible to add any more on to the shopping centre investment. Shopping centres are becoming mature assets.

iii. The market is heading for a significant oversupply of retail space.

iv. Short-termism is the order of the day: ‘There is a lot more interest at the moment in what you’ve got, on what you can buy, rather than the future’

v. Development opportunities are now limited and ownership of market share is the key issue: ‘it’s refurbishing, it’s remixing and it’s doing a little bit here, doing a little bit there, rather than a massive expansion’

vi. Within property asset allocation, there is a consensus that the office (commercial) sector will demonstrate expected recovery. There is a significant caution indicated, which suggests maintaining a reasonable asset weighting in the retail sector could prove optimal.

vii. There is a general acceptance that ultimately property yields, across the board, will have to ‘move out’. They are perceived to be too low because of current low inflation levels and the competition of alternative investments.

viii. The situation has changed on capital expenditure from being one which results in increased marginal return, to no marginal return, to the straight out defensive spend.

ix. Trader bankruptcy, increased and imbalanced occupancy costs and potentially reducing rents are all real threats to investment returns in regional shopping centres: ‘The level of bankruptcy and other things amongst the retail traders has blown out. We’ve got all the classic signs...’
We see it in occupancy costs where it’s not uncommon now to look at a regional and find that occupancy costs are 14%, maybe 15%, in some cases. It is getting way beyond the traditional 12% to 13% level which everyone was comfortable with. All these things indicate that retail profitability, particularly from specialty leases, is under a lot of pressure indicating a lack of future growth, or at least at a period of time where rents plateau. A lot of the better-informed people around in the retail industry suggest that rents will in fact go down. We have yet to see any definite sign of that, but it is certainly a possibility. As a result, the positive growth of recent years is likely to turn negative in the near future for regional shopping centres.

---

**Definition:**

(i) There has been a view that the ‘best’ regional centre will always be the ‘best’. The reality is that ‘it won’t. Either it will get out of fashion because it is no longer a “magnetic” centre, or it will get out of fashion because it has simply aged. Or both.’

(ii) Capital expenditure over the 10 year investment horizon is likely to be as much as the acquisition price: ‘Shopping centres are like that. It is really like just signing a blank cheque’

(iii) Department stores are currently downsizing though ‘probably by accident. Department stores are really the catalyst to shopping centre development in this country.’

(iv) Why would Westfield, Lend Lease or AMP disinvest from a centre? ‘The regionals are a very hyped market, they are just over-valued. Retail is flagging it is not a good time. It’s really a buyers market; it is not really a sellers market. People are still more focused on commercial. Our view is that you would only really want to sell if you really needed to sell now and you may have to look at offers below valuation and seriously consider them. It’s more of a counter-cyclical buy opportunity in our view. Other than that, it’s the product and the problem is finding a buyer.’

---

**Definition:**

(i) The impact of cinema’s and entertainment centres has been acknowledged already. It is current practice for owners to contemplate the addition of entertainment facilities in any refurbishment/expansion scheme.

Note: This node references the same comments as (2 9 1) and reference should be made to

---

244
that node.

<table>
<thead>
<tr>
<th>(3 9 2)</th>
<th>/Owner/Misc/M&amp;S</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>The Marks &amp; Spencer enigma</td>
<td></td>
</tr>
</tbody>
</table>

i. It is anticipated that, with the exception of ‘XX’ Centre, Marks and Spencers are going to take relatively small units initially.

Note: all owner ‘expert’ commentary for ‘The Marks & Spencer enigma’ was incorporated with the ‘Valuer’ node (2 9 2). That node should be referred back to.

<table>
<thead>
<tr>
<th>(3 9 3)</th>
<th>/Owner/Misc/Internat</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>International perspectives: AIVLE/RICS/MAI</td>
<td></td>
</tr>
</tbody>
</table>

No additional issues were included.

Note: all owner ‘expert’ commentary for ‘International perspectives: AIVLE/RICS/MAI’ was incorporated with the ‘Valuer’ node (2 9 3). That node should be referred back to.

<table>
<thead>
<tr>
<th>(3 9 4)</th>
<th>/Owner/Misc/Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>As in the service customers expect</td>
<td></td>
</tr>
</tbody>
</table>

No additional issues were included.

Note: all owner ‘expert’ commentary for ‘As in the service customers expect’ was incorporated with the ‘Valuer’ node (2 9 4). That node should be referred back to.

<table>
<thead>
<tr>
<th>(3 9 5)</th>
<th>/Owner/Misc/Gambling</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>Impact of gambling on consumer $</td>
<td></td>
</tr>
</tbody>
</table>

No additional issues were included.

Note: all owner ‘expert’ commentary for ‘Impact of gambling on consumer $’ was incorporated with the ‘Valuer’ node (2 9 5). That node should be referred back to.

<table>
<thead>
<tr>
<th>(3 9 6)</th>
<th>/Owner/Misc/Investment Vehicle</th>
</tr>
</thead>
<tbody>
<tr>
<td>*** Definition:</td>
<td></td>
</tr>
<tr>
<td>Redevelopment allows opportunity income to market, build, architect, and lease</td>
<td></td>
</tr>
</tbody>
</table>

i. The large funds make a profit out of each component: the design, marketing,
construction, management as well as the investment return.

ii. The nature of the ownership of these investments impacts on the return: ‘they are tightly held and that's one of the reasons why the yields are within a fairly tight band.’

iii. Of the large funds: ‘You don't get that big by being a charity.’

iv. Owners don’t often tender big redevelopment/refurbishment jobs because they can pass them to their subsidiaries: ‘we know what sort of work they can do and they are very good, it's better for us to have them do it and do it on time than...’

v. This does come with a caveat: ‘But all of our development work is assessed against returns that it is likely to generate rather than any other side benefits to the corporation.’

(3 9 7) /Owner/Misc/Robina
*** Definition:
The New (1996) Robina Town Centre Super Regional

For the reasons outlined in (2 9 7), it is considered inappropriate to detail the analysis of this node within this research.

(3 9 8) /Owner/Misc/Corrupt
*** Definition:
The grey area (possibly corruption)

i. Insider trading: ‘Shopping Centres are the only investment where insider trading is not only legal, but positively encouraged.’

ii. Secrecy prevails: ‘I don't know how external valuers can possibly come up with a number for shopping centres. They just are not privy to the information. It is all very sensitive. All of the owners keep everything very sensitive. I really feel for them’

iii. True market evidence is very hard to find: ‘a lot of things get handled off the market these days. Big assets don't get a 'for sale' sign put on them. People don't even know that they are in play and the next thing that you know a new owner pops up’

iv. Hidden incentives are common: ‘and they are very hard to find too’

v. Linking in with the comments made in (3 9 6) with the multiple benefits of the investment vehicle through construction, development, management and agency subsidiaries: ‘their motives are far from pure. They are not. They will argue that they are driven by the need to be on the front foot and to capture the market and reposition the asset and stay ahead of the...’
game and all of that sort of stuff. That is a little bit, that is a bit of it. But frankly most of it is to do with the fact that the assets are held by the public and the management company, and the development company and all the service providers are owned by the family or by another entity - and they need to generate fees and profits. And that is what drives their actions.

vi. Who makes the market? There is a call for valuers to take the lead: ‘because the growth is starting again and the pressure is coming on again for valuers to start thinking about making the market rather than following the market.’

vii. From an investors view, the decision to redevelop or do nothing is often a case of selecting the lesser of two evils: ‘the mechanics if you like of assessing those two positions: (1) the fall in value if you do nothing and (2) the position you’ll be in if you do spend the money. Highly debatable. A lot of the thinking and research and processes that go into those decisions I think are very questionable. I’m not criticising it or inferring if you like that it is corrupt in any way but to my mind it’s frequently not research based and it should be. There is a lot of knee jerk reaction.’

viii. The pressure on valuers to succumb to owner pressure is recognised by the owners themselves, not least of all the fee being paid to the valuation practice which can be as much as $50,000: ‘I’ve been aware of quite a few instances where valuers have and still are placed under immense pressure to produce figures of one level or another. Now that of course varies from owner to owner and frequently varies as to the holding entity. Typically I’ve found probably more pressure in that area from property trusts than from any other sector.’

ix. From an owners point of view a $50,000 valuation fee is often a small side issue. If the first valuation doesn’t produce the required answer, instruct another valuer who has been better briefed: ‘it’s certainly in our interest to see that the external valuer produces a figure that supports our internal work. If it doesn’t and he comes out with something significantly lower, our usual procedure there would be to go through in a lot of detail all his thinking as to why he’s arrived at that figure. I’m certainly not aware of any instances where we as an owner have demanded or required that it be changed on the basis that if it isn’t there is no future work. Although I believe there are owners around that do that sort of thing. At worst we’ve had instances where that has happened. When I say that has happened I mean we have sat down with a valuer and gone through all his reasoning and still haven’t been convinced that he has been fair in his judgements in such instances. We’ve appointed a further valuer to do exactly the same job and if he’s verified or supported effectively on a totally independent basis what the first valuer said, then we are inclined to go with their view.’

x. Of undue pressure by owners on valuers: ‘Well, it is a fact of life. I guess it’s unfortunately a profession that is wide open to that sort of thing. It’s just something I guess we’ve got to live with.’
No additional issues were included.

i. Owners also take the role of developer, manager and sometimes architect. In addition, many of those who take the role of owner have a valuation background. Most owners are intimately involved in at least four of the five roles, if not all of them.

ii. Note: Prior to undertaking the ‘expert’ interviews, the five roles of Owner, Developer, Manager, Architect and Valuer had been considered in isolation. There is a high level of cross fertilisation between the roles/functions with Westfield and Lend Lease having all five and QIC and AMP having all but the in house design capacity.

iii. Owners are of the view that they have a considerably higher skill base than managing agents. It is suggested that this be because owners have more time and governments/retailers do not want to be passed outsourced fees.

iv. Upgrades and extensions are perceived by owners as useful ‘job creation schemes’ for their development subsidiaries.

v. The owners are, effectively, the market: ‘the regional market is a little bit different to say, the sub-regional or community market, because there are only a specific number of players’

vi. General concern and criticism is levelled at the ‘fee’ valuers by the owners/funds because of their historian approach to analysis, their inability to forecast and the fact that they are rarely party to all the information as has been documented in other nodes. This concern is extended to the level of self delusion which results: ‘you get to a point where they believe their own bullshit’ and ‘There is no doubt the valuers are probably too far out of it in a number of instances because they report on the past and we spend the whole time talking to people about the businesses and the future’

vii. Valuers are considered a necessary evil: ‘There is no doubt the valuers are probably too far out of it in a number of instances because they report on the past and we spend the whole time talking to people about the businesses and the future’
4.6 Patterns of data for the investment appraisal of enclosed shopping centres

What is clear from the analysis is the close relationship between the roles of all the ‘experts’ interviewed. The enclosed regional shopping centre market is the most tightly controlled property investment sector in Australia. It is a sector that has demonstrated abnormally high returns to the owners over the last decade.

The strongest theme that came through the coding of data was the role of the valuer, in that the majority of respondents had a valuation background (the architects/analyst excepted). This meant that many respondents in the role of owner could see the challenge facing the fee valuers that they employed to provide the periodic investment appraisals that they were legally bound to obtain on their enclosed regional shopping centre. This research obtained 100% response from the specialist valuers employed by the owners of enclosed regional shopping centres in Australia.

A common pattern evolved during the coding process which is demonstrated in both Figures 4-1 and 4-2 and the way that they evolved from Figures 3-6 and 3-2 respectively. Where appropriate the same coding reference was provided for each evolution, for example (5 3) for Depreciation “definition” and (6 4) Yield Impact of Major Refurbishment. This facilitates cross-referencing of the empirical data.

As was stated earlier in this chapter, the analysis of the data has concentrated on the role of the Valuer and the Owner client. The developer, manager, architect and analyst respondents have been fully coded, but the separate analysis is not included in this work. Instead the relevant cross-coding references from each of these respondents has been included within the analysis of (2) Valuer and (3) Owner as appropriate. The relevant view of these ‘experts’ as it relates to the research hypothesis – an analysis of the investment appraisal of enclosed regional shopping centres - is therefore fully incorporated in this work. As was outlined above (section 3.3.2.6) 14 of the 19 ‘experts’ hold a valuation qualification or had valuation training. The incorporation of the Valuer and Owner analyses therefore incorporates the sum of the data.

The layout of the evolved conceptual framework for both the Valuer and the Owner allows for quick reference to the summarised nodal analysis for each numbered node on Figure 4-1 and 4-2.
4.7 Conclusion

The results presented in this Chapter represent a significant advancement in the understanding of the investment appraisal of enclosed regional shopping centres in Australia. This Chapter has presented and analysed the empirical data obtained from the expert views offered by the key players in the regional shopping centre investment market. In so doing, the process has evolved and presented the conceptual framework for the Valuer and Owner of enclosed regional shopping centres in Australia. These are significant ‘models’ in that they present a comprehensive analysis of the complex and sometimes contentious process of investment appraisal in this major sector.

The summaries in this Chapter, supported and reinforced by direct quotations from the expert respondents, allow key issues to be exposed and explored. These key issues are summarised in Chapter 5. It is not the purpose of this Chapter to draw conclusions or compare results to those other researchers who were discussed in Chapter 2. This analysed qualitative data has enabled a depth of understanding of the investment appraisal of enclosed regional shopping centres that provides a significant contribution to knowledge in this field, as contained in the summaries above and in the conclusions in Chapter 5.
References: Chapter 4


Chapter 5

CONCLUSIONS AND IMPLICATIONS

5.1 Introduction

This work has attempted to present a new and deeper understanding of the investment appraisal of enclosed regional (or larger) shopping centres. Within that framework, the hypothesis considered the application of contemporary appraisal theory to the regional shopping mall investment class, whilst qualifying the depreciation and other aspects with empirical Australian data of the shopping centre life cycle. Through this approach a theory (a system of ideas intended to explain something325) contextualising the framework and the forces surrounding the investment appraisal of enclosed regional shopping centres has been evolved. What this adds is the first fully analysed and accessible qualitative data set that synthesises, categorises and clarifies the group experience of the players (experts) in this key sector of the Australian property investment market. It is the first in-depth study to incorporate the views and experience of main owners, valuers, managers, architects and developers of regional shopping centres.

The goal of this research project was to build theory through the analysis of qualitative data, which can then be applied to the wider property investment and appraisal market. As cited, such a goal is a logical, achievable and worthwhile aim for a doctoral thesis.326 Hitherto, what limited theory was available in this area took a largely historical perspective. This thesis represents a new domain of enquiry, since it is the first study which specifically qualitatively examines and synthesises participants (“experts”) perceptions under a conceptual framework of the investment appraisal of enclosed shopping centres. In so doing it generates and evolves new theory that is grounded in the expert opinion and experience of the significant proportion of experts in the Australian regional shopping centre investment sector.

Chapter 1 established a framework for the research. The literature relating to enclosed regional shopping centres, appraisal theory and depreciation issues were explored in Chapter

2. An understanding of the literature facilitated the design of conceptual frameworks for the key players in the process. The research methodology, establishing a case for adopting a qualitative approach, was presented in Chapter 3. A qualitative approach, based on semi-structured interviews, produced a significant amount of empirical data. This data was analysed using Q.S.R. NUD•IST™. The qualitative coding process allowed for the conceptual frameworks to be evolved with clear nodal headings which questioned specific components of the investment appraisal process from the understanding of key valuers, owners, developers, managers, architects and analyst. The valuer is seen as the principle area of focus, supported by a deep understanding of the owners’ view. The analysed data was then summarised for inclusion in Chapter 4, with referencing to the nodal points on the Valuer and Owner Evolved Conceptual Frameworks. This concluding Chapter demonstrates that this Ph.D. research does make a significant contribution to the body of knowledge relating to the investment appraisal of enclosed regional shopping centres – an Australian perspective.

5.2 Conclusions about the research hypothesis: an analysis of the investment appraisal of enclosed regional shopping centres - an Australian perspective.

