NSW GOVERNMENT | Valuer General

Valuer General's Policy

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Valuation of industrial land

What

This policy guides valuers on the methods to use, and factors to consider, when valuing industrial land for rating and taxing purposes.

How

Under this policy, valuers use mass valuation methods based on specific assumptions and considerations.

Valuers must also apply market evidence and do ongoing quality reviews to support valuations.

Valuers assess the value of the land only, without including the value of structures or other improvements on that land.

Why

This policy will ensure that the Valuer General's valuations of industrial land are:

- consistent and accurate
- transparent
- in line with the *Valuation of Land Act 1916* (Valuation of Land Act).

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Contents

1 Policy

1.1 Scope

Industrial land

highest and best use

Use this policy to assess the value of industrial land.

Industrial land is:

- land zoned for industrial purposes or
- land which is currently used for industrial purposes and that use is the highest and best use.

The highest and best use is a valuation concept meaning the possible use of a property that would produce the highest market value. The use must be legal, physically possible and financially viable.

Land value

improvement

land improvement

The land value excludes any structures or improvements, but includes land improvements.

See section 6A of the *Valuation of Land Act 1916* (Valuation of Land Act).

1.2 Valuation methods

Mass valuation process

The Valuer General uses a mass valuation process to value most industrial land. It involves the systematic valuation of groups of properties at a given date using standardised procedures.

Mass valuations must also meet the requirements of the Valuation of Land Act. Section 6A of the Valuation of Land Act applies for most industrial land valuations. All valuations must be supported by market evidence and quality assured.

The mass valuation method used in NSW is the component method. Valuation methods, such as the direct comparison method and the hypothetical development method, are used to value a sample of individual properties within the component.

Component method

component

primary benchmark

reference benchmark

The group of properties used for mass valuation is called a component. These properties have similar attributes, such as location, size and amenity, and are expected to experience similar changes in market value. Industrial components contain land zoned for industrial purposes.

When using the component method, you must select properties from each component as the primary benchmark

and reference benchmarks**.**

The primary benchmark is individually valued each year based on real estate market sales evidence to determine how much the land value has changed from the previous year. The rate of change recorded for the primary benchmark is then applied to the other properties in the component.

Reference benchmarks are selected from within the component and used to check the quality of the proposed valuations. Reference benchmarks are important for checking the accuracy of the mass valuation process.

Benchmarks must represent the range of properties in a component, and their valuations must be supported by market evidence.

Primary benchmark

median

For your primary benchmark:

- base it on a property that is within five per cent of the component's median land value
- use direct comparison to value it at 1 July each year and calculate the rate of change from the prior year's 1 July land value.

The rate of change is called the component factor.

Reference benchmarks

handcraft

quartile

subfactor

Choose reference benchmarks with values further away from the median land value (upper and lower quartile). Then:

- value these at 1 July and check your valuations against the primary benchmark's rate of change
- determine if subgroups of properties have had changes in value inconsistent with most of the component.

If you find inconsistencies with your reference benchmarks, you may need to handcraft valuations for some properties or create a component subfactor.

Component factor

Use the component factor, derived from your primary benchmark, to value other properties in the component. Apply it to each property in the component, except for handcrafted valuations or those valuations which have been valued using a component subfactor.

Handcrafted and subfactor values override component factor values.

Direct comparison

Direct comparison involves comparing market sales with the subject land.

When using direct comparison to value industrial land, you must:

- consider a broad range of market evidence, including sales of vacant and improved land
- consider the value of existing lease arrangements in the sale price
- follow an evidence-based approach when using sales of improved land to deduce the land value (see 1.4 for sales analysis)
- analyse sales to provide a unit of measure such as rate per square metre
- consider all factors that influence the land's value such as the land's size, aspect, location, zoning, planning controls and permitted use.

Hypothetical development method

net rental

improved value

land improvement

capitalisation

The direct comparison method of valuation should be the primary method of valuation for industrial land. However, situations may arise where there is not any suitable market evidence to apply this method.

Where there are not enough directly comparable sales to value the subject land you can use the hypothetical development method.

