Discussion Paper

Pastoral Rent Review: Valuer-General's Proposed Methodology

Pastoral Rent Advisory Working Group
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Locate Value Secure

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The objectives of this *Discussion Paper Pastoral Rent Review: Valuer-General's Proposed Methodology* are:

- to provide clarity to the PRAWG on the Valuer-General's current pastoral rent valuation methodology (methodology)
- to address outstanding concerns around transparency and provide the PRAWG with an alternative pastoral rent determination methodology for its further consideration, discussion and feedback.

Current pastoral rent determination methodology

- Pastoral rents are based on land values, the economic state of the pastoral industry and the rate of return.
- The Valuer-General determines rents based on accepted valuation practice. This is achieved by analysing sales of pastoral leases in the marketplace and deducting the value of any improvements to determine the unimproved land value. A rate of return is then applied to the unimproved value to derive a rental value.
- Only pastoral lease sales which are considered to represent "fair market" transactions are used in determining what is termed 'market unimproved value':
  - these sales are analysed by distributing the sale price between livestock, plant and equipment, house and buildings, waters, fencing, any other improvements AND the unimproved land value (also known as the "disclosed unimproved value")
  - the quality of the land the purchaser has acquired, expressed as the hectares required to run a large stock unit (ha/LSU) is derived via examination of records such as sale advertisements, prospectus and stock return data as well as interviews with the purchasers, vendors, agents and/or others
  - this discloses a value on a per hectare basis for each sale with a particular carrying capacity
  - a group of sales (basket of evidence) is then utilised to determine the Base Unimproved Value (BUV) of land for all stations in a certain area
  - the BUV for each individual station can then be adjusted to take into account different factors that may impact on the unimproved value of the station as follows:
    - water/rainfall
    - access
    - location, and
    - other: a "catch-all" factor to allow for any other issue deemed to impact on the unimproved value of the lease

- once the BUV is adjusted, it results in the "unimproved capital value"
- a rate of return is then applied to the unimproved capital value to derive a rent:
    - unimproved capital value x 1.8% = rent.

Proposed Alternative Methodology

- The Valuer-General has committed to a review of the valuation calculation
- method (the methodology) to further address the outstanding issue of transparency, being the major frustration expressed by industry in the 2019 rent determination.
- The Valuer-General is proposing a methodology which more closely reflects the way that market participants (buyers and sellers) participate in the market.
- This would provide the clarity and transparency the industry is calling for.
- Investigations into alternative calculation methodologies include reviewing the previous work completed by the PRAWG.
- The following methodology proposed by the Valuer-General is the starting point for industry consideration and discussion.

Proposed Methodology	Example	Explanation
Adopted $ / cattle unit including Lease and improvements at date of valuation	$700/CU	• Determined from the market – referencing recent sales evidence and speaking with the buyer, seller and agent. • Widely understood and accepted metric used by market participants when discussing the perceived or expected value of a given station. • The adopted figure considers a long-term lease. • This figure will be different from region to region reflecting differences in the rangelands, environments and topographies etc, and may be different lease to lease, reflecting intrinsic differences.
	(multiplied by)	
Potential Carrying Capacity (PCC)	7,300 CU PCC	• The best available up-to-date estimate of this crucial metric at the time will be provided by recognised experts including from Department of

		Primary Industries and Regional Development (DPIRD), Rangelands Science Unit.
	(equals)	
Lease and Improvements Value	$5,110,000	• The product of the first two figures equates to the total value including the land and all improvements.
	(multiplied by)	
Prescribed % for the land component	25%	• Discussions with active market participants including pastoralists, agents and other valuers, together with analysis of sales has indicated that it is widely accepted that the unimproved land component of pastoral lease transactions comprises between 20% and 30% of the total price. • The suggestion is to adopt a mid-point of 25% for this figure. • There is scope to adopt a 'scale' for this figure, whereby the prescribed figure could be varied depending on locational factors to reflect different added value of development and improvements as a proportion of the Lease and Improvements Value.
	(equals)	
Unimproved Value	$1,277,500	• The resultant figure equates to the unimproved value of the land.
	(multiplied by)	
Capitalisation Rate	1.8%	• The rate of return is applied at this point, the same as the current methodology. • This rate is determined with reference to the current state of the pastoral industry and having due regard to the influencing factors and current state of the wider economy.
	(equals)	
Pastoral Rent	$22,995 p.a.	• The annual pastoral rent.

Benefits

- The benefits of a calculation approach such as the above is:
    - starting point (adopted $/stock unit including lease and improvements) is based on market evidence and market intelligence
        - this will account for relativities because the market will adjust for intrinsic differences between properties such as rangelands, environments, topographies, and level of improvements/development etc
        - The adopted figure considers a long-term lease
    - calculation is straight line
    - easy to follow
    - easy to describe, and
    - readily repeatable and transparent.

Modelling

- To determine the appropriate percentage rate/s to apply to the Lease & Improvement (L&I) values, over 160 sales were examined over a 20-year time frame.
- Evidence indicates that in lower value areas, the improvements on the lease comprise a larger proportion of the overall L&I value.
- Initial suggested prescribed percentage rates for the land component:
    - Kimberley: 25%
    - Pilbara: 20%
    - Gascoyne: 15%
    - Goldfields-Esperance: 10%
    - Southern Rangelands: 10%.

Example Calculations

Hypothetical Example

WA Station		Date of Valuation: 01/07/2019
Station Details	Area: PCC:	• 254,617ha • 19,191 LSU (13.27ha/LSU)
Adopted $ / cattle unit including Lease and improvements at date of valuation	$900/LSU	• Determined from the market – referencing recent sales evidence and speaking with the buyers, sellers and agents.
	(multiplied by)	
Utilisable Potential Carrying Capacity (PCC)	17,535 LSU	• PCC = 19,191 LSU • Unwaterable area: 32,920ha, 1,656 LSU • Total utilisable are = 221,697ha • Utilisable PCC = 17,535 LSU (12.64ha/LSU)
	(equals)	
Lease and Improvements Value	$15,781,500	• The product of the first two figures equates to the total value including the land and all improvements.
	(multiplied by)	
Prescribed % for the land component	25%	• Location prescribed percentage
	(equals)	
Unimproved Value	$3,945,375	• The resultant figure equates to the unimproved value of the land.
	(multiplied by)	
Capitalisation Rate	1.8%	• The rate of return is applied at this point, the same as the current methodology.
	(equals)	
Pastoral Rent	$71,000	• The annual pastoral rent, rounded from $71,017 p.a. • $4.05/LSU/yr, 32c/ha/yr • Rent by current method is $72,000

Discussion Points

- The Valuer-General is seeking feedback from the pastoral industry on the above proposed alternative pastoral rent determination methodology.
- This paper is the starting point for discussions and to commence detailed conversations with the PRAWG about options and the best way forward to socialise the proposed methodology with industry.
- The next rent determination is due to take effect on 1 July 2029 (based on market data as at 1 July 2028).
- Any methodology change will require more investigation and the PRAWG may wish to consider:

  1. Whether the proposed methodology addresses the outstanding issue of transparency?
  2. Are there any fundamental objections to, or gaps in, the proposed methodology?
  3. Are there any other rent methodologies or considerations the Valuer-General could explore?
  4. How the Valuer-General can best engage/consult with industry to obtain feedback?