The findings presented in Chapter 4 provide a detailed contribution to the body of knowledge in respect of each point, or node, summarised. The analysis included 79 nodes (45 Valuer nodes and 34 Owner nodes) incorporated in the evolved conceptual frameworks. These 79 nodes introduced 453 salient numbered points (290 within the Valuer evolved conceptual framework and 163 under the Owner evolved conceptual framework) supported with associated ‘expert’ quotations. It is not appropriate for the conclusion to reiterate each of these 453 points.

This section highlights several of the key findings derived from the analysis in Chapter 4. It is important to note that the following points highlight issues not previously considered by the literature (Chapter 2) in this area. Accordingly, they add to the existing body of knowledge on regional shopping centres. The detail is provided in Chapter 4, the key concepts are developed below.
5.2.1 Shopping centres are an evolving asset

The literature identified that the area of depreciation and obsolescence of enclosed regional shopping centres had not been fully researched. Baum identified it as an area requiring further investigation following his, and others, consideration of depreciation in city offices and industrial property. The perception was that shopping centres have a shorter life-span between refurbishment’s than other property investments.

The reality is that shopping centres evolve over time, often from humble beginnings as a supermarket and discount department store. With time, they get added to and expand as their catchment grows and the market becomes more sophisticated. There is a need for ongoing capital expenditure throughout the life of the asset to ensure that it remains relevant: ‘shopping centres are like that. It (owning them as an investment) is really like just signing a blank cheque’.

Regional shopping centres cannot be directly compared with office assets. Office buildings are ‘mature’ from the day that they open: ‘when it (an office) opens it is fully deduced’. In contrast, shopping centres are an evolving asset. An office normally cannot expand and depreciates from building completion. Shopping centres allow much greater flexibility and, as a result, opportunities for further investment.

5.2.2 Owners will have to spend about 100% of what they pay for the asset within the first ten years to maintain the yield and income

Regional shopping centres require significant ongoing capital expenditure. This variable is completely overlooked in the valuation approach, with most valuers making only a ‘token’ allowance of $10 million dollars (or thereabouts) during the ten-year cash flow. It is very difficult for the valuer to do other than make a ‘token’ allowance and maybe adjust the terminal capitalisation rate for the hypothetical sale at the end of the tenth year to reflect reduced security. The reality is that owners will have to spend about 100% of what they pay for the asset within the first ten years to maintain the yield and income.

---

328 refer (3 5 3 2 i) p. 235.
329 refer (3 5 3 iv) p. 231.
330 refer (3 5 3 v) p. 231.
331 refer (2 5 3 iii) p.196.
332 refer (2 5 3 viii) p. 197.
Valuers acknowledge that: 'Depreciation is one of the most subjective areas of the cash flow.' Whilst some fund managers argue that they will not tackle uneconomic schemes, taking an example of a $100m centre an owner ‘might be thinking of putting another $100m into it hoping for rental growth and a hardening cap rate because it is a newer product. You would at least get a revaluation of $185m so there is a shortfall of $10m-15m’.

If the capital injection is not undertaken the potential percentage loss in value, and thus investment return, would be considerably higher.

5.2.3 Refurbishment and expansion mask the depreciation

If owners made an assertion to their asset allocation committee that an additional 100% capital would be required within 10 years, it is unlikely that the initial permission to invest would be granted. However, this capital expenditure can work significantly to the owners’ advantage. Economies of scale and the effective oligopolistic situation of many regional centres make the allocation of large tranches of income capital for their refurbishment and expansion a positive investment strategy. This expenditure, coupled with pressure on valuers to be optimistic in their investment appraisal, can mask failings (depreciation) of the existing asset and demonstrate good (hypothetical) return figures to investors. In other words, at least the shopping centre will be a ‘new’ asset after each capital injection, because refurbishment and expansion mask the depreciation. However, once shopping centres fully mature ‘around the 100,000m² mark’ the masking may cease to be replicated. This is different from the ‘inflation masking’ referred to in the literature.

5.2.4 Owners spend money to depreciate the competition

It is because shopping centres are immature assets that depreciation has never been a quantified issue. This critical issue was not raised in the literature. Owners openly acknowledge that depreciation does exist and is an issue for regional shopping centres. However, unlike offices for example, depreciation in shopping centres does not primarily occur though the effluxion of time or through technological advancement. It occurs because owners spend money to

---

333 refer (2 5 3 xiii) p. 197.
334 refer (2 6 3 vii) p. 206.
335 refer (3 5 3 1 ii) p. 234.
336 refer Chapter 2 (2.3.10.10) p. 96.
depreciate the competition. Funds are either pro-active, and openly spend income capital to enhance their asset resulting in a competitive advantage causing a potential increase in yield, increasing vacancies and falling rental values of the competition – instigating a depreciation in the capital value. Other owners are open about their defensive philosophy taking a ‘totally reactive’ stance. Such owners only expend capital ‘defensively and uneconomically when forced to do so as a result of the actions of their competition. This is because you don’t really need to do anything if there is no competition.’ This competitive issue undermines the ‘optimal time’ to refurbish a centre theory as proffered in the literature.

5.2.5 Owners also have development, management and architectural subsidiaries that gain employment and income from the continual expansion process.

The owners of regional shopping centres include some major and large organisations. Whilst the ongoing injection of capital into a regional shopping centres serves as a useful investment vehicle in its own right, there are also major benefits that feed back into the wider organisation. This is because owners also have development, management and architectural subsidiaries that gain employment and income from the continual expansion process. They (the owners) ‘make the profit all the way through.’ The feedback of benefits may not reach the individual investor.

5.2.6 Acquire investments at low yields to maintain portfolio value

In a market where there are few players, it is to mutual advantage to maintain the value of their respective portfolios. This is especially so for players who only invest in one asset class. It is also a market sector where few others can afford to enter, if the value of a regional shopping centre is taken to be in the range $150 million to $600 million. It is essential, in order to support the recent high performance of regional shopping centres for owners to acquire investments at low yields to maintain portfolio value. Owners also appreciate the need for valuers coming to appraise their assets to have some form of market evidence to support the optimistic valuation.

---

337 refer (3.5.5.i) p. 235.
338 refer (3.5.5.v) p. 236.
339 refer (3.5.3.xiv) p. 233.
340 refer (3.5.3.x) p. 232.
341 refer Chapter 2 (2.3.10.12) p. 104.
342 refer (3.9.6.i) p. 245.
343 refer (2.9.6 i et seq.) p. 214.
which an owner inevitably seeks in order to demonstrate positive performance of the asset to the investors.

For this reason a ‘magical’ initial yield is spoken of within the marketplace. Initial yields, as with all the investment return terminology is provoking by its nature. However, the market still supports a published initial yield figure for regional shopping centres of around 7½% (in 1996/7 terms). In other words, taking the net passing (current) income and dividing by the sale price. Or conversely, taking a passing income and dividing by 0.075 (7½%) to achieve a market value. From an owners viewpoint the overall performance of a fund can be adversely diminished if this yield increases to 8% or more. For that reason funds are keen to dispose of or acquire partial shares of ownership in centres if only to provide an ongoing component of (hypothetical) market evidence which forces the valuer to ‘follow the market’. Funds have got a vested interest to maintain the value of their portfolios; they can’t afford to sell for 9% or 10%. That would downgrade the value of the whole portfolio in one transaction. No one can upset the apple cart. This point is neatly summarised by quoting an owner who said ‘This is the only investment sector where insider trading is not only legal, but positively encouraged.’

5.2.7 Let the valuer struggle to find information

An ongoing theme in this research is that ‘knowledge is power. It is all a very closed market.’ Indeed it shaped the whole research methodology and resulted in a far more insightful qualitative approach. The adage is equally true in the relationship between the valuer and the owner client. Whilst there is a duty of disclosure on the owner to make all information available to the valuer, there is a grey area between public and private information. Owners openly acknowledge the difficult position valuers are placed in, but only because it works to the owner’s advantage. Rarely is the valuer presented with the full story. They are not privy to the information. It is all very sensitive. The view of the majority is to let the valuer struggle to find information. At best, a valuer is likely to know 90 – 95% of the information relating to income receipts and proposed capital expenditure: ‘you have to fill in the gaps yourself.’ Incentivisation is an important issue in operational property management, and confidentiality clauses can ensure that valuers are not

344 refer (2 5 4 v) p. 201 & (2 9 6 iv) p. 214.
345 refer (2 9 6 iv) p. 214.
346 refer (2 9 8 iv) p. 216 & (3 9 8 i) p. 246.
348 refer (3 9 8 ii) p. 246.
349 refer (2 1 1 xv) p. 172.
party to tenant deals or money which ‘passes under the table’: ‘a lot of things get handled off the
market these days’.\footnote{ref (3 9 8 iii) p. 246.}

5.2.8 The valuer is as confused as everybody else about the terminology

Whilst the AIVLE have produced a Practice Standard on Discounted Cash Flow\footnote{AIVLE (1996) \footnote{ref (2 5 1 i) p. 182.}}, the
terminology relating to differing investment performance indicators (yields) remain unclear.\footnote{Boydell & Gronow (1997) \footnote{ref (2 5 1 xv) p. 184 & (2 5 1 2) p. 187 et seq.}} The fact that the valuer is as confused as everybody else about the terminology was evident
from the data.\footnote{ref (2 1 2 ii) p. 173.} What may be a term yield to one valuer could be a terminal yield, or
disposal/sale yield to another. There is general confusion over the target yield (or internal rate of return) of the cash flow by many valuers. The market has not embraced academic definitions
of equated yield,\footnote{ref (2 9 8 vii) p. 216 et seq.} with many confusing this with equivalent yield. There is a need for the
valuation/appraisal profession within Australia, and ideally internationally given the nature of
investment at this level, to adopt a clear and properly founded terminology and nomenclature
for the risk component of appraisal.

5.2.9 Intimidation

All parties recognise the value of regional shopping centres as investment vehicles. The need
not to ‘upset the apple cart’ has already been espoused. Valuers are paid comparatively large
fees for their professional advice at this level. There is a challenging balance that every
professional must reach between serving their client whilst demonstrating the highest integrity
and professional ethics. Certain owners are attempting to undermine that integrity by seeking
tenders for their valuation work.\footnote{ref (2 9 8 vii) p. 216 et seq.} Whilst under the guise of investor efficiency and obtaining
the best value service, a dangerous undercurrent is the request to provide indicative yields at the
time of tendering: ‘market forces force valuers to do things they shouldn’t be doing.’\footnote{ref (2 9 8 vii) p. 216 et seq.}

In contrast to the fee amount to the valuer, owners see the valuation and related fee as a
statutory obligation. If a valuer does not provide a ‘satisfactory’ valuation figure for a regional
shopping centre there is nothing to stop them ignoring that report and instructing a different practice/valuer to obtain a hopefully more benevolent, or optimistic, opinion of value. \textit{I believe there are owners around that do that sort of thing}.\footnote{357 refer (3 9 8 ix) p. 247.}

5.2.10 Who can forecast beyond 3 or 4 years

Investment in property is a futures concept. Funds expend capital to acquire regional shopping centres in the anticipation that they will provide a future income flow that demonstrates rental growth and capital appreciation. In making the decision to purchase, refurbish, redevelop or extend, investors obtain econometric forecasts of the demographic, political, economic and other issues relating to the centre. They normally project forward with a modicum of accuracy for a period of around three years. The value of the forecasts is in question: \textit{there is no doubt that the majority of market research reports that have been produced in the last five to ten years have been absolute works of fiction}.\footnote{358 refer (3 7 ix) p. 242.}

In contrast, the valuer is normally expected (by professional requirement of their professional body, the AIVLE) to produce a ten year cash flow forecast and sensitivity analysis. However, enclosed regional shopping are ‘\textit{a moving target}’ shrouded in uncertainty.\footnote{359 refer (2 7 i) p. 208.} In accepting the valuation instruction, the valuer accepts professional responsibility to complete an impossible task. Valuers rarely possess the numeracy and forecasting skills of economic forecasters, yet they willingly accept a fee to forecast, in detail, the expected income from an investment over a ten year period with a more generalised expectation of value into perpetuity thereafter. This is untenable in the light of the key points raised in this section and will be developed in 5.3.

\textbf{5.3 Conclusions about the research problem}

This thesis analyses the investment appraisal of enclosed regional shopping centres. At the outset it considered the possibility of providing a spreadsheet ‘model’ to synthesise the research findings. This is clearly not a reasonable expectation. The (simplified) ‘normal’ approach to tackling an investment appraisal of an enclosed regional shopping centre would be to prepare, or use, a ten year discounted cash flow spreadsheet model with associated sensitivity analysis,
supported as appropriate by the capitalisation approach and other appropriate appraisal methods. From these approaches a valuer will then provide the best estimation of the market (or other) value of the regional shopping centre investment.

The valuer is being confronted with a clearly impossible task where regional shopping centres are concerned. Why would a prudent professional accept the role of arbiter of value in an environment of (covert) intimidation when they are expected to:

Forecast rental income and capital expenditure for eleven years (given that a ten year cashflow model considers a sale at the end of the tenth year based on projecting the eleventh year’s income into perpetuity);

Determine risk based on either clients ‘expectations’ of return, or attempt to analyse other transactions where they do not have all the information. This is undertaken in a framework of confusion over the yield terminology;

Make income projections for the future when they are unlikely to even have accurate details about the income for the current year;

Assume likely notional expansion/refurbishment work that is likely to occur over the next ten years in the knowledge that their client is going to have to spend at least 100% of the current purchase price (or net present value) over the coming ten years to maintain the investment return of the asset;

Ignore the major capital expenditure that the client will undertake in maturing the asset as at the end of ten years it will undoubtedly have a different (increased) floor area, tenant profile and income stream to the centre that they are being asked to advise on.

If a valuer takes the view of the last two points, it is reasonable to expect that full consideration of a ‘depreciation’ factor will have to be accounted for in the model – albeit that the depreciation will, ordinarily, be masked by refurbishment and expansion initiatives with the passage of time.

In open knowledge of the above, it is unclear why an ethical and professional valuer would accept the responsibility to undertake the investment appraisal of enclosed regional shopping centres. It is only a matter of time before there is major litigation which will expose the ‘insider trading’ nature of this investment sector. There has been recent media attention in Australia suggesting ‘Shopping Centre Armageddon Coming? Shopping centres overvalued by 35%’ on the basis of a
This thesis would support the contention that regional shopping centres may indeed be overvalued, but on the basis of the key issues outlined in 5.2 above rather than mere occupancy costs.

The summarised data contained in Chapter 4 contains a detailed insight into the investment appraisal of enclosed regional shopping centres and the evolved conceptual frameworks provide a comprehensive model for understanding the process. As was stated in the research methodology, Chapter 3, the dichotomy with grounded theory research is not merely to test relationships amongst variables. The purpose is to discover categories and the relationships between them, grouping them in new rather than standard ways. This goal of qualitative research has been achieved in this thesis.

5.4 Implications for theory

This Ph.D. research has made a significant contribution to knowledge in its immediate discipline as outlined in 5.2 and 5.3 above. Moreover it has implications for the wider body of knowledge, including the parent disciplines of appraisal, depreciation, portfolio strategy and property research.

5.4.1 Appraisal

Having developed a case for the adoption of discounted cash flow models in the literature review, this research questions the reasonableness of expecting valuers to make detailed forecasts over an eleven-year period. The adoption of a simple capitalisation rate using passing (current) net operating income into perpetuity was criticised for ‘complex’ investments as concealing the implicit risk, growth and depreciation issues behind the façade of an all risks yield. In reality most valuation practitioners arrive at an early opinion of value by discretely using this approach and then spend subsequent weeks justifying their fee with DCF models and associated sensitivity analysis. In a market where the client seeks an initial return of 7½%, maybe it is the valuer who is being self-defeating by making the appraisal issue more complex than it need be. This complexity is undertaken in order to be able to naively compare property

---

360 Shoebridge, N. (1997)

361 refer Chapter 3 (3.6) p. 140.
to other asset performance, rather than adopting the underlying simplicity of their clients’ expectation.