To derive the land value of an industrial site using this method, you must:

1.	Estimate the improved value of the site assuming a hypothetical building which represents the highest and best use of the land.
2.	To arrive at the improved value either: a) Capitalise the estimated net rental that would be derived from the hypothetical building or b) Establish the improved value by comparison with the sales of strata units
3.	Deduct the estimated cost of developing the site (including holding costs and developer's margin) from the improved value of the site.

The cost of developing the site includes ancillary costs such as purchase fees and stamp duty. Costs should include an allowance for interest payments based on 100 per cent funding for the project. However, interest payment calculations for development costs should reflect the progressive payment of these costs.

When you apply the hypothetical development method you must remember that land improvements are included in land value.

Where land improvements on the site to be valued would be retained for the hypothetical development (reducing the time

and cost of the development) this will need to be factored into the calculation. For example, you may establish that the excavation for an industrial building and associated support for that excavation should be retained for a hypothetical development on that site.

1.3 Assumptions and considerations

Valuation assumptions

unencumbered

fee simple in possession

highest and best use

sale

In line with section 6A of the Valuation of Land Act, you must value the land at its highest and best use, while assuming:

- there is a sale of land
- the buyer and seller are hypothetical
- the title is unencumbered, and the valuation is of the full fee simple in possession
- the land is vacant and has no improvements other than land improvements
- there is no existing development consent for the land.

Valuation considerations

date the valuation was made

statutory restrictions

You must also consider and reflect in the valuation these other requirements:

- the current use of the property if it differs from planning controls and would, if allowed, result in a higher land value (section 6A(2))
- all statutory restrictions on the land
- the valuation reflects a sale of the property at 1 July of the valuing year (section 14B)
- the property's physical condition, surroundings, zoning and allowable uses that applied on the date the valuation was made (section 14K).

Further considerations

The land value of industrial land may be affected by other sections of the Valuation of Land Act or other legislation. Examples that may be relevant are listed below.

Valuation of Land Act	section 14L section 14T Division 5 and 5A section 14G section 28
Local Government Act 1993	section 585
Land Tax Management Act 1956	sections 9C and 9D section 62K
Heritage Act 1977	sections 123-125

1.4 Sales analysis

Wide analysis of sales evidence

sale

You must analyse all market sales of industrial land to establish or verify industrial land values at 1 July in the valuing year. Make sure you cover the breadth of the market, and not just sales of vacant land or sales relating to benchmark properties.

To deduce the land value of an improved property, use an evidence-based approach to remove the added value of improvements from the sale price. The added value is not the replacement or insurance value of the improvements.

Where a sale includes improvements that add no value to the land and are to be removed, the demolition and removal costs of those improvements are to be added to the sale price.

Paired sales approach for improved land

added value of improvements

Use a paired sales approach to work out the value that improvements, such as buildings, add to the land. Do this by comparing the difference between sales of improved land and sales of vacant or lightly improved land.

Example

A property with a 400 square metre single storey factory sold for $750,000.

The land was valued at $500,000 by direct comparison with vacant land sales.

Therefore the added value of improvements is $250,000.

Use your analysis of the added value of improvements by applying it to other sales of improved properties to work out the residual land value.

Include in your analysis a wide range of sales that show the added values of different improvements, including those of varying age.

This type of analysis will capture the added value of any:

- developer's margin
- building improvements and internal inclusions, like air conditioning systems, office fit outs and other fixtures
- fencing, paths, driveways and landscaping
- professional fees, council approval fees and holding costs.

In your analysis, consider the leasing arrangements of the improved property and whether they add to or detract from the value of the property.

Sales analysis by replacement cost

You may need to use the replacement cost approach to analyse sales if there are no vacant land sales which can be

approach

used in a paired sales analysis.

obsolescence

The replacement cost approach is based upon the principle that an informed buyer, in purchasing a property and upgrading it to a new condition, would pay no more than the total cost of buying the site vacant and building a new but similar building.

