

**From:** Australian Lease & Property Consultants Pty Ltd  
**Sent:** Saturday, 12 October 2013 7:13 AM  
**To:** Min Employ Rel & Cons Affairs - Jo Swinson ([pubs.consultation@bis.gsi.gov.uk](mailto:pubs.consultation@bis.gsi.gov.uk)): Minister Jo Swinson, Parliament UK ([jo.swinson.mp@parliament.uk](mailto:jo.swinson.mp@parliament.uk)); , contact for Jo Swinson  
**Cc:** Billson, Bruce (MP) ([B.Billson.MP@aph.gov.au](mailto:B.Billson.MP@aph.gov.au)); Peter Strong, Executive Director  
**Subject:** Statutory Code and an independent Adjudicator for the pubs sector - extremely valuable lease material and solutions for your problem

Dear Jo Swinson, Minister for Employment Relations and Consumer Affairs

I was listening to a program on TV in Australia and picked up that pubs are closing left right and centre in the UK.

I tripped over this initiative undertaken by your office. I know that the submission closing date is past, however I believe I can introduce some valuable IP ('Intellectual Property') and **solutions** to your problems.

The key circuit broker is the leases, how they are structured, suitable security of tenure and *how the lease is valued i.e. the price the current market rent that is placed on the Business Opportunity* that the lease offers.

I have devoted the last 20 years of my life to trying to master the art of valuing leases. and I believe I am pretty good at it with all checks and balances in place.

1. **The circuit breaker – all leases to be negotiated/offered at current market rent; definable; arguable; negotiable at intermittent periods**

I wrote a paper "Market rent: what is it?" in 1995, published in November in our valuers Journal in Australia, then in S Africa, then presented in 2006 in Singapore – ref my LinkedIn site and [www.auslease.com.au](http://www.auslease.com.au) The paper can be downloaded there. That Webpage is being fully refurbished; it is now hopelessly out dated.

The International Definition was adopted from my paper in 2000.

In 1997 we had an inquiry into Fair Trading here.

I submitted that:

1. All leases should be offered at current market rent;
2. In absence of that an expert determining valuer be appointed.

Following that, the Australian Capital Territory introduced a complete end of lease/new lease solution that is better than my suggestion. It introduces compulsory mediation. It forces the parties to review their position based on key criteria.

Like litigation, I envisage that only 3.0% of disputed rents will go through to the keeper; the Specialist Retail Valuer. 97.0% would be resolved by the process the ACT introduced below; if people know/realise the power it affords in the/their bargaining process and or they get experts in to advise.

**It reads as follows:**

### **51 Rent on renewal**

- (1) This section applies if—
  - (a) either—
    - (i) the lessor proposes to renew the lease and makes an offer to the tenant to renew the lease in response to a request under section 107 (Lessor's intentions about renewal); or
    - (ii) the lessor gives the tenant preference under section 108 (Rules of conduct at end of lease term for shopping centre leases) by making an offer to the tenant to renew the lease; or
  - (b) the lessor otherwise makes a renewal offer to the tenant within 12 months after the end of the existing lease.
- (2) The lessor must not propose that the rent to be charged initially under the renewed lease exceed the market rent for the premises (other than under an option to renew contained in the lease).
- (3) In this section, a proposal or offer to renew the lease does not include an option to renew contained in the lease.

### **52 Market rent—rent reviews, options and renewals**

- (1) Subsection (2) applies in relation to a lease if—
  - (a) the lease states that market rent is to be charged for premises; or
  - (b) market rent is to be charged for the premises because of section 49 (Rent setting or review if lease method void).
- (2) The lessor or tenant may ask the Magistrates Court to refer a dispute about market rent for the lease for mediation if the lessor and tenant cannot agree on the market rent for the premises within 14 days after either tells the other that it disputes the proposed rent.
- (3) The lessor or tenant may also ask the Magistrates Court to refer a dispute about the rent to be paid under a renewal to mediation if—
  - (a) the lessor—
    - (i) proposes to renew the lease and makes an offer to renew the lease in response to a request under section 107 (Lessor's intentions about renewal); or
    - (ii) gives the tenant preference under section 108 (Rules of conduct at end of lease term for shopping centre leases) by making an offer to the tenant to renew the lease; or
    - (iii) otherwise makes a renewal offer to the tenant before the end of 12 months after the end of the existing lease; and
  - (b) the tenant accepts the lessor's offer to renew the lease subject to the rent for the lease being market rent.
- (4) On request under subsection (2) or (3), the Magistrates Court must—
  - (a) if the court considers that mediation would not be productive or if the parties agree—after consultation with the parties, appoint a valuer to work out the market rent; or
  - (b) refer the dispute to a mediator for mediation.