5.4.2 Depreciation

At the outset, it was assumed that the impact of depreciation on regional shopping centres could be quantified using cross-sectional or longitudinal analysis as others have done in respect of the office or industrial sector. What is apparent is that depreciation (and implicitly obsolescence) cannot be forecast for immature assets. The maturity of city offices is acknowledged, but there is an implication for an industrial complex that may not be so physically constrained. Much of the research that was incorporated as the American School in the literature was similarly based on a finite, complete object that would have no significant value (above scrap) after a number of years. Optimal equipment replacement theory is satisfactory in that context – for equipment. Optimal mall replacement is another issue whereby the depreciation factor is driven by a ‘competition’ factor rather than time and decay. A significant contribution to the body of knowledge on depreciation is the addition of a new classification emanating from this research, that of ‘Competition Depreciation’.

5.4.3 Portfolio Strategy

There are implications for portfolio strategy through the detailed contribution to knowledge afforded by the evolved ‘Owner’ conceptual frameworks as well as the insight into the valuation process. The relative performance of property as an investment is tracked by various sources, most notably the Property Council (PCA) in Australia. The return on investments and sector performance is based on the contentious background to valuations highlighted in 5.2 and 5.3 above. One owner is cited as criticising valuers as ‘believing their own bullshit’. However, nowhere is self (and arguably public) delusion more perpetuated than in the valuation reports that owners willingly proffer for collation in the indices of the Property Council and others.

5.4.4 Property Research

This research comprises a new domain of enquiry, being the first in-depth qualitative study to incorporate the views of valuers, owners, developers, managers, architects and an analyst involved in the investment appraisal of enclosed regional shopping centres. As a qualitative study it adds to the evolving body of qualitative research in the area of property investment. It
is the first property investment research to satisfactorily utilise Q.S.R. NUD•IST™ to handle, process and analyse non-numerical unstructured data. The research demonstrates the value of non-numerical data to the existing body of property research knowledge. The depth of participant (expert) knowledge that the unstructured interview process, based on conceptual frameworks, elicited was significant. The interview process demonstrated an interesting synergy, whereby it took on average 10 – 15 minutes for the researcher to put the ‘expert’ at ease and establish a level of mutual respect and trust in the interview being recorded. The process allowed for a very open, detailed, often-explicit dialogue to develop whereby significant confidences were shared with the researcher, safe in the knowledge that the data processing would ensure that comments could not be directly traced back to the ‘expert’.

5.5 Implications for policy and practice

The evolved conceptual framework presented for the Valuer (Figure 4-1) provides a significant additional resource to the due diligence process that should be addressed by the competent property professional advising on the investment appraisal of enclosed regional shopping centres. As a model it provides an annotated checklist of issues to consider and pitfalls to avoid based on the analysis of data which represents 100% representation of ‘experts’ with significant experience in the investment appraisal of enclosed Australian regional shopping centres.

Similarly, the evolved Owner conceptual framework allows benchmarking by owners on where they stand in relation to processes and investment strategy in comparison to their competition. The annotated model facilitates cross-referencing to the summarised nodal information.

5.6 Limitations

The data-collection and subsequent analysis undertaken for this thesis comprehensively incorporates the views and experience of the key players in the investment appraisal of enclosed regional shopping centres within Australia. This included interviews with owners, developers, managers, architects, an analyst and valuers that provided information from which the significant and original conclusions have been derived.
If looked at from a cynical perspective, there are those who may argue that this research confirms what many people already privately thought. However, the thorough methodology and analysis undertaken has served to test such concerns, it has theoretically confirmed many the issues and identified others, and thus has significantly and publicly contributed to the body of knowledge in this investment area.

Whilst the ‘experts’ sampled in this survey represent the significant proportion of players in this investment sector, the resource limitations of time and distance (and thus cost in Australia) meant that respondents were limited to those who had been actively involved in three or more regional shopping centres. Furthermore, as the majority of these players were accessible for interview in Brisbane and Sydney, interviews were limited to these two State Capitals rather than extending the interviews to some of the smaller players in Adelaide, Melbourne or Perth.

As a result, the views of the owners are within an oligopolistic framework, whereas investors with less than three regional centres may ultimately have different rationale for being involved in this property sector. The inference from the analysis is that the smaller (in terms of centre ownership) are, in any event, significantly influenced by the actions of those represented in the research – that is the other owners and the valuers who represent them.

5.7 Further research

This research has identified unreasonable expectations that are placed on the valuer in the investment appraisal of enclosed regional shopping centres. Therein lies a dilemma. It was contended that it is unreasonable for a valuer to serve as arbiter of value within the framework pervading in this sector within the current property investment market. But who then is to determine value, if not the valuer? It is an area for the property professions to embrace, to set a clear basis on which value can be reasonably estimated for the purposes of investment appraisal. The forms of depreciation and obsolescence outlined in the literature have had a new category added, that of Competition Depreciation.

In addition to depreciation, this research highlights implications for theory (5.4) in the areas of appraisal, portfolio strategy and property research. Of these it is the area of risk terminology, quantification and determination within the appraisal area that requires the most urgent determination. The empirical data clearly demonstrates that confusion currently abounds
within the marketplace. It is an area where professional bodies such as the AIVLE should take the lead, in conjunction with their overseas counterparts, in today’s global market.

Whilst objectivity should philosophically and ethically be the byword of all valuers, this research demonstrates the conflicts and pressures which contrive to challenge that view. Through the publication of this research and the open discourse that must follow, the issues presented will have the opportunity to be publicly aired and debated within professional fora. It is the supportive realisation through understanding this research that valuers, in proffering their independent professional advice, share the same challenges and influences as their peers. Such realisation is likely to invoke a group support ethic that will facilitate greater objectivity and a more reliable approach to the valuation process from within. Valuers compete for work (professional instructions) in a business environment, so it is inevitable that whatever high morals are put forward by professional institutions there will still be those who are influenced by client pressure in an oligopolistic market. Now that such pressures are clearly outlined herein, the investment market and the courts will inevitably take a much closer look at the due diligence process undertaken by the valuation profession. The application and use of the evolved conceptual frameworks (Figures 4-1 and 4-2) will serve as a valuable reference in preparing their advice. Such external influence should, in a reasonably short time span, also contribute to a more objective and reliable approach to the valuation process.

This thesis highlighted aspects of risk, growth and depreciation. Risk and depreciation have been mentioned above. The area of growth (or rather forecast growth) highlights the importance of further work into forecasting in investment appraisal in general and regional shopping centres in particular. There is scope for a quantifiable model to be developed to forecast market variations during the term of a discounted cash flow.

Much of the background literature for this thesis was drawn from the US and UK markets. The empirical research presented takes an Australian perspective, albeit that several of the interviewees had an UK background. The Australian regional shopping centre bears greater similarity to the US market, only on a much smaller scale with a significantly smaller population base. There is scope to utilise the same methodology in both the US and the UK to qualify the extent to which the same results are forthcoming within a different economy where retail has not performed as successfully in recent years.
References: Chapter 5


BIBLIOGRAPHY


Adams, S. (1776) Oration said to have been delivered at Philadelphia, 1 August 1776, cited in Oxford Dictionary of Quotations (3e) (1985), Oxford University Press.


63 – 78.


BOMA (1996) *Australia Shopping Centre Database* (version dated 01/05/96), Building Owners and Managers of Australia, Sydney.


Gladstone Associates (1976) *Shopping Center Useful Lives an economic analysis*, prepared for the National Retail Merchants Association (NRMA), New York.


Harrington, A. (1995b) “Stamp duty - a barrier to investment”, in *Building Owner & Manager*, July
1995, the journal of the Building Owners and Managers Association of Australia, Sydney.


ICSC (undated) *ICSC Shopping Center Definitions*, Published by the International Council of Shopping Centres, New York, US. The ICSC librarian provided this in April 1995.


Trimboli, F. (ed.) (1979) A Glossary of Terms used in Real Estate and Valuation Practice (2e), The Real Estate Institute of Australia, Canberra.


Turner, N.J.K. (1995) Tenant Environmental Performance and Property Investment – the Use of


Wilson, D.J. (1991) “Elements of the Capitalization Rate”, in The Canadian Appraiser, Fall 1991,
pp. 10-14.


Software References:

**ATLAS/ti**, (Release 1.1E) designed by Muhr, T., Scientific Software Development, Trautenaustr. 12, D-10717 Berlin, Germany.

**The Ethnograph**, (Version 4.0) designed by Seidel, J.V., Qualis Research Associates, PO Box 2070, Amherst, MA 01004, US.

**NUD·IST**, (Version 3.0) designed by Richards, T. & Richards, L., Qualitative Solutions & Research Pty. Ltd., Box 171a La Trobe University Post Office, Vic.3083, Australia.
Appendix One: Meeting with AMP Property Investments

Outline of meeting with AMP Property Investments in

This meeting formed the basis of progressive research interest and support by AMP, the largest Superannuation fund in Australia. I ran the session as a seminar and one of the key outcomes was to rebuild the existing AMP model.

The key findings from the meeting indicated a difficulty within the Triple YP or shortcut DCF in an Australian environment where indexation to CPI (consumer price index) annually and rent reviews to market value every two or three years is the norm. This is more in accordance with the US lease structuring and at odds with the institutional UK lease where the 5 year upwards only traditional rent review pattern makes for a significant staircasing of rentals over time. By comparison, the real value rental growth graph in Australia for major retail investments is considerably smoother.

The AMP model is considered (by them/AMP) to be among the best in Australia. It has been evolved by the valuers in the property team on Lotus 123 and Excel rather than using outside consultants to develop a model and then educate the staff. As such it is subject to constant refinement. The team acknowledged its inherent weaknesses in:

- ignoring depreciation;
- ignoring acquisition and disposal costs (although this is a contentious issue in that such additional outgoings would significantly prejudice perceived performance - to develop this issue {maybe elsewhere} stamp duty on property transactions runs at 5.35% of the cost of a building compared to 0.15% on the cost of shares. Thus property stamp duty is 1683% higher than on shares and as such cannot be ignored in a comparative calculation of IRR (Harrington, 1995, p.6)
- funding/finance is ignored. This is of particular significance in the case of the Centenary/Mt. Ommaney Centre on the outskirts of Brisbane where $50 million has just been injected into the centre increasing its book value from $50 m. - $100 m. However, the cost or value of the money utilised in the extension has been ignored because "it happened to be available in that particular fund". The political reason is the real cause however, in that it would be prejudicial to the total return figures and hence the portfolios marketing ability to account for a return on borrowing requirement.

The key outcome of the meeting was a mutual appreciation of depreciation as the key issue. The direction is thus to undertake research of the existing 65 Australian regional + centres to attempt to draw some life cycle conclusions and concrete data to allow the depreciation prone growth explicit valuation model to be more accurately constructed.
Towards a Rational Model

AMP Investments

Sydney

18 - 19 May 1995

Bill Toxward (Head of Property Valuations, AMP)
Jeremy Apted (AMP, Brisbane)
Mark Flockhart (AMP, Sydney)
Tim Stringer (AMP, Melbourne)
Spike Boydell (University of Queensland)

Venue: 20th. Floor, "old" AMP Building, 33 Alfred St., Sydney
09:30 Thursday 18 May

Context:

At Jeremy Apted's behest I set out below a suggested agenda for our meeting which I hope will be informal, stimulating and mutually beneficial. What follows may look like a lengthy list of issues, but in summary they centre around the three key aspects of life cycle, income receipt timing and yield/analysis and how they affect the valuation. I have tried to give them some order but obviously there is some overlap. Many of the aspects are no doubt currently accounted for in your valuation approaches, either explicitly or at a "gut" level. The purpose of spelling them out is to provide a forum to assess their practicality, significance and applicability. Hopefully we shall be able to devote the bulk of our time together to item 4 - Valuation modelling.

As I mentioned in earlier correspondence, the value, or otherwise, of modelling techniques can only be qualified if they are tested and critically examined against current practice on real, as well as hypothetical, scenarios. Indeed, the research outcomes are equally valid if current practice is proven more realistic or useful than applied contemporary techniques.

Jeremy also talked of including a speaker on demographic forecasting/ABS/GIS and I have provided some comments, suggestions separately. From a personal point of view I would benefit from a site inspection of the Macquarie Shopping Centre as it will put the valuation that I have received in context and also serve as a useful vehicle to discuss the "on-site issues" as well as getting us out of the office/seminar environment for a while.

I will leave the timing up to you as other than meeting you at 09:30 on Thursday 18 May and catching an 18:00 plane back to Brisbane on Friday 19 May, my time is flexible.
1. **Life Cycle:**

(a) Determining a centres position on the life cycle

(b) Forecasting for general maintenance

(c) Forecasting for major refurbishment/upgrade (approx. 15 years?)

(i.) Projecting costs

(ii.) Funding the costs (micro - property cash flow)

(macrol - from the portfolio)

(external - other fund or bank)

(iii.) Spreading the costs (through whole DCF period)

(until end of DCF)

(over 10 years or 15 year cycle)

(iii.) Optimal equipment replacement analysis

(iv.) Obsolescence (dependent on effectiveness of 1.c above)

(v.) Accounting for depreciation in the cash flow

(vi.) Dealing with depreciating reversionary value (ie. year 11 capitalisation)

(vii.) Relevance of capitalising reversion into perpetuity

(viii.) Residual site value

(e) Competition

(i.) Impact of planning consents for other centres

(ii.) Demographic modelling/projections

(iii.) Isochrone modelling/gravity modelling

(f) Lease structures

(i.) Security of anchor beyond year 15 in a 20/21 year lease

(ii.) Security of majors/nationals if competing centre proposed
2. **Income Receipt Timing**

(a) Traditional approach

(i.) income annually in arrears
(ii.) overage incorporated for same year end
(iii.) expenditure grouped annually
(iv.) acquisition timing (year zero) for NPV?

(b) Contemporary ideals

(i.) income monthly in advance
(ii.) overage as received, 15 months in arrears
(iii.) expenditure as incurred
(iv.) monthly, quarterly, half yearly, annually, less frequently

3. **Yield Analysis**

(a) Are valuers the historians and investment advisers the forecasters?

(b) Relevance of "comparable" transactions

(i.) As you analyse so you value
(ii.) Are "comparable" sales analysed by DCF or simple decapitalisation
(iii.) What is comparable?
(iv.) other shopping centre valuations
(v.) other shopping centre sales
(vi.) other property investments
(vii.) other non-property investments

(c) **Risk/Return**

(d) Basis of target IRR

(i.) other shopping centre valuations
(ii.) other shopping centre sales
(iii.) other property investments
(iv.) other non-property investments
(e) Purpose of including shopping centre in portfolio
(i.) abnormal positive returns
(ii.) negative correlation/diversification
(iii.) flock mentality

(e) Equated yields, IRR's & NPV's

(f) Inflation risk free yields (IRFY)
(i.) towards a rational approach

4. Valuation Modelling

(a) The AMP "model"
(i.) origin
(ii.) evolution
(iii.) sensitivity
(iv.) applicability
(v.) backsolving yield analysis
(vi.) in practice:

Knox City Shopping Centre, Melbourne
Macquarie Shopping Centre, Sydney
Centenary/Mt. Ommaney Shopping Centre, Brisbane

(b) Traditional approaches
(i.) Simple capitalisation (Years Purchase in perpetuity)
(ii.) DCF approaches:

Growth

yields/equated yields/IRR's

holding period

(iii.) Fee valuer/appraiser approaches
(iv.) Commercial Models (US approach)

Project Plus & Project "C"
(c) Contemporary approaches - "Advanced Valuation Techniques"

(i.) Growth

Rental growth versus real value growth
Inflation prone/inflation proof
Inflation
Growth/inflation forecasts - econometric models
Asset Depreciation

(ii.) Yields - the IRFY approach

(iii.) Shortcut DCF's - the "Triple YP"

(iv.) Towards a rational model

5. Speaker on demographic/ econometric forecasting/ ABS/ GIS

6. Site visit to Macquarie Shopping Centre and other topical schemes

7. Conclusion

(a) Summary of prime issues

(b) Learning outcomes

(c) Future directions

Spike Boydell, 11 May, 1995
Appendix Two: Overseas Travel Report

Overseas Travel Report

PhD Research Study Tour & Singapore Conference

31 March - 30 April 1995

This paper sets out the learning outcomes of my recent study tour. It was undertaken as part of my Qualifications Upgrading Scholarship.