To derive the land value of an industrial site using the replacement cost approach, you must:

1.	Estimate the improved value of the property (value of property "as new")
2.	Estimate the development costs that would be incurred to replicate the "as new" building
3.	Deduct the estimated cost of developing the site (including holding costs and developer's margin) from the improved value of the site.

These steps are explained below.

Step 1 – Estimating the improved value

Add an allowance for refurbishments to the sale price of the existing property. The allowance must reflect the cost incurred to bring the existing improvements to an "as new" standard.

Cost estimates used to estimate the allowance for refurbishment should be based on a style of building as similar to the sale property as possible.

You must also allow for any building obsolescence.

improved value = sale price of property + allowance for refurbishment + cost due to obsolescence

If the allowance for refurbishment cannot bring the building to a condition that would achieve comparable rent to a new building, due to the building's obsolescence, the sale may not be suitable to be used as part of the replacement cost approach.

The replacement cost approach should not result in an adjusted sale price that exceeds the sale price for comparable sales with new improvements.

Step 2 – Estimating development costs

Next, you must estimate the development costs that would be incurred to replicate the "as new" building. These costs must

include a reasonable profit for the developer. Costs you will need to consider include:

- building construction costs, including all professional fees
- the costs of site works in preparation for building (although those that are land improvements will still be reflected in the land value)
- stamp duty and legal charges on purchase of the site
- rates and taxes over the development period
- loss of interest on capital outlaid on purchase of site
- loss of interest on capital outlaid on construction
- the developer's margin
- legal costs and commission on sale.

You must obtain building costs from recognised industry sources or use estimates provided by an industry expert.

Step 3 – the residual land value

Finally, you calculate the residual land value by deducting the development cost from the value of the sale property on an "as new" basis.

Residual Land value	=	Improved value	-	Total development costs

The calculations used as part of the replacement cost approach are sensitive to the data used so caution needs to be taken in relying on a limited number of sales. You need to analyse a broad selection of sales, enough to support your conclusion.

Sales analysis by depreciated cost approach

This approach is useful when there are not enough sales for a paired analysis and not enough comparable rents to determine the rental value of the building "as new".

Using this approach you work out the added value of the improvements for a sale property by depreciating the cost to build the existing improvements as new. To calculate the land value you deduct the added value of the improvements from the sale price.

You must obtain building costs from recognised industry sources or use estimates provided by an industry expert. The depreciation must include allowance for the condition and obsolescence of the building.

Valuation date adjustment

If the sales you are analysing are earlier or later than 1 July, adjust the sale price to reflect market values at 1 July.

valuing year

Ways to estimate market movement between the two dates include:

1.Sales and resales	Look at sales and resales of properties for the period to work out the market movement. Use this to calculate a monthly movement rate to apply to other sales. Take care to also consider other factors affecting value, such as property improvements made since the original sale.
2.Rental analysis	Look at rental prices to gauge the market movement, especially over the long term. Be aware, though, that returns on property may fluctuate and so the relationship between rental prices and market values may change.
3. Track price movements	Analyse sales of comparable properties over time to track price movements.

1.5 Quality control

Ongoing quality reviews

Mass valuation processes aim to provide reliable and consistent valuations that lie within the market range. However, they also have limitations, especially when used over time or for valuing properties that are complex or lack comparable market evidence.

You must implement quality assurance processes and ongoing reviews of industrial land values and property attributes to:

- ensure consistency in the values
- correct any valuations that have moved out of the market range.

Review sample land values individually and as a group to ensure that they can be tested and supported against the available market evidence.

Quality assurance measures

Tools that you should apply to measure the quality of your valuations include:

- individual land value reviews (verification)
- statistical tests
- valuation process reviews.

Verification

Verification is the name given to the process of systematically reviewing individual land values, based on risk.

Verification must be completed with an understanding of the physical and market factors that influence value. You must have sufficient knowledge of the property to determine that the property is correctly valued.