*Note 1* For the making of appointments (including acting appointments), see the Legislation Act, pt 19.3.

*Note 2* In particular, a person may be appointed for a particular provision of a law (see Legislation Act, s 7 (3)) and an appointment may be made by naming a person or nominating the occupant of a position (see s 207).

- (5) If the Magistrates Court refers a dispute for mediation, the mediator must report the result of the mediation to the court not later than 28 days after the dispute was referred.
- (6) If the mediator reports to the Magistrates Court that the parties to the lease cannot agree on the market rent, the court must, after consultation with the parties, appoint a valuer to work out the market rent.
- (7) In this section, a proposal or offer to renew the lease does not include an option to renew contained in the lease.

**Our Queensland Act stipulates how valuer must make his determination; I do this for a living. It reads as follows:**

29 Matters to be considered by specialist retail valuers In making a determination of the current market rent, the specialist retail valuer—

(a) must determine the rent—

- (i) on the basis of the rent that would be reasonably expected to be paid for the retail shop if it were unoccupied and offered for leasing for the use for which the shop may be used under the lease or a substantially similar use; and
- (ii) on the basis of gross rent less lessor's outgoings payable by the lessee under the lease; and
- (iii) on an effective rent basis; and

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

(c) must have regard to—

- (i) the terms and conditions of the lease; and
- (ii) submissions from the lessor and lessee about the market rent of the shop; and
- (iii) the other matters prescribed by regulation.

If valuer (Specialist Retail Valuer) follows that to a T including codes and convention he will have done his job; no ratchet clauses in any lease allowed!

Few do. Why? We have a "cultural" problem in Australia. And lack of education for valuers. And Old School Tie issues. But it is working; and stops; prevents the "churning and burning" of capital and of course asset bubbles in the market. We have a major property group called Westfield in Australia who have been fighting to prevent the end of lease/rent dispute resolution mechanism getting into our wider legislation. And have largely succeeded so far. Because our Government are weak here; they do not like upsetting The Old School tie i.e. the status quo.

Here are actual examples of how this process is working in Australia; preventing asset bubbles; the avoidance of the blowing up of Business Capital; people paying too much for their property; people lending/over borrowing, etc.

Type of business & location	Old rent	New rent	Comment
Restaurant, GC	\$300,000	\$200,000	On renewal. By determination. Tenant now trading successfully. My involvement was to "Peer Review" valuers determination.
Gift Shop, GC	\$270,000	\$140,000	On renewal, determination
Pubs and Clubs, Logan Hyperdome	\$600,000	\$360,000	As above; we prepared submission to Specialist Retail Valuer
Furniture, GC	\$145,000	\$75,000	Half rent agreed mid-term; I prepared a review to current market rent
Newsagent, North-West of Brisbane	\$45,000	\$31,000	As above, also floor effected; I provided IP (Intellectual Property) which lead to reduction
Food, Reflections Tower 2 <sup>[1]</sup>	\$116,000	\$80,000	<b>Mid-term of lease; receiver managers forced to negotiate. Development capital up in smoke; finance capital up in smoke; asset overvalued</b>
Newsagent, GC	\$90,000	\$64,000	Landlord sought \$120,000 and lost tenant who relocated into adjoining centre; business relocated in same precinct. Developer landlord had used extortion tactics
New lease for above shop	\$120,000 sought	\$64,000	Lost good covenant; the market operating; no solution for embedded capital i.e. forced Landlords hand
Video, Wynnum	\$90,000	\$55,000	Lease renewal, determination; we provided submission to determining valuer
Food, Reflections Tower 2	\$78,000	\$36,000	<b>Mid-term; receivers forced to renegotiate or lose tenant</b>
Food, Reflections Tower 2, Le Café Enchanté	\$66,600	Estimated Effective Rent \$30,167	<b>Over first three years, 3 months rent free (6 months half rent); \$200,000 fitout amortised at 15.0% over 3+5 years reduces rent by at least \$30,000 per annum</b>
As above	\$84,000	\$64,000	As above

<b>Supermarket, GC</b>	\$165,000	\$100,000	End of lease/renewal. Expert determination. We provided submission to determining valuer. Extended trading has cause massive shift in spending to major shopping centre groups
<b>Pharmacy, Gold Coast</b>	\$140,000	\$140,000	Relocated to new site, 200.0% more floor space; 1/3 greater business opportunity at same rent. We prepared a expert's report for possible claim in regard to losses
<b>Above lease</b>	\$140,000	\$50,000	Vacant one year, rent dropped by 2/3rds in order to lease
<b>Convenience, GC</b>	\$93,000	\$78,000	Lease is set to decrease further
<b>Restaurant, Coolangatta</b>	\$134,000	\$80,400	By determination
<b>Many businesses</b>			Walking away from lease; fitout in situ becomes major incentive and must be amortised; many incentives in leases not being properly reflected