San Francisco (31 March - 5 April)

The weekend was used for shopping centre visits and market familiarisation. I was provided with accommodation at the Faculty Club, University of California Berkeley. I met with Mike Yovino-Young a highly regarded Berkeley appraiser and vice-Chairman of FIG (Federation International Geometers) on the Saturday.

Monday was spent with Professor Bob Edelstein, Co-Chair of the Real Estate Group, University of California Berkeley. Also Nancy Wallace (Assistant Professor Economic Analysis & Policy), Professor John Quigley, Chair Economics Group. I took part in a PhD seminar which was fronted by George Galster from Urban Institute, Washington DC, who delivered a paper "What do we know about racial discrimination in mortgage markets." I was entertained by the Real Estate Group in the evening.

Tuesday, discussions with Michael Yovino-Young on appraisal methodology - and FIG programme.

Atlanta (5 - 8 April)

Meeting with professors James Vernor & Joseph Rabianski, Georgia State University to discuss and develop their recent allied publication "Shopping Centre Appraisal and Analysis" and have access to certain of their research data and library. Attended Appraisal Institute meeting with James Vernor and agreed to undertake some collaborative research.

Meeting with Chuck Walsh, Rebecca Carr & Lorena Redding of Landauer, fee appraisers, to
discuss computerised appraisal packages and applied methodology for enclosed shopping centres.

Meeting with Don Burns and David Denney of Equitable Real Estate Investment to discuss appraisal issues in relation to their 75+ enclosed shopping centres in an 800 property portfolio (US$ 3 billion) and the application of ProJect, Argus and DynaLease computing software.

Enclosed shopping centre visits.

**New York** (8 - 13 April)

Library research at International Council of Shopping Centers members library - 2 days. Librarian Susan Pistilli.

Meeting with Perry Suddith, Jones Lang Wooton, to discuss appraisal methodology.

Meeting with Kevin Gray, Landauer, to discuss appraisal methodology.

Meetings with Professor Arthur Zabarkes, Dean of Real Estate, and Visiting Professor Donald Bleich, New York University to discuss appraisal issues.

Enclosed shopping centre visits.

**Denver** (18 - 19 April)

Meeting with Professor Mark Lee Levine, acting Professor of Real Estate & Construction Management, University of Denver and discussions on appraisal issues and Denver Software Testing Center, the main real estate appraisal testing unit in the US.

**London** (20 - 22 April)

Meetings with John Milligan, Mark Morgan, John Buckingham and James Hamilton Stubber of Jones Lang Wooton. They invited me to advise on the British Council of Shopping Centres working party into the investment appraisal of enclosed shopping centres.

Meeting with Meirion Griffiths and Nathan Thompson of MEPC property fund in connection with their shopping centre holdings.
Singapore (23 - 29 April)

International Congress on Real Estate 24-26 April. Paper 'Shopping Centres - Their Role in Strategic Property Portfolio Management' in session 3, Monday 24 April.

Pacific Asia property research Conference 27-29 April. Paper 'Investment Appraisal of Enclosed Shopping Centres - The Life Cycle Problem' in session 10, Saturday 29 April.

Meeting with Prof. Neil Crosby, University of Reading, PhD supervisor - Prof. Crosby also had papers at both conferences.

Singapore provided an excellent forum to discuss my research issues with other UK, US, Australian and Singapore academics and practitioners.

Enclosed shopping centre visits.

Learning Outcomes

The study tour, whilst demanding, served to tie up many lose ends within the research and exposed me to the US market. I had the opportunity to discuss research issues at length with interested academics and practitioners as well as accessing library resources unavailable in Australia. There is a growing awareness and concern over the issues that my research highlights in relation to the shopping centre life cycle, income receipt timing and yield analysis.

Spike Boydell

11 May, 1995
Appendix Three: ‘Expert’ Interviewees

Contributors/participants in “Expert” Interviews:
October - December 1996

Alan Fife, Landauer Grant Samuel, 28/10/96
Andrew Buckingham, Richard Ellis, 28/10/96
Bill Toxward, AMP, 29/10/96
Brian Waghorn, McGees, 04/12/96
Chris Burns, Stanton Hillier Parker, 30/10/96
Des Kahn, Westfield Trust, 30/10/96
Eric Staminer, Knight Frank, 29/10/96
Henry Peel, Architect, Cameron Chisholm & Nicol, 16/12/96
James Whealing, Brady Whealing, 29/10/96
Jim Long, AMP Developments, 04/12/96
John Burdekin, Jones Lang Wootton 28/10/96
Keith Goddard, Knight Frank, 29/10/96
Michael O’Brien, Lend Lease, 29/10/96
Peter Jeffries, Byvan, 20/12/96
Rashmi Mehrotra, Purvis Van Eyk, 30/10/96
Roger Fairweather, Schroders, 28/10/96
Steve Bridges, Byvan, 06/12/96
Steven Leigh, QIC, 04/12/96
Trevor Gerber, Westfield Trust, 30/10/96

The open, willing and frank participation of these 19 Experts is fully acknowledged and appreciated. This thesis could not have been completed without their involvement.
Appendix Four: Shopping Centre Classifications

Shopping Centre Classifications

Shopping Centre Directories Definitions:

The revised system (1995) comprises six (6) core and three (3) specialist classifications. Core classifications appear in all BOMA directories. Specialist classifications are included in directories at the discretion of BOMA’s local state or territory ACSC committee.

Each classification contains a definition of the centre type and a summary of key features.

A. Core Classifications

1. City Centres

Definition:
Retail premises within an arcade or mall development owned by one company, firm or person and promoted as an entity within a major Central Business District. Total gross lettable area retail exceeds 1,000 square metres.

Key Features:
• dominated by specialty shops;
• likely to have frontage on a mall or major CBD road;
• generally do not include supermarkets; and,
• often co-exist with large department stores.

2. Super Regional Centres

Definition:
A major shopping centre typically incorporating two full line department stores, one or more full line discount department stores, two supermarkets and around 250 specialty shops. Total gross lettable area exceeds 85,000 square metres.

Key features:
• one stop shopping for all needs;
• comprehensive coverage of the full range of retail needs (including specialised retail), containing a combination of full line department stores, full line discount department stores, supermarkets, services, chain and other specialty researchers;
• typically include a number of entertainment and leisure attractions such as cinemas, arcade games and soft play centres; and,
• provide a broad range of shopper facilities (car parking, food court) and amenities (rest rooms, seating).

3. Major Regional Centres

Definition:
A major shopping centre typically incorporating at least one full line department store, one or more full line discount department stores, one or more supermarkets and around 150 specialty shops. Total gross lettable area retail generally ranges between 50,000 and 85,000 square metres.
Key features:
- one stop shopping for all needs;
- extensive coverage of the full range of retail needs (including specialised retail), containing a combination of full line department stores, full line discount department stores, supermarkets, services, chain and other specialty retailers;
- typically include a number of entertainment and leisure attractions such as cinemas, arcade games and soft play centres; and,
- provide a broad range of shopper facilities (car parking, food court) and amenities (rest rooms, seating).

4. Regional Centres

Definition:
A shopping centre typically incorporating one full line department store, a full line discount department store, one or more supermarkets and around 100 or more specialty shops. Total gross lettable area retail typically ranges between 30,000 and 50,000 square metres.

Key features:
- extensive coverage of a broad range of retail needs (including specialised retail), however, not as exhaustive as major regional centres;
- contains a combination of full line department stores, full line discount department stores, supermarkets, banks, chain and other specialty retailers; and,
- provide a broad range of shopper facilities and amenities.

5. Sub-Regional Centres

Definition:
A medium sized shopping centre typically incorporating at least one full line discount department store, a major supermarket and around 40 or more specialty shops. Total gross lettable area retail will typically range between 10,000 and 30,000 square metres.

Key features:
- provide a broad range of sub-regional retail needs; and,
- typically dominated by a full line discount department store or major supermarket.

6. Neighbourhood Centres

Definition:
A local shopping centre comprising a supermarket and up to around 35 shops. Total gross lettable area will typically be less than 10,000 square metres.

Key features:
- typically located in residential areas;
- service immediate residential neighbourhood;
- usually have extended trading hours; and,
- cater for basic day to day retail needs.
B. Specialist Classifications

1. Showroom-Warehouse Centres

**Definition:**
A medium to large sized shopping centre dominated by bulky goods retailers (furniture, white goods and other housewares), occupying large areas to display merchandise. Typically contain a small number of specialty shops.

**Key features:**
- generally located adjacent to large regional centres or in non-traditional retail locations (ie. Greenfield sites and industrial areas);
- purpose designed, built and operated, generally with a layout of outlets around a central landscaped area and an overall design and colour theme to promote the appearance of an integrated development; and,
- generally greater than 5,000 (GLAR) square metres in size.

2. Themed Centres

**Definition:**
A specialty shopping centre located primarily in resort areas to cater for specialist tourist needs, which does not normally include a supermarket.

**Key features:**
- resort/tourist style development;
- size of centre is not a determining factor; and,
- comprises mainly specialty shops with food courts.

3. Markets

**Definition:**
A covered centre of at least 5,000 square metres dominated by food retailing with at least 50 stalls or outlets. It operates on a permanent or irregular basis.

**Key features:**
- includes areas with refrigeration facilities and air conditioning as well as areas without these facilities.

US Classifications

**Regional Center:**
This center type provides general merchandise (a large percentage of which is apparel) and services in full depth and variety. Its main attractions are its anchors: traditional, mass merchant or discount department stores or fashion speciality stores. A typical regional center is usually enclosed with an inward orientation of stores connected by a common walkway, and parking surrounds the outside perimeter.

**Concept:** General merchandise fashion (Mall, typically enclosed)
**Sq.ft inc anchors:** 400,000 - 800,000  (37,161m$^2$ - 74,322m$^2$)
**Acreage:** 40 - 100  (16.2ha - 40.5ha)
Typical Anchor(s):
Number: 2 or more
Type: Full-line dept. store; jr. dept. store; mass merchant; disc. dept. store; fashion apparel
Anchor ratio\(^a\): 50 - 70%
Primary trade area\(^b\): 5 - 15 miles (8 - 24 kilometres)

\(^a\) The share of a center's total square footage that is attributable to its anchors
\(^b\) The area from which 60 - 80% of the center's sales originate

**Superregional Center:**

Similar to a regional center, but because of its larger size, a superregional center has more anchors, a deeper selection of merchandise, and draws from a larger population base. As with regional centers, the typical configuration is an enclosed mall, frequently with multi-levels.

Concept: Similar to Regional Center but has more variety and assortment
Sq.ft inc anchors: 800,000 + (74,322m\(^2\) +)
Acreage: 60 - 120 (24.3ha - 48.6ha)

Typical Anchor(s):
Number: 3 or more
Type: Full-line dept. store; jr. dept. store; mass merchant; fashion apparel
Anchor ratio\(^c\): 50 - 70%
Primary trade area\(^d\): 5 - 25 miles (8 - 40 kilometres)

\(^c\) The share of a center's total square footage that is attributable to its anchors
\(^d\) The area from which 60 - 80% of the center's sales originate
Appendix Five: Regional Centres Refurbishment/Extension Profile

Refurbishment/extension profile of 72 Regional + Shopping Centres

Source: BOMA (1996) Australian Shopping Centre Database (version dated 01/05/96), Building Owners and Managers Association, Sydney.

<table>
<thead>
<tr>
<th>Centre Name</th>
<th>Date Centre Opened</th>
<th>First Centre Extension</th>
<th>Second Centre Extension</th>
<th>Third Centre Extension</th>
<th>Fourth Centre Extension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Westfield Shoppingtown Arndale</td>
<td>1963</td>
<td>1970</td>
<td>1984</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Warringah Mall</td>
<td>1963</td>
<td>1986</td>
<td>1990</td>
<td>1992</td>
<td></td>
</tr>
<tr>
<td>Forest Hill Chase Shopping Centre</td>
<td>1964</td>
<td>1975</td>
<td>1989</td>
<td>1990</td>
<td></td>
</tr>
<tr>
<td>Carlingford Court Shopping Centre</td>
<td>1965</td>
<td>1971</td>
<td>1978</td>
<td>1989</td>
<td></td>
</tr>
<tr>
<td>Garden City Kotara</td>
<td>1965</td>
<td></td>
<td>1988</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Westfield Shoppingtown Burwood</td>
<td>1966</td>
<td>1972</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Elizabeth City Centre</td>
<td>1966</td>
<td>1982</td>
<td>1985</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eastland Shopping Centre</td>
<td>1967</td>
<td>1993</td>
<td>1994</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Westfield Shoppingtown Marion</td>
<td>1968</td>
<td>1982</td>
<td>1989</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Westfield Shoppingtown Southland</td>
<td>1968</td>
<td>1987</td>
<td>1990</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Garden City</td>
<td>1970</td>
<td>1986</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Castle Plaza</td>
<td>1970</td>
<td>1987</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brookside Shopping Centre</td>
<td>1971</td>
<td>1985</td>
<td>1991</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rockingham City</td>
<td>1971</td>
<td>1990</td>
<td>1995</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Garden City - Booragoon</td>
<td>1972</td>
<td>1983</td>
<td>1994</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Westfield Shoppingtown Liverpool</td>
<td>1972</td>
<td>1991</td>
<td>1993</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bayside Shopping Centre</td>
<td>1972</td>
<td></td>
<td>1994</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Continues…
<table>
<thead>
<tr>
<th>Centre Name</th>
<th>Date</th>
<th>Centre Opened</th>
<th>First Centre Extension</th>
<th>Second Centre Extension</th>
<th>Third Centre Extension</th>
<th>Fourth Centre Extension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Karrinyup Shopping Centre</td>
<td>1973</td>
<td>1982</td>
<td>1987</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marketown Mt Druitt</td>
<td>1973</td>
<td>1987</td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Belmont Forum Shopping Centre</td>
<td>1974</td>
<td>1992</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Highpoint Shopping Centre</td>
<td>1975</td>
<td>1995</td>
<td>1989</td>
<td>1993</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Westfield Shoppingtown Bondi Junction</td>
<td>1976</td>
<td>1987</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Knox City Shopping Centre</td>
<td>1977</td>
<td>1990</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Whittford City Shopping Centre</td>
<td>1978</td>
<td>1985</td>
<td>1990</td>
<td>1993</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Greensborough Plaza</td>
<td>1978</td>
<td>1990</td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mirrabooka Square Shopping Centre</td>
<td>1978</td>
<td>1990</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Charlestown Square</td>
<td>1979</td>
<td>1983</td>
<td>1989</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Carindale Shopping Centre</td>
<td>1979</td>
<td>1984</td>
<td>1991</td>
<td>1995</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Macarthur Square Shopping Centre</td>
<td>1979</td>
<td>1987</td>
<td>1989</td>
<td>1990</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Colonnades Shopping Centre</td>
<td>1979</td>
<td>1989</td>
<td>1991</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Castle Towers Shopping Centre</td>
<td>1979</td>
<td>1989</td>
<td>1992</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mt Ommanney Centre</td>
<td>1979</td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Northgate Shopping Centre</td>
<td>1979</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sunshine Plaza</td>
<td>1980</td>
<td>1993</td>
<td>1994</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capalaba Park Shopping Centre</td>
<td>1981</td>
<td>1985</td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Macquarie Shopping Centre</td>
<td>1981</td>
<td>1992</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chatswood Chase</td>
<td>1983</td>
<td>1994</td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Toowong Village</td>
<td>1986</td>
<td>1992</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tuggeranong Hyperdome</td>
<td>1987</td>
<td>1991</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Erina Fair</td>
<td>1987</td>
<td>1993</td>
<td>1994</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Westfield Shoppingtown Eastgardens</td>
<td>1987</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dandenong Plaza</td>
<td>1989</td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Logan Hyperdome</td>
<td>1989</td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grand Plaza</td>
<td>1994</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Westfield Shoppingtown Tuggerah</td>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Robina Town Centre</td>
<td>1996</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Appendix Six: Shopping Centre ‘Players’

OWNERS

Source: analysed for this research from BOMA (1996)
DEVELOPERS

Source: analysed for this research from BOMA (1996)

305
CENTRE MANAGERS

Source: analysed for this research from BOMA (1996)
ARCHITECTS

Source: analysed for this research from BOMA (1996)
Appendix Seven: Letter of Introduction to ‘Experts’

A Qualitative Analysis of Risk, Growth and Depreciation in the Investment Appraisal of Enclosed Regional Shopping Centres

Spike Boydell Ph.D. thesis

Expert Interviews (background)

The hypothesis centres on the three key aspects of risk, growth and (specifically) depreciation as they affect the investment appraisal of enclosed regional shopping centres. There are seventy-two regional (or larger) enclosed shopping centres in Australia. They have a total investment value of c. $14 billion. It is a high performing sector, yielding the best returns in Australian property over the last 10 years. Diversification is restricted at this level of investment with only seven funds owning three or more centres. It is valid and pertinent to "triangulate" both analysis and theory by undertaking some complementary quantitative analysis of available data. Available Property Council of Australia return data will be so analysed. By triangulating, or combining, these two approaches to the research problem the validity of the conclusions are enhanced if there is evidence of mutual confirmation. A qualitative, grounded theory, approach allows the only true empirical insight into this sector. Interviews (approximately 45 - 60 minutes) with key participants are recorded and transcribed, while maintaining full confidentiality and anonymity. The data collection focuses on semi-structured interviews (see enclosed conceptual framework) with:

* owners seven owning three or more centres
* developers five developing three or more centres
* managers seven managing three or more centres
* architects six designing three or more centres
* appraisers five valuing three or more centres

These interviews allow for the analysis of the key participants (experts) views on risk, growth and specifically depreciation. These are the three key components of investment appraisal within discounted cash flow analysis. Empirical data are to be analysed using NUD·IST\textsuperscript{TM} which stands for Non-numerical Unstructured Data Indexing Searching and Theorizing. It is a reasonable assertion that the analysed data, which are based on current practice and recent professional experience will have historic roots. In contrast, the evolution of theory allows a development forward based on this grounding. The detailed background papers will be provided at the interview.