2 References

2.1 Definitions

added value of improvements	The value that improvements add to the land. It is determined by comparing market evidence for land with improvements to that for vacant or lightly improved land.
capitalisation	Capitalisation is a method used to determine the current market value of a property by converting the net income stream into a capital value using a single conversion factor.
component	A group of properties, used for mass valuation, whose market values move uniformly. It is also known as a 'sub-market group' or 'sales group' in other Australian jurisdictions.
date the valuation is made	The actual date on which the valuer performs the valuation. The physical condition of the land and the manner in which it may be used on the date the valuation is made must be assumed to be the same as at 1 July. See section 14K of the Valuation of Land Act.
fee simple in possession	Absolute title to land, free of any other claims against the title, which one can sell or pass to another by will or inheritance.
handcraft	Individually value a property based on market evidence.
highest and best use	Valuation concept that refers to the possible use of a property that would give the highest market value. The use must be lawful, physically possible and financially feasible.
improved value	The market value of a property's land and improvements inclusive.
improvement	Something that improves the value of the land. This is not defined in the Valuation of Land Act, and is different from the term 'land improvement'.
land improvement	Land improvement, such as draining, excavating, filling or clearing, as defined in section 4 of the Valuation of Land Act and included in the land value.
land value	Value of the land excluding any structures or improvements, but including land improvements. See section 6A of the Valuation of Land Act for a full explanation.

median	The median land value or median sale price is the half-way value in a series of land values or sale prices from lowest to highest value.
net rental	Rent payable excluding all outgoings and GST.
obsolescence	May occur if the building does not comply with modern design standards or if the building lacks the functionality of a modern building.
outgoings	The total of all statutory charges, operating expenses and other outgoings for which the lessor is liable.
primary benchmark	An individually valued property that represents the majority of properties in a component. The primary benchmark should be within 5 per cent of the median value in a component. It is used to calculate the component factor.
quartile	A statistical term describing a division of observations into four equal intervals based upon the values of the data.
reference benchmark	An individually valued property used to check the quality of proposed valuations in a component. It is used only as a quality check for the application of mass valuation, and not to calculate the component factor.
sale	The transfer of property between parties. To use a sale as market evidence, it must have been: • an arm's length transaction • between a willing buyer and willing seller who both acted knowledgably, prudently and without compulsion • properly marketed.
statutory restrictions	Statutory restrictions on the land may include environmental planning instruments and development control plans, as well as restrictions relating to the clearing of land, water and soil management.
subfactor	A subfactor is any factor other than the component factor used to value sub groups of properties that have experienced value movements which are inconsistent with the majority of the component.
unencumbered	Unencumbered land is land without any encumbrances. An encumbrance is any right to or interest in land by someone other than the owner, and that prevents the transfer of that land or lowers its value. It might include an easement, restrictive covenant, mortgage, or other restriction.
valuing year	The year starting 1 July. Valuation reflects the property market at the start

of the valuing year.

2.2 Laws and policies

Governing NSW law

Valuation of Land Act 1916 (Valuation of Land Act)
Section 6A

3 Context

3.1 Role of the Valuer General

The Valuer General for NSW

In NSW, the *Valuation of Land Act 1916* establishes the Valuer General as the independent statutory authority responsible for ensuring the integrity of land valuations in NSW.

Valuation Services, Property NSW manages the valuation system on behalf of the Valuer General, outsourcing the majority of valuation services to private valuation firms.

The Valuer General is committed to an open and transparent valuation process that is easy for landholders to understand.

3.2 Background

Mass valuation methods

Mass valuation improves cost efficiencies, because it allows a small number of valuations to be used for a large number of properties.

Mass valuation is used increasingly around Australia and the world.

Different mass valuation methods

In NSW, valuers who do valuations for the Valuer General all currently use the component method.

A number of other mass valuation methods are used in Australia and around the world and alternative methods may be acceptable for use in NSW. You must seek the Valuer General's approval to use any alternative valuation method.

The replacement cost approach v the Hypothetical Development Method

The replacement cost approach is similar to the hypothetical development method but it is based on an existing building which is hypothetically upgraded, rather than a hypothetical building. The hypothetical development method is used to value land where there is not enough sales evidence while the replacement cost approach is used specifically to analyse a sale.

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Document control

Approval

Name and position	Signature and date
Simon Gilkes, Valuer General	 05/05/2017

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