Spike Boydell is Lecturer in Property Investment at the University of Queensland, Australia. Co-author of the Financial Times Management Report Property in your portfolio - the role of property as an investment medium he lectures in the areas of property investment, development and advanced valuation. He is a member of the Royal Institution of Chartered Surveyors (ARICS), Pacific Rim Real Estate Society (PRRES), the American Real Estate Society (ARES), The American Real Estate and Urban Economics Association (AREUEA) and the Property Council of Australia (PCA). He has also been invited to sit on the AIVLE Practice Standard Review Board.

Telephone: 07 5465 2054    Fax: 07 5460 1171    EMail: sb@burger.uqg.uq.oz.au
Address: Spike Boydell, Lecturer in Property Investment, Dept. of Business Studies, University of Queensland, Gatton College, Qld. 4345.
Appendix Eight: Nodal References

Sample NUD•IST™ Screen View

The following comprise the total Nodal listings for this research. As outlined in the body of the report, the Valuer and Owner nodes have most referencing. These nodes include referencing from the other ‘experts’. Node 1 (Overview) and its ‘children’ was not used in the final analysis as it would have incorporated all data.
### Overview

**Definition:**
Overview (including analyst commentary)
This node indexes 0 documents.

#### Motive

**Definition:**
Developer motivation
This node indexes 0 documents.

#### Process

**Definition:**
Commentary on the development process
This node indexes 0 documents.

#### WhyRetail

**Definition:**
Merits of retail development over other sectors
This node indexes 0 documents.

#### Software

**Definition:**
Nature of development appraisal models
This node indexes 0 documents.

#### Return

**Definition:**
Node to balance "Depreciation" position
This node indexes 0 documents.

##### Depreciation

**Definition:**
The impact of depreciation
This node indexes 0 documents.

#### Lifecycle

**Definition:**
Anticipated lifespan
This node indexes 0 documents.

##### Main Structure

**Definition:**
Anticipated lifespan of main structure
This node indexes 0 documents.

##### Retrofit

**Definition:**
Lifespan before major refurbishment or lesser retrofit
This node indexes 0 documents.
Overview/Lifecycle/Funding
*** Definition:
How refurbishment is funded (years income or whole portfolio income)
This node indexes 0 documents.

Overview/Lifecycle/Yieldimp
*** Definition:
Impact of refurbishment on yields
This node indexes 0 documents.

Overview/Lifecycle/OrigLife
*** Definition:
Original planned lifespan
This node indexes 0 documents.

Overview/Lifecycle/Horizon
*** Definition:
Investment Horizon (could be notional holding period)
This node indexes 0 documents.

Overview/Forecasting
*** Definition:
Research approach & resources
This node indexes 0 documents.

Overview/Future
*** Definition:
Future directions
This node indexes 0 documents.

Overview/Misc
*** Definition:
Miscellaneous relevant commentary
This node indexes 0 documents.

Overview/Misc/Cinema
*** Definition:
Influence & Impact of Cinemas
This node indexes 0 documents.

Overview/Misc/M&S
*** Definition:
The Marks & Spencer enigma
This node indexes 0 documents.

Overview/Misc/Internat
*** Definition:
International perspectives: AIVLE/RICS/MAI
This node indexes 0 documents.

Overview/Misc/Service
*** Definition:
As in the service customers expect
This node indexes 0 documents.

Overview/Misc/Gambling
*** Definition:
Impact of gambling on consumer $
This node indexes 0 documents.

Overview/Misc/Investment Vehicle
*** Definition:
Redevelopment allows opportunity income to market, build, architect, lease
This node indexes 0 documents.

Overview/Misc/Robina
*** Definition:
The New (1996) Robina Town Centre Super Regional
This node indexes 0 documents.

Overview/Misc/Corrupt
*** Definition:
The grey area (possibly corruption)
This node indexes 0 documents.
(1 9 9) /Overview/Misc/Negligence
*** Definition:
The potential litigation for current and past approaches
This node indexes 0 documents.

(1 10) /Overview/Relate
*** Definition:
Relationship with Owner, Manager, Architect, Valuer
This node indexes 0 documents.

(2) /Valuer
*** Definition:
Valuation Practitioner, Appraiser
This node indexes 5 documents.

(2 1) /Valuer/Ann Val Process
*** Definition:
Motivation for annual valuation process
This node indexes 10 documents.

(2 1 1) /Valuer/Ann Val Process/Knowledge
*** Definition:
Why instructed/specialism
This node indexes 12 documents.

(2 1 1 1) /Valuer/Ann Val Process/Knowledge/Indep
*** Definition:
Independent Valuer (no management or sale conflict)
This node indexes 2 documents.

(2 1 1 2) /Valuer/Ann Val Process/Knowledge/Player
*** Definition:
Active in management/leasing/sales/invest advice
This node indexes 2 documents.

(2 1 2) /Valuer/Ann Val Process/Pressure
*** Definition:
Pressure to meet client expectations
This node indexes 7 documents.

(2 2) /Valuer/AIVLE DCF Guidelines
*** Definition:
Relationship & understanding of 1996 AIVLE DCF Practice Standard
This node indexes 8 documents.

(2 3) /Valuer/10 Year Model
*** Definition:
Nature of model adopted, eg. 10 year with assumed sale adopting year 11 i
This node indexes 9 documents.

(2 3 1) /Valuer/10 Year Model/AdvanceArrears
*** Definition:
Valuations calculated in advance/arrears
This node indexes 7 documents.

(2 3 2) /Valuer/10 Year Model/Period
*** Definition:
Monthly/Quarterly/Annually etc.
This node indexes 6 documents.

(2 3 3) /Valuer/10 Year Model/CapRate
*** Definition:
Paranoia over DCF or initial approach
This node indexes 3 documents.

(2 3 4) /Valuer/10 Year Model/TenantXT
*** Definition:
Tenant by tenant approach
This node indexes 4 documents.

(2 4) /Valuer/Software
*** Definition:
Lotus, Excel, Quattro Pro, Project
This node indexes 7 documents.
<table>
<thead>
<tr>
<th>Path</th>
<th>Definition</th>
<th>Indexes</th>
</tr>
</thead>
<tbody>
<tr>
<td>(2 4 1) /Valuer/Software/Designer</td>
<td>Who designed package</td>
<td>8</td>
</tr>
<tr>
<td>(2 4 2) /Valuer/Software/Client specified</td>
<td>Client guidance, restrictions</td>
<td>2</td>
</tr>
<tr>
<td>(2 4 3) /Valuer/Software/Project</td>
<td>Commentary on use of Project &quot;Plus&quot; &amp; &quot;C&quot;</td>
<td>6</td>
</tr>
<tr>
<td>(2 5) /Valuer/Return</td>
<td>Determinants of return</td>
<td>3</td>
</tr>
<tr>
<td>(2 5 1) /Valuer/Return/Yields</td>
<td>Definition and related understanding</td>
<td>12</td>
</tr>
<tr>
<td>(2 5 1 1) /Valuer/Return/Yields/Initial</td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>(2 5 1 2) /Valuer/Return/Yields/Equated</td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>(2 5 1 3) /Valuer/Return/Yields/Equiv</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>(2 5 1 4) /Valuer/Return/Yields/Reversion</td>
<td>Reversionary or Terminal</td>
<td>9</td>
</tr>
<tr>
<td>(2 5 1 5) /Valuer/Return/Yields/Cap Rate</td>
<td>Capitalisation Rate, YP (may be confused with the initial yield)</td>
<td>5</td>
</tr>
<tr>
<td>(2 5 1 6) /Valuer/Return/Yields/IRR</td>
<td>Internal Rate of Return</td>
<td>3</td>
</tr>
<tr>
<td>(2 5 2) /Valuer/Return/Growth</td>
<td>Definition &amp; source/basis</td>
<td>10</td>
</tr>
<tr>
<td>(2 5 3) /Valuer/Return/Depreciation</td>
<td>Definition</td>
<td>8</td>
</tr>
<tr>
<td>(2 5 3 1) /Valuer/Return/Depreciation/Redevelopment</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>(2 5 4) /Valuer/Return/Analysis</td>
<td>Details of analysis (non-specific)</td>
<td>9</td>
</tr>
<tr>
<td>(2 6) /Valuer/Lifecycle</td>
<td>Anticipated lifespan</td>
<td>7</td>
</tr>
<tr>
<td>Node</td>
<td>Definition</td>
<td>Indexes</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>---------------------------------</td>
<td>---------</td>
</tr>
<tr>
<td>(2 6 1)</td>
<td>/Valuer/Lifecycle/Main Structure</td>
<td></td>
</tr>
<tr>
<td></td>
<td>No Definition</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>This node indexes 1 document.</td>
<td></td>
</tr>
<tr>
<td>(2 6 2)</td>
<td>/Valuer/Lifecycle/Retrofit</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Before major refurbishment</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(retrofit terminology)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 4 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 6 3)</td>
<td>/Valuer/Lifecycle/Funding</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>How the scheme is funded and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>spread in DCF</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 6 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 6 4)</td>
<td>/Valuer/Lifecycle/Yieldimp</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Impact on yield of refurbishment</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 6 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 7)</td>
<td>/Valuer/Forecasting</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Techniques (ABS, Jebb Holland</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Dimasi)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 8 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 8)</td>
<td>/Valuer/Future</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Directions indicated</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 3 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 9)</td>
<td>/Valuer/Misc</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Miscellaneous commentary which</td>
<td></td>
</tr>
<tr>
<td></td>
<td>adds value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 7 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 9 1)</td>
<td>/Valuer/Misc/Cinema</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Influence &amp; Impact of Cinemas</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 2 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 9 2)</td>
<td>/Valuer/Misc/M&amp;S</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The Marks &amp; Spencer enigma</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 2 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 9 3)</td>
<td>/Valuer/Misc/Internat</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>International perspectives:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>AIVLE/RICS/MAI</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 3 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 9 4)</td>
<td>/Valuer/Misc/Service</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>As in the service customers</td>
<td></td>
</tr>
<tr>
<td></td>
<td>expect</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 2 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 9 5)</td>
<td>/Valuer/Misc/Gambling</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Impact of gambling on consumer</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 1 document.</td>
<td></td>
</tr>
<tr>
<td>(2 9 6)</td>
<td>/Valuer/Misc/Investment Vehicle</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Redevelopment allows</td>
<td></td>
</tr>
<tr>
<td></td>
<td>opportunity income to</td>
<td></td>
</tr>
<tr>
<td></td>
<td>market, build, architect,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>lease</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 6 documents.</td>
<td></td>
</tr>
<tr>
<td>(2 9 7)</td>
<td>/Valuer/Misc/Robina</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The New (1996) Robina Town</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Centre Super Regional</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 1 document.</td>
<td></td>
</tr>
<tr>
<td>(2 9 8)</td>
<td>/Valuer/Misc/Corrupt</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Definition:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The grey area (possibly</td>
<td></td>
</tr>
<tr>
<td></td>
<td>corruption)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>This node indexes 6 documents.</td>
<td></td>
</tr>
</tbody>
</table>
(2 9 9) /Valuer/Misc/Negligence
*** Definition:
The potential litigation for current and past approaches
This node indexes 2 documents.

(3) /Owner
*** Definition:
Expert Owners (3 or more regional centres) nb. strong valuation background
This node indexes 2 documents.

(3 1) /Owner/Motive
*** Definition:
Investor motivation - nature of fund
This node indexes 2 documents.

(3 1 1) /Owner/Motive/Knowledge
*** Definition:
Fund knowledge over and above valuers and managers
This node indexes 3 documents.

(3 2) /Owner/Rationale
*** Definition:
Rationale for property investment
This node indexes 4 documents.

(3 3) /Owner/WhyRetail
*** Definition:
Rationale for Shopping Centre Investment (cf. other property)
This node indexes 5 documents.

(3 1 1) /Owner/WhyRetail/PCAview
*** Definition:
Observations over Property Council view that shopping centres are the best
This node indexes 6 documents.

(3 4) /Owner/Goals
*** Definition:
Goals of Shopping Centre investment (Macro/Micro)
This node indexes 2 documents.

(3 4 1) /Owner/Goals/Macro
*** Definition:
Macro view of investment (holistic)
This node indexes 4 documents.

(3 4 2) /Owner/Goals/Micro
*** Definition:
Micro view (property specific)
This node indexes 3 documents.

(3 5) /Owner/Return
*** Definition:
Investment return. To correlate to Valuer (2.5) view
This node indexes 5 documents.

(3 5 3) /Owner/Return/Depreciation
*** Definition:
The impact of depreciation
This node indexes 4 documents.

(3 5 3 1) /Owner/Return/Depreciation/Masking
*** Definition:
Masking depreciation through refurbishment or redevelopment
This node indexes 3 documents.

(3 5 3 2) /Owner/Return/Depreciation/%reinvest
*** Definition:
What percentage of initial cost would need to be reinvested to maintain
This node indexes 2 documents.

(3 5 5) /Owner/Return/KneeJerk
*** Definition:
Pro-active or re-active in refurbishment/redevelopment plans
This node indexes 4 documents.
**Owner/Lifecycle**

*** Definition: Anticipated lifespan

This node indexes 4 documents.

---

**Owner/Lifecycle/Main Structure**

*** Definition: Anticipated lifespan of main structure

This node indexes 0 documents.

---

**Owner/Lifecycle/Retrofit**

*** Definition: Lifespan before major refurbishment or lesser retrofit

This node indexes 4 documents.

---

**Owner/Lifecycle/Funding**

*** Definition: How refurbishment is funded (years income or whole portfolio income)

This node indexes 3 documents.

---

**Owner/Lifecycle/Yieldimp**

*** Definition: Impact of refurbishment on yields

This node indexes 1 document.

---

**Owner/Lifecycle/OrigLife**

*** Definition: Original planned lifespan

This node indexes 2 documents.

---

**Owner/Lifecycle/Horizon**

*** No Definition

This node indexes 4 documents.

---

**Owner/Forecasting**

*** Definition: Research approach

This node indexes 4 documents.

---

**Owner/Future**

*** Definition: Future Directions

This node indexes 4 documents.

---

**Owner/Misc**

*** Definition: Copy of node (2 9) and its subtree.

This node indexes 10 documents.

---

**Owner/Misc/Cinema**

*** Definition: Influence & Impact of Cinemas

This node indexes 2 documents.

---

**Owner/Misc/M&S**

*** Definition: The Marks & Spencer enigma

This node indexes 3 documents.

---

**Owner/Misc/Internat**

*** Definition: International perspectives: AIVLE/RICS/MAI

This node indexes 4 documents.

---

**Owner/Misc/Service**

*** Definition: As in the service customers expect

This node indexes 3 documents.

---

**Owner/Misc/Gambling**

*** Definition: Impact of gambling on consumer $

This node indexes 1 document.
<table>
<thead>
<tr>
<th>Node Path</th>
<th>Definition</th>
<th>Indexes</th>
</tr>
</thead>
<tbody>
<tr>
<td>(3 9 6)</td>
<td>/Owner/Misc/Investment Vehicle</td>
<td>9 documents</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Redevelopment allows opportunity income to market, build, architect, lease</td>
<td></td>
</tr>
<tr>
<td>(3 9 7)</td>
<td>/Owner/Misc/Robina</td>
<td>2 documents</td>
</tr>
<tr>
<td></td>
<td>*** Definition: The New (1996) Robina Town Centre Super Regional</td>
<td></td>
</tr>
<tr>
<td>(3 9 8)</td>
<td>/Owner/Misc/Corrupt</td>
<td>8 documents</td>
</tr>
<tr>
<td></td>
<td>*** Definition: The grey area (possibly corruption)</td>
<td></td>
</tr>
<tr>
<td>(3 9 9)</td>
<td>/Owner/Misc/Negligence</td>
<td>2 documents</td>
</tr>
<tr>
<td></td>
<td>*** Definition: The potential litigation for current and past approaches</td>
<td></td>
</tr>
<tr>
<td>(3 10)</td>
<td>/Owner/Relate</td>
<td>4 documents</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Relationship with Developer, Manager, Architect, Valuer</td>
<td></td>
</tr>
<tr>
<td>(4)</td>
<td>/Developer</td>
<td>0 documents</td>
</tr>
<tr>
<td></td>
<td>*** Definition: The developer as a player (expert)</td>
<td></td>
</tr>
<tr>
<td>(4 1)</td>
<td>/Developer/Motive</td>
<td>0 documents</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Developer motivation</td>
<td></td>
</tr>
<tr>
<td>(4 1 1)</td>
<td>/Developer/Motive/Knowledge</td>
<td>1 document</td>
</tr>
<tr>
<td></td>
<td>*** No Definition</td>
<td></td>
</tr>
<tr>
<td>(4 2)</td>
<td>/Developer/Process</td>
<td>1 document</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Commentary on the development process</td>
<td></td>
</tr>
<tr>
<td>(4 3)</td>
<td>/Developer/WhyRetail</td>
<td>1 document</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Merits of retail development over other sectors</td>
<td></td>
</tr>
<tr>
<td>(4 4)</td>
<td>/Developer/Software</td>
<td>1 document</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Nature of development appraisal models</td>
<td></td>
</tr>
<tr>
<td>(4 5)</td>
<td>/Developer/Return</td>
<td>0 documents</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Node to balance &quot;Depreciation&quot; position</td>
<td></td>
</tr>
<tr>
<td>(4 5 1)</td>
<td>/Developer/Return/Yield</td>
<td>1 document</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Aspects affecting return and yield</td>
<td></td>
</tr>
<tr>
<td>(4 5 2)</td>
<td>/Developer/Return/Growth</td>
<td>1 document</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Growth aspects</td>
<td></td>
</tr>
<tr>
<td>(4 5 3)</td>
<td>/Developer/Return/Depreciation</td>
<td>1 document</td>
</tr>
<tr>
<td></td>
<td>*** Definition: The impact of depreciation</td>
<td></td>
</tr>
<tr>
<td>Node Path</td>
<td>Definition</td>
<td>Indexes</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>-----------------------------------------------------------------------------</td>
<td>---------</td>
</tr>
<tr>
<td>/Developer/Return/Depreciation/Masking</td>
<td>Masking depreciation through refurbishment of redevelopment</td>
<td>1</td>
</tr>
<tr>
<td>/Developer/Return/Depreciation/%reinvest</td>
<td>% of initial cost reinvested to maintain income flow</td>
<td>1</td>
</tr>
<tr>
<td>/Developer/Return/Analysis</td>
<td>Details of analysis (non-specific)</td>
<td>0</td>
</tr>
<tr>
<td>/Developer/Return/KneeJerk</td>
<td>Pro-active or re-active in refurbishment/redevelopment plans</td>
<td>0</td>
</tr>
<tr>
<td>/Developer/Lifecycle</td>
<td>Anticipated lifespan</td>
<td>1</td>
</tr>
<tr>
<td>/Developer/Lifecycle/Main Structure</td>
<td>Anticipated lifespan of main structure</td>
<td>1</td>
</tr>
<tr>
<td>/Developer/Lifecycle/Retrofit</td>
<td>Lifespan before major refurbishment or lesser retrofit</td>
<td>0</td>
</tr>
<tr>
<td>/Developer/Lifecycle/Funding</td>
<td>How refurbishment is funded (years income or whole portfolio income)</td>
<td>1</td>
</tr>
<tr>
<td>/Developer/Lifecycle/Yieldimp</td>
<td>Impact of refurbishment on yields</td>
<td>1</td>
</tr>
<tr>
<td>/Developer/Lifecycle/OrigLife</td>
<td>Original planned lifespan</td>
<td>0</td>
</tr>
<tr>
<td>/Developer/Lifecycle/Horizon</td>
<td>Investment Horizon (could be notional holding period)</td>
<td>0</td>
</tr>
<tr>
<td>/Developer/Forecasting</td>
<td>Research approach &amp; resources</td>
<td>1</td>
</tr>
<tr>
<td>/Developer/Future</td>
<td>Future directions</td>
<td>0</td>
</tr>
<tr>
<td>/Developer/Misc</td>
<td>Miscellaneous relevant commentary</td>
<td>0</td>
</tr>
<tr>
<td>/Developer/Misc/Cinema</td>
<td>Influence &amp; Impact of Cinemas</td>
<td>0</td>
</tr>
</tbody>
</table>
### Definitions

#### Manager/Return/Yields

**Definition:**
Definitions and related understanding
This node indexes 1 document.

#### Manager/Return/Depreciation

**Definition:**
The impact of depreciation
This node indexes 1 document.

#### Manager/Return/Depreciation/Masking

**Definition:**
Masking depreciation through refurbishment of redevelopment
This node indexes 1 document.

#### Manager/Return/Depreciation/%reinvest

**Definition:**
% of initial cost reinvested to maintain income flow
This node indexes 0 documents.

#### Manager/Return/Analysis

**Definition:**
Details of analysis (non-specific)
This node indexes 0 documents.

#### Manager/Return/KneeJerk

**Definition:**
Pro-active or re-active in refurbishment/redevelopment plans
This node indexes 1 document.

#### Manager/Lifecycle

**Definition:**
Anticipated lifespan
This node indexes 1 document.

#### Manager/Lifecycle/Main Structure

**Definition:**
Anticipated lifespan of main structure
This node indexes 0 documents.

#### Manager/Lifecycle/Retrofit

**Definition:**
Lifespan before major refurbishment or lesser retrofit
This node indexes 1 document.

#### Manager/Lifecycle/Funding

**Definition:**
How refurbishment is funded (years income or whole portfolio income)
This node indexes 0 documents.

#### Manager/Lifecycle/Yieldimp

**Definition:**
Impact of refurbishment on yields
This node indexes 0 documents.

#### Manager/Lifecycle/OrigLife

**Definition:**
Original planned lifespan
This node indexes 0 documents.

#### Manager/Lifecycle/Horizon

**Definition:**
Investment Horizon (could be notional holding period)
This node indexes 0 documents.

#### Manager/Forecasting

**Definition:**
Research approach & resources
This node indexes 1 document.

#### Manager/Future

**Definition:**
Future directions
This node indexes 1 document.
(5 9) /Manager/Misc
*** Definition:
Miscellaneous relevant commentary
This node indexes 1 document.

(5 9 1) /Manager/Misc/Cinema
*** Definition:
Influence & Impact of Cinemas
This node indexes 1 document.

(5 9 2) /Manager/Misc/M&S
*** Definition:
The Marks & Spencer enigma
This node indexes 0 documents.

(5 9 3) /Manager/Misc/Internat
*** Definition:
International perspectives: AIVLE/RICS/MAI
This node indexes 0 documents.

(5 9 4) /Manager/Misc/Service
*** Definition:
As in the service customers expect
This node indexes 1 document.

(5 9 5) /Manager/Misc/Gambling
*** Definition:
Impact of gambling on consumer $
This node indexes 0 documents.

(5 9 6) /Manager/Misc/Investment Vehicle
*** Definition:
Redevelopment allows opportunity income to market, build, architect, lease
This node indexes 0 documents.

(5 9 7) /Manager/Misc/Robina
*** Definition:
The New (1996) Robina Town Centre Super Regional
This node indexes 1 document.

(5 9 8) /Manager/Misc/Corrupt
*** Definition:
The grey area (possibly corruption)
This node indexes 1 document.

(5 9 9) /Manager/Misc/Negligence
*** Definition:
The potential litigation for current and past approaches
This node indexes 0 documents.

(5 9 10) /Manager/Misc/Safety
*** No Definition
This node indexes 1 document.

(5 10) /Manager/Relate
*** Definition:
Relationship with Owner, Manager, Architect, Valuer
This node indexes 1 document.

(6) /Architect
*** Definition:
Architect Expert View
This node indexes 0 documents.

(6 1) /Architect/Brief
*** Definition:
The Architects brief and all that stems from it
This node indexes 1 document.

(6 1 1) /Architect/Brief/Structure
*** Definition:
Structural definition of a shopping centre
This node indexes 1 document.
<table>
<thead>
<tr>
<th>Node</th>
<th>Definition</th>
<th>Indexes</th>
</tr>
</thead>
<tbody>
<tr>
<td>/Architect/Brief/Fabric</td>
<td>Selecting a fabric (and style) for a centre</td>
<td>0 documents</td>
</tr>
<tr>
<td>/Architect/Brief/Rigidity</td>
<td>Challenges of a rigid plan</td>
<td>0 documents</td>
</tr>
<tr>
<td>/Architect/Brief/SiteCon</td>
<td>Site Constraints</td>
<td>1 document</td>
</tr>
<tr>
<td>/Architect/Brief/ClientCon</td>
<td>Client Constraints</td>
<td>1 document</td>
</tr>
<tr>
<td>/Architect/Brief/Funding</td>
<td>Funding issues (and constraints)</td>
<td>0 documents</td>
</tr>
<tr>
<td>/Architect/Brief/Quality</td>
<td>Quality issues</td>
<td>0 documents</td>
</tr>
<tr>
<td>/Architect/Brief/Adaptability</td>
<td>Adaptability (avoiding design obsolescence)</td>
<td>0 documents</td>
</tr>
<tr>
<td>/Architect/Return</td>
<td>Node to balance &quot;Depreciation&quot; position</td>
<td>0 documents</td>
</tr>
<tr>
<td>/Architect/Return/Depreciation</td>
<td>The impact of depreciation</td>
<td>1 document</td>
</tr>
<tr>
<td>/Architect/Return/Depreciation/Masking</td>
<td>Masking depreciation through refurbishment of redevelopment</td>
<td>1 document</td>
</tr>
<tr>
<td>/Architect/Return/Depreciation/%reinvest</td>
<td>% of initial cost reinvested to maintain income flow</td>
<td>1 document</td>
</tr>
<tr>
<td>/Architect/Return/Depreciation/DesignOb</td>
<td>No Definition</td>
<td>1 document</td>
</tr>
<tr>
<td>/Architect/Return/Analysis</td>
<td>Details of analysis (non-specific)</td>
<td>0 documents</td>
</tr>
<tr>
<td>/Architect/Return/KneeJerk</td>
<td>Pro-active or re-active in refurbishment/redevelopment plans</td>
<td>0 documents</td>
</tr>
<tr>
<td>Node</td>
<td>Definition</td>
<td>Indexes</td>
</tr>
<tr>
<td>--------------</td>
<td>-----------------------------------------------------------------------------</td>
<td>---------</td>
</tr>
<tr>
<td>(6 6)</td>
<td><strong>Architect/Lifecycle</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>*** Definition: Anticipated lifespan</td>
<td>1</td>
</tr>
<tr>
<td>(6 6 1)</td>
<td><strong>Architect/Lifecycle/Main Structure</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>*** Definition: Anticipated lifespan of main structure</td>
<td>1</td>
</tr>
<tr>
<td>(6 6 2)</td>
<td><strong>Architect/Lifecycle/Retrofit</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>*** Definition: Lifespan before major refurbishment or lesser retrofit</td>
<td>1</td>
</tr>
<tr>
<td>(6 6 3)</td>
<td><strong>Architect/Lifecycle/Funding</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>*** Definition: How refurbishment is funded (years income or whole portfolio income)</td>
<td>1</td>
</tr>
<tr>
<td>(6 6 4)</td>
<td><strong>Architect/Lifecycle/Yieldimp</strong></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Impact of refurbishment on yields</td>
<td>0</td>
</tr>
<tr>
<td>(6 6 5)</td>
<td><strong>Architect/Lifecycle/OrigLife</strong></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Original planned lifespan</td>
<td>0</td>
</tr>
<tr>
<td>(6 6 6)</td>
<td><strong>Architect/Lifecycle/Horizon</strong></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Investment Horizon (could be notional holding period)</td>
<td>0</td>
</tr>
<tr>
<td>(6 7)</td>
<td><strong>Architect/Forecasting</strong></td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Research approach &amp; resources</td>
<td>1</td>
</tr>
<tr>
<td>(6 8)</td>
<td><strong>Architect/Future</strong></td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Future directions</td>
<td>1</td>
</tr>
<tr>
<td>(6 9)</td>
<td><strong>Architect/Misc</strong></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Miscellaneous relevant commentary</td>
<td>0</td>
</tr>
<tr>
<td>(6 9 1)</td>
<td><strong>Architect/Misc/Cinema</strong></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Influence &amp; Impact of Cinemas</td>
<td>0</td>
</tr>
<tr>
<td>(6 9 2)</td>
<td><strong>Architect/Misc/M&amp;S</strong></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>*** Definition: The Marks &amp; Spencer enigma</td>
<td>0</td>
</tr>
<tr>
<td>(6 9 3)</td>
<td><strong>Architect/Misc/Internat</strong></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>*** Definition: International perspectives: AIVLE/RICS/MAI</td>
<td>0</td>
</tr>
<tr>
<td>(6 9 4)</td>
<td><strong>Architect/Misc/Service</strong></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>*** Definition: As in the service customers expect</td>
<td>0</td>
</tr>
<tr>
<td>(6 9 5)</td>
<td><strong>Architect/Misc/Gambling</strong></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>*** Definition: Impact of gambling on consumer $</td>
<td>0</td>
</tr>
<tr>
<td>Node</td>
<td>Description</td>
<td></td>
</tr>
<tr>
<td>------</td>
<td>-------------</td>
<td></td>
</tr>
<tr>
<td>(6.9.6)</td>
<td>Redevelopment allows opportunity income to market, build, architect, lease.</td>
<td></td>
</tr>
<tr>
<td>(6.9.8)</td>
<td>The grey area (possibly corruption).</td>
<td></td>
</tr>
<tr>
<td>(6.9.9)</td>
<td>The potential litigation for current and past approaches.</td>
<td></td>
</tr>
<tr>
<td>(6.10)</td>
<td>Relationship with Owner, Manager, Architect, Valuer.</td>
<td></td>
</tr>
</tbody>
</table>
Appendix Nine: Sample ‘original’ transcription of ‘Expert’ interview

This appendix was added at the behest of the external examiners after the viva-voce examination. The request was “the submission as a further appendix, of a sample of the data in an anonymous format”. This interview was one of the shortest, totalling 6,909 words and the ‘expert’ in this case was one of the valuer interviewees.

In order to protect confidentiality, all personal, corporate, centre and place names have been replaced with XXXX (descriptor). The researcher has directly transcribed the spoken recordings. No attempt has been made to correct the ‘spoken’ English into a formal written style, as this would change the essence of the qualitative interview. In its ‘original’ form (with names) the following comprises a sample of the data which was analysed in NUDIST Tm and incorporated in the analysis in Chapter 4.

In all instances there was an informal pre-amble to put the ‘expert’ at ease. This pre-amble also explained details of the process, what the researcher was investigating and an assurance of full confidentiality (this was also contractually agreed in writing). In order to comply with confidentiality, written consent has been obtained from the ‘expert’ for the interview below to be included in its amended format.

Once the pre-amble was completed, it was agreed to turn on the tape recording device. This explains why in the following sample the ‘expert’ appears to commence the conversation in mid-sentence.

*XXXX (reference) (Valuer), XXXX (location) Interviews, (‘expert’ name), (‘expert’ company), (date)/XX/96

(Expert) - ...of XXXX (Regional Shopping Centre ‘a’)... it’s got adequate carparking. More than adequate carparking - it is over carparked at the moment. I’ve done the car park analysis actually of all the regional centres that I am aware of. And I have spoken to all the managers, and asked what is the number of carparks - undercover and outdoors. What is the total? Then I have analysed those per square metre of net lettable space and then per square metre of net speciality space. And it’s produced some interesting statistics, which are probably meaningless to anyone.

(Researcher) - If I can refer to the framework. Often the owner, when you are looking at this (regional level) is also the manager, is also the developer, and in the case of people like XXXX (Investor/Owner ‘p’) and XXXX (Investor/Owner ‘q’) (with Investor/Owner ‘r’) is also the architect. So it narrowed my "n" number down quite considerably. I ran through with XXXX (Investor/Owner ‘s’), XXXX (INVESTOR/OWNER ‘T’), XXXX (Investor/Owner ‘p’) and XXXX (Investor/Owner ‘u’) in Sydney and I am seeing XXXX (INVESTOR/OWNER ‘V’) today and XXXX (INVESTOR/OWNER ‘t’) Developments out at XXXX (Regional Shopping Centre ‘c’) this afternoon.

(Expert) - You are aware of XXXX (INVESTOR/OWNER ‘V’)s recent acquisition?

(Researcher) - Being?

(Expert) - 50% of XXXX (Regional Shopping Centre ‘d’) as of the newspapers this morning.

(Researcher) - Really? No, I haven’t read the newspaper; we don’t get them in the bush at
this time of day!

(Expert) - Okay, XXXX (Investor/Owner ‘s’), as it now known as, bought 50% of XXXX (Investor/Owner ‘x’), interest in XXXX (Regional Shopping Centre ‘d’) and what that shows is very little growth in value (since it was built) to the purchaser. If it is a true 50% arms length transaction today, and I am making that assumption at the moment because I have no means of saying that it isn't true. If it is truly an arms length transaction, then there has been very little growth in value from the day it was built to the purchase today... about $50m in six/nearly seven years.

(Researcher) - Well, I might ask that question in a couple of hour’s time. Linking in those functions, obviously the valuer is very much at the end of the line, often, as far as the information side is concerned, and all the rest of it. So, within the framework, I have looked at the motivation and leading through what I perceive as the key areas, but we are not constrained by those if you go off at a tangent - for I am happy and keen to follow that. Presumably I am right in saying that the motivation in most of your work is the annual valuation process and occasionally for purchase?

(Expert) - Quarterly. For valuation purposes as far as XXXX (Investor/Owner ‘s’) is concerned it is quarterly. And it is a "report by" date at the end of the quarter day, the accepted quarter day of the quarter - that is December 31st, March 31st etc. Otherwise, yes, annual valuations normally. But XXXX (Investor/Owner ‘s’) being a very sensitive portfolio I can see the logic and the sense of reviewing everything every three months. I think that makes good sense.

(Researcher) - I presume that you are valuing in accordance with the AIVLE guidelines?

(Expert) - Totally. Willing buyer and willing seller.

(Researcher) - Because some practices are going off at a tangent and putting their appropriate exclusions on and citing it accordingly. But you are just following it more or less...?

(Expert) - Pure market. We are assuming that the property will be sold at the date of valuation. That is to say all marketing has taken place prior to that date. Now in the case of land where there is no buyer, residential land where there is no buyer perceived at the moment, our instructions are to say okay, are you telling us that it will take two years to sell? In which case, that two years started two years before the date of valuation, leading to a sale today. What will the market pay today for that property having allowed the full marketing time that the agents and specialists advise? And that still comes back to a willing buyer and a willing seller on the 31st December 1996. There was a discount applied in order to get it sold, and that discount is really what we are trying to estimate at the moment in the case of those residential holdings. In the case of a retail shopping centre there are no real problems there are plenty of buyers for retail and, as has been demonstrated by XXXX (Investor/Owner ‘v’) in the last couple of days or so, which would mean the last three or six months or so, they have done all their investigations and are happy to purchase and have been able to find a vendor willing to sell at what I would say again is a true market price, i.e. it hasn't grown very much. But nevertheless there were two willing parties and the transaction has happened.

(Researcher) - Right. I’ll come back to a couple of things that you raised there but sticking with the model and software, I presume that you are doing it on a spreadsheet format. Is it one that you have bought in or is it one that you have designed yourself, or is it a client specified?

(Expert) - The model we use follows the AIVLE standard so far as discounted cash flows go. That is the standard that you (Researcher) had a hand in. We have incidentally taken note of your comments in particular and have applied them in terms of making sure that our discount effectiveness is taking account of any changes that take place through the term for any factors.
We haven't restricted; we are looking at all factors that can apply in the market place, and then treating those on a year by year basis. In one valuation we are required by the client, XXXX (Investor/Owner 's'), to value XXXX (property) in Sydney on monthly cashflows over a ten-year period. So, we have had to break that down into every month is analysed.

(Researcher) - In advance or in arrears?

(Expert) - In advance. There are various fluctuations that take place during that period: there are incentives being worn out - people received enormous incentives to go into that building in Sydney and they were long term incentives so they, we, are wearing them out through the term of the cash flow. There are incentives with regard to outgoings, so we are having to wear those out as well, and then adjusting them back at the proper review time back to market at the appropriate rates.

(Researcher) - So with the software, it is something that you have actually designed yourself using Excel or Lotus?

(Expert) - We had to design ourselves. We are using Q-Pro Professional and we are checking it, I am checking it, at home against Excel. The only check, I mean mathematics is mathematics is mathematics is logic, but Excel has got a number of other features which enable us to, enable me, to play around at home and test that our Q-Pro function is working properly.

(Researcher) - Did you have to get ProJect-C when you were doing stuff for XXXX (Investor/Owner 's')?

(Expert) - No.

(Researcher) - Right. Because they did use ProJect-C on XXXX (Regional Shopping Centre 'e') internally.

(Expert) - I am sure they did. That is to do with their feasibilities. No.

(Researcher) - Right, that's fine, the reason I ask is that it links into the philosophy of using ProJect and there is only one practice which is using it as standard in Australia that I know of. But when ProJect were marketing it they were trying get the "Funds" to buy it so that it would force through pyramid selling for all valuers to go and get a copy and they would have a captive market and follow the American route where XXXX (Investor/Owner 's') would give you the disk with all their lease terms on it. You would be given everything with all the data on it and you wouldn't have to re-enter anything like that as fact, but all you would then do is "crunch" the numbers. That is how it operates in the States.

(Expert) - I would love that to happen in this country.

(Researcher) - Except then they are conditioned on ProJect-C and you are stuck with a black box.

(Expert) - I am always suspicious of black boxes.

(Researcher) - You are stuck with a database that you can't tweak. Okay, so the actual design of the project was an internal XXXX (company name) design for yours?

(Expert) - Yes. It's a XXXX (expert – personal name) design. I take the blame.

(Researcher) - You have talked on return and affecting return with the example to the XXXX (property) in Sydney taking a monthly cashflow and how you are actually planning different variables in it. How would you define the return on a yield on a shopping centre? You have got a shopping centre, you have got various things that come into play that you put into your cashflow like, I presume, IRR, a term yield of some description, and a reversionary yield. How do you define each of those?
(Expert) - To start with the term yield, we look at that as being a figure that should reflect not only the advanced age of the property, we talking about far more at year eleven. It is eleven years older than it is today. Having read your paper and thought quite a bit about depreciation and the age of the building, were we taking note of it and doing anything about it in real terms or are we just taking it for granted that a building would always grow older and therefore does it have an additional value? No. Does it have the same value? Arguable, probably not. Therefore there is in terms of the asset to the building, there is a depreciation to the worth of that building, but it doesn't necessarily lose its ability to earn income.

(Researcher) - There is a "real value" depreciation? But not necessarily a monetary depreciation because of inflation?

(Expert) - That's right.

(Researcher) - So the inflation is masking the depreciation?

(Expert) - Yes. We have decided after quite a bit discussion, XXXX (colleague ‘a’), XXXX (colleague ‘b’) and myself that we are taking due note in adjusting upwards generally speaking our term yield as opposed to our initial yields. So, we might add a quarter or a half or even one percent if we are "capping" at eight today, in ten or eleven years we may well say it is not going to be eight, it is going to be eight plus a bit.

(Researcher) - That's your reversionary yield?

(Expert) - That's our reversionary yield. Our Term yield tends not to have too many differences in it. We tend to leave it alone.

(Researcher) - So it's largely an initial yield that you are using through the term?

(Expert) - Yes. And we have had one example where in a particularly, XXXX (Regional Shopping Centre ‘a’), there is a situation where the yield did get adjusted as stages of the development are completed. And it was very interesting trying to forecast what those changes would be in advance of any work appearing in reality on the ground, it was all off drawings. I tended to apply quite a hard, harsh, yield at the beginning - which upset my client considerably because he had expectations that because he was going to do the development and because he had got his consents, that yield on day one should reflect the finished product.

(Researcher) - To qualify on that, you say a "harsh yield", do you mean a high yield, in other words a "riskier" yield?

(Expert) - Yes. I reflected the risks involved in doing the development in the yield...

(Researcher) - As opposed to pushing the yield down?

(Expert) - I pushed it up because I could see a lot of risk attaching and there is still risk attaching because population hasn't grown as was expected by all the people who did the feasibility studies.

(Researcher) - With the terminal yield which you have touched on, you say that you blow that out by 1% or whatever, do you analyse buildings - say you are looking at a ten year old regional shopping centre now - would you try and find a comparative sale of a twenty year old regional shopping centre and analyse that to get your terminal yield?

(Expert) - We do endeavour to compare like with like, but when you deal with regional shopping centres that is not always easy. And when you deal with a peculiar animal like XXXX (Regional Shopping Centre ‘a’) which was before its time, probably in the wrong place, you have got no real comparability, true comparability, to go and look at anywhere else. So you are looking at superior bodies and trying to analyse backwards. Saying that we have got this inferior product in the wrong location, and that makes analysis purely in the eyes of the analyst - it is very much a personal thing.
(Researcher) - Right. That sort of covers that aspect. Looking at growth, you have touched on that with saying you are expecting growth in a centre where you have got developments coming on stream and so you are going to be building in factors for growth on that. Are you taking an inflation risk free view or are you just accounting for the inflation and growing up your rentals 1. at an inflationary rate and 2. at a real growth rate?

(Expert) - We tend to try and use the real growth rate all the time.

(Researcher) - So you don't look at CPI, inflation?

(Expert) - We look at CPI. In fact the DCF that we are using Spike, has five layers at the top. There is the CPI where we forecast the CPI, at the moment annually - do the quarterly ones and the monthly ones is hairy and we tend to say a month is one year divided by twelve. In simple terms. We look at CPI. We have a figure for outgoings and whether they are going to follow CPI or whether the outgoings structure of a building is such that there is a requirement to allow for a greater growth than CPI for outgoings. Then we have got true rent. Do we grow true rent as per the lease and we plot that in the growth line. Then we come down to effective rent and we plot that in the line in percentage terms. And I am talking in percentages all the way. And because of XXXX (Investor/Owner 's') of late, and I think that this would be true of XXXX (Investor/Owner ‘p’) as well, are seeing that tenants cannot pay even market rent as perceived by the market place - they are having to give a discount to rent to enable the tenant to trade profitably rather than to trade at a loss because the rent has jacked up so high. XXXX (Investor/Owner ‘s’) have taken the line we'll take a percentage of turnover for the first three years of the term. If it is a six-year lease we will go to market at the end of year three hoping that market will be better than we are achieving as a percentage of turnover. And that forecasting is crystal balling, largely, but we can check how a particular tenant in a particular location is going to trade by going at that same type of tenancy or even the same trader, and how he is operating in other centres. Then we make the adjustments for demographics that go with that particular centre that we are looking at.

(Researcher) - On the knowledge side of that, to what degree is your client giving you that data? Or, how are you managing to get that information? Because obviously if you are XXXX (Investor/Owner ‘p’) you know what everybody is trading just about everywhere. If you are a valuer working for XXXX (Investor/Owner ‘p’), or working for XXXX (Investor/Owner ‘s’), do you get all that data in the same context? How are you coping with the knowledge factor in that?

(Expert) - We are going to the valuers who are looking after the particular client. XXXX (Investor/Owner ‘p’), we to their valuers and talk to them and they give us the, I believe they are giving me the actuals. I have no reason to doubt it.

(Researcher) - They are giving you the MAT figures?

(Expert) - They are giving the MAT figures for every tenancy, or every tenancy type, and we go to the Retailers Association of Queensland and checking that information. That is to say they have the tenants view and probably the tenants ear. And I am generally talking to landlords’ valuers, so that is the other side of the table. And I am checking the facts against each other. If I find a discrepancy, I go back to both parties and say one of you is not telling me the truth, please can you verify. And more often than not it is the landlord who has upped the figures that he has given his valuer. We are probably more tenacious here at trying to get real figures, because of my experience historically with the XXXX (Regional Shopping Centre ‘f’) than the average valuer might be. I think a lot of valuers tend to still take information that they are given as being the truth. XXXX (colleague ‘a’) and I tend to say well lets go and talk to the man who is actually running that business face-to-face on site and ask him what his turnover figures are.

(Researcher) - Within that context, you are perhaps more independent than the XXXX
(competitor ‘a’) and XXXX (competitor ‘b’) and the like because you are not actually trying to let the space?

(Expert) - That's true. That is probably why we have been picked by XXXX (Investor/Owner ‘s’) to do this particular job at this particular time, because we are entirely independent.

(Researcher) - And you have no vested interests, you are not going to get any management fee...

(Expert) - We are getting nothing other than the valuation fee to do the valuation properly.

(Researcher) - Is it primarily XXXX (Investor/Owner ‘s’) that you have looked at for regional centres or have you looked at regional's elsewhere?

(Expert) - Regional's elsewhere. XXXX (Investor/Owner ‘w’), I personally do most of XXXX (Investor/Owner ‘w’) valuation work, particularly for their financing... the expansion of XXXX (placename) currently is something that they are going to the market for money to be able to extend XXXX (placename) shopping centre, XXXX (Regional Shopping Centre ‘g’). And that gives me an insight into how other owners work. I must say that XXXX (Investor/Owner ‘w’) are actually probably the most down-to-earth shopping centre owners. They really are in touch with their tenants on a daily basis and they treat their tenants very well, which is why their centres do very well.

(Researcher) - Coming on to an aspect that has not been heavily put out in the AIVLE standard which the anticipated lifespan. You are faced with a shopping centre - you have talked about having this impact on the yield at the end of ten years. How do you tackle, in the case of a centre that you have done, you are looking at a centre today, you can see that the buildings have a certain lifespan, the frame - you know that the roof is going to last thirty years, but the building itself is going to require capital injection periodically to maintain its "glitz". Do you break down those two aspects, looking at main structure and, for want of a better word, a "retrofit" internally separately?

(Expert) - Again we look at them separately and every year it is necessary, in our view, to have seed capital injected. We NPV that and we account for it. If XXXX (Regional Shopping Centre ‘d’) needs (it's a carpeted centre) and if it were not touched, if it was just going to be the same centre for the next ten years, we renew the carpet every so often through that cash flow. And that amount is grown at least by CPI to allow for the cost that the carpet will be dearer in ten years time than it is today.

(Researcher) - So you put that in on a program of three years? Five years?

(Expert) - Normally three years.

(Researcher) - When you say you NPV it, would you NPV it at the cost of borrowing, or would you NPV it at the discount rate, or term yield?

(Expert) - We use the true cost of money.

(Researcher) - So you would use borrowing requirement. And when you say the true cost of money, are you talking about what I would originally would call bank base rate, which doesn't exist in the same context here, plus a few percent?

(Expert) - Yes. Because of my XXXX (nationality) background why should I change just to value in a different country! No, we talk to the banks and say 'what would you be lending money at'? And we say... it's for XXXX (Regional Shopping Centre ‘d’), for carpet. And we have a pool of banks, we talk to them regularly, and we know what they are going to charge in the way of credit.

(Researcher) - So you don’t just take it out as a negative item on the clients funding. You
don't just say, "OK we are receiving $10m gross income on this centre or whatever it happens to be, and carpets are going to cost us $2m or $3m or whatever it is, so we will just take that off as a minus for this year, as a negative on the cash flow... You would actually take it out as a funded item and spread that funding over three or five years?

(Expert) - That's right. We think that is a far more realistic way as to what a real person in the real market place would do.

(Researcher) - Rather than your client actually "dipping out" and having a bad year which would affect his annual returns - which is what he is investing in that shopping centre for in the first place...

(Expert) - Sometimes we spread it out and sometimes we treat it as a total amount due at that time, at a particular time. Go back to the basic question, it we have got a brand new shopping centre today, most owners tend to enter into maintenance agreements for plant and machinery such that it is maintained as new, lifts and air-conditioning are kept as new, escalators and travelators are the same. But when you come to roofs you are right. They just are ageing and at some stage they have to be stripped off and renewed. Ten years with a new centre you would say no, we haven't got to touch any of the basic fabric yet, it will still be virtually as new if it is maintained properly. We look at the maintenance contracts and everything else to make sure that everything is thoroughly maintained. There are some centres where you can find, and I think that this would apply to XXXX (Regional Shopping Centre ‘h’), I am not sure in my own mind whether that structure - that was built down to cost originally - and I believe that there is going to be quite a large capital cost required, within the next twenty years, to renew the fabric.

(Researcher) - So, if you were coming to tackle that, how would you look at the renewal of fabric? You are taking a ten-year cash flow, but you know that five or ten years after your time frame some money has got to be spent. Because your client is not going to want you to, depending on your clients motive, be it advising the trust to respond to shareholders, or it is a very difficult situation for a clients point of you for having you value for purchase because they want you to reflect that in a purchase to argue a price down, presumably? But presumably they are advising a trust that don't really want to see that property perceptually under performing by something which is fifteen years down the track, and that is probably on a longer time frame than their investment horizon on that building?

(Expert) - Yes. I think as a good example, XXXX (Regional Shopping Centre ‘i’) up on the XXXX (location), that is very definitely going to have problems. It is one of the few regional centres that is going to be damaged by salt. In my view, if I was the valuer, I would be saying that my yield in ten years time will not only reflect the ability of the building to earn money, but it will also reflect the fact that there has to be capital put back into that building very soon after a 10 year cash flow period because of salt effect on roof, gutters etc. etc.

(Researcher) - Which then has a major effect on the reversionary rate. It will deteriorate that reversionary significantly.

(Expert) - Yes, it will knock it about quite severely.

(Researcher) - To a very unquantifiable sort of a figure.

(Expert) - I believe that it is unquantifiable at the moment, but in ten years time there will undoubtedly be data which can be said 'we have had to renew gutters far quicker than we though we would and it has cost us this and we can say okay, what sort of effect is that going to have on the roof... as indeed we have got a lot of problems with a lot of water with that particular centre, and a lot of timber. They could be looking at, in fact, effectively replacing the fabric well within the thirty years that you use, I would say twenty years would see substantial fabric being replaced, not only on the top, but also 'out of sight', in the core fabric.
of the building.

(Researcher) - There was one point which I overlooked before when I was asking you on taking an annual or half yearly basis. If you are valuing annually for a client, do you take an annually in arrears, monthly in advance, monthly in arrears or mid-year view of the cash flow?

(Expert) - We always follow the terms of the lease. So if the lease says that the rent is payable in advance, or in effect advance, then we would take all the cash flow in advance. If it is in arrears we would do the same - we would if it is an in arrears calculation then we would move everything into an in arrears view.

(Researcher) - Do you then look at a scenario and say 'okay, the cash is in arrears but it is going to be another two months before the cash becomes available to the client ultimately to spend by the time it goes through...

(Expert) - ...arrears and so on. No, we tend to take the word of the lease.

(Researcher) - Within the context of what we have talked about with this 'wearing out', how would you define depreciation. What do you see as depreciation representing within a regional shopping centre?

(Expert) - In terms of percentages?

(Researcher) - No, in terms of... you could put it into percentage terms, but in terms really of the obsolescence, depreciation - how would you define depreciation? What does it actually...

(Expert) - In the extreme cases, again going to a waterside centre, I've said we are not only capitalising, but we are introducing the old English words "Sinking Fund". So it is a cap rate plus sinking fund. In the case of an inland centre, we just simply capitalise and that cap rate might get adjusted slightly to show... If it is an old centre, then over a ten-year period, the replacement of fabric is going to be far more real than if it is a brand new centre. And it is just to then assume an adjustment, which is simply to adjust the figures to show in our minds that we have allowed for not only.... To sustain income it is necessary for an owner to sustain the building ... and if he doesn't do it, then the income will not be sustained. At some stage income will fall because the building is no longer able to attract the people into it.

(Researcher) - Regional shopping centres are a very different market as you have already said, because they are often - they can only in isolation, there is nothing really that matches another. To what extent do you see your clients taking a pro-active view to counter that depreciation? Or, are they taking a "knee jerk" reaction to other factors like planning consents and other expenditure on centres, which are within a competing driving distance?

(Expert) - We are finding now, we as valuers have had to educate the client in many respects with regard to building depreciation. They have tended to say that the best regional centre will always be the best - and we have come along and said 'no, it won't'. Either it will get out of fashion because it is no longer a "magnetic" centre, or it will get out of fashion because it has simply aged. Or both. Again if we come back to XXXX (Regional Shopping Centre 'a')... XXXX (Regional Shopping Centre ‘a’) is the wrong centre in the wrong place at the wrong time. And it has been demonstrated in its life, it was built early '80s, that here we are in the late '90s it has required total rebuilding virtually. They called it refurbishment but really what they have done is rebuilt. They have said it is neither the right product nor is it the right shape of building and neither is it the right angle of building. Again the same is going to happen at XXXX (Regional Shopping Centre ‘d’)... they are changing the axis of the building in the 1990s and the year 2000 to overcome the problems of sun, to overcome the problems of design that were wrong in the first place, and reducing the points of entry considerably. The number of entry points in to the building is reduced so that the traffic has to flow through it and therefore the dollar spender has to travel through the centre to get to where he wants to be, and in so doing it is reckoned that he will spend money on the way on impulse. XXXX
(location), XXXX (Regional Shopping Centre ‘j’), where XXXX (Investor/Owner ‘s’) have got a new scheme, they have allowed the opposite to happen. If it is a grocery person, then that person can drive, park, shop and go away without going into the centre. They can obtain their groceries and go. In XXXX (Regional Shopping Centre ‘d’) the opposite is true. If you are a grocery shopper you have to go right through the centre to get your groceries and right back pushing your trolley. I believe that will go against the owner of that centre in twenty or thirty year’s time.

(Researcher) - ...because it is a different purpose, it is a different shopping purpose. In the same way, you don't go shopping to go to a movie but...

(Expert) - But you often, yes you are right, but in XXXX (location) they had to buy the movie company out - they had to buy the competitors out - to make sure that nobody goes in there and opens another cinema centre. The only cinemas that are going to be now in XXXX (location) are going to be in the shopping centre. You can’t do that in a city the size of XXXX (state capital); you can’t go and buy up all the cinemas to make sure that your cinemas in your regional centre work. You have to allow for the fact that you have to face the competition.

(Researcher) - XXXX (Regional Shopping Centre ‘j’) doesn’t have a huge competition in that respect, it has got other centres on the periphery but it hasn’t got the same level of competition presumably?

(Expert) - There was a risk that an independent cinema company would come and open cinemas that would compete with XXXX (Regional Shopping Centre ‘j’). So what XXXX (Investor/Owner ‘s’) did was go to valuers and say where are all these centres where we could put cinemas and where is there potential for cinemas to go. And they were told, and they went and bought them. It was probably the right thing to do.

(Researcher) - Which is a pro-active rather than knee jerk...

(Expert) - Yes. It is thinking ahead - what will happen in the lifetime of this building which could damage its cash flow.

(Researcher) - Which again is linking in with, I suppose, forecasting techniques and taking the wider view as to how it is impacting on the bigger picture.

(Expert) - It is a wider view but it is a very capital-intensive view. It does require capital if you are going to take something out of the market that could affect your business you have got to spend capital now, not later.

(Researcher) - But within that context, on showing the return - the IRR or whatever - in the books on, sticking to XXXX (Regional Shopping Centre ‘j’), the other sites that they have bought are not prejudicing the return on XXXX (Regional Shopping Centre ‘j’) because they will be held as land holding investments...

(Expert) - They are treated by me, as a valuer, as being part of the development costs of that centre.

(Researcher) - But not if you were to value it in two years time as an outside valuer, not knowing that they had bought up half of XXXX (location)?

(Expert) - True. True.

(Researcher) - So on their annual valuation figure, whilst it shows in the development appraisal with different sorts of cash flow which you are tacking for a development appraisal - which isn't necessarily a ten year term, presumably - you are looking at the initial development feasibility...

(Expert) - That's right.

(Researcher) - you would be doing it on an advanced residual coming into a monthly cash
flow based on the QS data and so on. So it is a different purpose to the AIVLE guidelines. It still can be within the guidelines, but it is a different sort of valuation...

(Expert) - ...stretching the guidelines.

(Researcher) - ...yes, because the guidelines don’t address that.

(Expert) - They don’t. It hasn’t been applied at all...

(Researcher) - That’s right. Because that is where DCF came from. But they overlooked that. The fact that people have always used DCF for doing development appraisal. But within that context, if you were asked to value XXXX (Regional Shopping Centre ‘j’) in two years time, as an investment to stand alone.... Yes, you now have prior knowledge that they have all these other sites in XXXX (location)... but you are not valuing those other sites in XXXX (location), you are valuing the one shopping centre.

(Expert) - I am valuing the ability of that shopping centre to sustain it's income.

(Researcher) - But the cost of holding those other sites isn’t related to the feasibility, or rather viability of that centre, because...

(Expert) - Now I think that it has been addressed at day 1, and yes in two years time it is history.

(Researcher) - It is just a land holding. XXXX (Investor/Owner ‘s’) own this land...

(Expert) - Yes. Yes.

(Researcher) - Because ultimately what you are under pressure to do, surely, is show a positive increasing, better than inflation, as least as good as BOMA, return from anything you come to look at. Whilst that is what the clients expectation would be, to what degree do you find as independent valuers, a conflict of interest with the client in that respect?

(Expert) - We say to the client who we reflect in our cash flows the reality of real life. We say - yes that's fine, but in some stage over the life of this project, the material facts are going to change. The market is going to change, the centre is going to age, there will be other entrepreneurs who will come on to the scene and they will say - and I can think of a simple instance of this in terms of market place - the XXXX (retailer) in XXXX (Regional Shopping Centre ‘c’) has to compete with the XXXX (retailer) in XXXX (Regional Shopping Centre ‘d’) at XXXX (Regional Shopping Centre ‘d’) because there is a new owner of the XXXX (Regional Shopping Centre ‘d’) centre who has been given an assurance by virtue of a 5+5+5 year lease that XXXX (retailer) is going to stay at least. I am concerned as far as the retailers are tending still to be very insular. They are tending to just be looking at Australia, they don't think that the advent of a Marks and Spencer’s in Sydney with Marks and Spencer’s nous to develop business in the world market means that when Marks and Spencer’s come to Australia they intend to stay. They don't intend to come and tickle the market and see it gets a reaction and then go away. Marks and Spencer’s will become a player in Australia in the next twenty years. And it will become something that the Australian shopper has never had to deal with before. They have always had either Coles, KMart or Woolworth’s. Now they have got, in my view, Coles, Woolworth’s and Marks and Spencer’s. It will influence the retail market because in terms of Marks and Spencer’s they are not just dealing with a product, they are dealing with manufacture and they are also dealing with being owners of the business. They own not only the manufacturing business but they own the retailing business and the petrol station and the oil supply that goes with that as well.

(Researcher) - Except it is a difficult crack to break into, because in the UK they don't pay rent because they are the "magnet". But in the short term they have to create that "magnetism" but to a different, more disparate market who don't spend as much on their underwear, or whatever it is Marks and Sparks excel at. And they have got a very different
middle aged female fashion shopper in Australia with far greater competitive shopping than you would see in a list of English centres.

(Expert) - Yes. But to go back to your underwear, you know that if you have bought M & S underwear it will last. If you buy Australian manufactured underwear you are going to have to replace it.

(Researcher) - It will be holeproof and you will be a hero.

(Expert) - And that is a type thing the Australian Valuer has got to be educated about.

(Researcher) - Having said that, the Australian valuation profession surely is dominated by people who, before they came to Australia, had a strong influence from places like Marks and Spencer's. Because the Australian valuation profession at this level is dominated by people who have got a UK background.

(Expert) - That is absolutely true.

(Researcher) - Because when JLW came, when Richard Ellis came...

(Expert) - They brought English valuers with them who knew how the market place worked. Then we get the XXXX (Investor/Owner 'v') of this world who are Australian born and bred - they have had to go and look at the world in the real terms and I think the XXXX (Investor/Owner 'v') - the two XXXX (people) who are part of the XXXX (Investor/Owner 'v') - are well aware of how their business works, and they are well aware of what they have to do to make sure that their business will always work. And the valuer has got to reflect that. They have got to reflect the quality of the owner, the quality of the buyer. And it is a very small market place and it is a shrinking market place in Australia because we don't yet have a political idiom that will allow, in fact it has been taken away, the growth of population has been stunted by a politician called Howard who has said that we are not going to import people. We are going to grow the business that we have here. That, in my review, will ultimately reflect itself in the retail shopping centres because population is ageing and it is not being replaced. And that does effect how any particular centre will trade. There are too many factors which are overlooked by the purist valuer produced by the Australian academic system - that valuer is not trained to look outside. That valuer is only trained to look at Australia.

(Researcher) - They are trained to 'value' as opposed to the wider picture. I think that is changing. But, I know that this is at a tangent, but the Australian valuer was a very very narrow, like the American Appraiser, they appraise. They don't give the wider advice, which is inherent in the UK model. Of giving wider advice and of being a jack of all trades, and specialise in a couple of avenues as time goes on. But you have got a broader basis. But in Australia, it seemed very like the American model. You take a very narrow route where graduates become valuers and follow that rather than getting development, getting into investment, getting into management.

(Expert) - Getting into replacement. I think that is the thing that in fifty years time will show itself in Australia - that replacement was not planned for in any of the regional shopping centres. It is now. But it wasn't twenty years ago. When XXXX (retailer) were going into being the owner of the land and the centre, as at XXXX (Regional Shopping Centre 'd'), they did not allow for the growth of XXXX (Regional Shopping Centre 'd'). And the XXXX (personal name) of this world whose father's are on this wall, they bought the land to build XXXX (Regional Shopping Centre 'd') mark 1, and we are now here in 1996 having to realise that XXXX (Regional Shopping Centre 'd') has got to grow within the confines of demographics that were in his fathers eyes. So we are having to grow a centre by other means - which is to either grow it upwards or move its boundaries outwards to allow it to grow.

(Researcher) - Some of the bigger centres are fairly landlocked anyway...
(Expert) - Yes they are.

(Researcher) - But it doesn't happen at XXXX (Regional Shopping Centre ‘a’), you have plenty of growth towards the bush.

*Fin: 6,909 words (in original format, before it was amended to ensure confidentiality).