**2. Attached my "Attachment" to submission into Retail Leases Queensland Act 2012 – balance to follow on another email as size of PDF too big**

Australia is great on ideas; very slow to implement. I have recently complimented the UK on one of our business Webpages for taking its GFC Medicine in 2007. As I understand it you are fast coming out of the woods; only threat low interest rates are possibly if not probably causing an asset bubble i.e. cause of 2007 GFC!

The three pages attached would produce an ideal Template to build legislation round/a Code of Conduct around.

Feel free to use it.

**3. How not to value leases?**

I attach a summary of an article on how not to value leases. Your valuers in UK have a massive problem. What I pick up on RICS ('Royal Institution of Chartered Surveyors') Webpage and LinkedIn discussions, they do not know how to value leases properly.

My series of papers (three in total; started off with a small article; my mentor and colleague said "Oh what about .....") **Everyone Loses When There Is a Misallocation of Stakeholders' Capital in the Retail Property Sector**, by Don E Gilbert Part I now has three parts. Part I written, peer reviewed and edited; Part II has not been peer reviewed or edited; Part III is in my head.

Now this material I believe is not only valuable for your Statutory Code Minister Swinson it is valuable for the whole retail sector, also noting that there is a serious drive to push the SME Sector ahead in UK. Those were my roots ref my LinkedIn site.

I am pushing Hon Minister our new Federal Government to have a Mini-Business summit to address key leasing and market imbalance issues in Australia.

I have copied in Hon Bruce Billson and Peter Strong who are also putting the SME Sector centre and forefront to getting our local economies right.

I hope this provides some useful information in your endeavours to resolve issues between small pub operators and their overzealous large brewery suppliers/landlords in the UK. Probably also on incentive bonuses.

Kind regards

Sincerely

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**Specialist Retail Valuers, Arbitrator**

- |   |   |   |
|---|---|---|
| <ul style="list-style-type: none"> <li>• Expert Determinations/ Expert witness</li> <li>• Specialist Retail Valuations</li> <li>• Lease Negotiation &amp; Dispute Resolution</li> </ul> | <ul style="list-style-type: none"> <li>• Outgoings Analysis / Benchmarking</li> <li>• Business Analyses / Benchmarking</li> <li>• Ratio &amp; Sensitivity Analyses</li> </ul> | <ul style="list-style-type: none"> <li>• Breach-of-lease Loss Calculations</li> <li>• Shopping Centre &amp; Business Modelling</li> <li>• Due Diligence - acquisitions</li> </ul> |
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[1] See additional evidence below re Reflections Tower 2

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## Attachment A

Department of Justice and Attorney-General Retail Shop Leases Act Review  
considerations in order to ensure that this becomes a fully functional market – where  
applicable this should apply to commercial and industrial leases

Critical parts of law to address	Reason
Security of tenure	<p>A business needs tenure to set-up, build up and close-down. Within a 5-year lease term, it is impossible, the business being most vulnerable at lease renewal with fixtures and fittings not yet written off. The broad principles should be:</p> <ul style="list-style-type: none"><li>▪ That for any new lease in a shopping centre, tenure should be granted to amortise set-up costs twice under the taxation legislation viz. 8 + 8 years; <b>[maybe less, say 6 + 6 or 7 + 7 years]</b>. Terms may be split into terms within that, at the tenant's request, (say 3 + 5 = 8), and have at least one market review opportunity within each 8 year term and the commencement of the next 8 years;</li><li>▪ At the request of either party, up to one year before the end of the final term more 8 year terms can be requested;</li><li>▪ For strip shops, the above principles apply but it is not a controlled environment and only a single 8 year term should be offered (or period totalling 8 years), but with options if agreed;</li><li>▪ A requirement to do a refit will trigger a new 8 year term (to write it off);</li><li>▪ Fitout requirements generally should be in sufficient detail for full costings to be done to negotiate the lease terms with IAS 38 or AASB 138 zero based costing principles, to avoid opportunistic leverage at renewal because of fitout cannot be written off and avoid unconscionable conduct arising;</li><li>▪ At end of 8 + 8 years, to avoid a previous tenant's site goodwill being taken without being paid for and to prevent "gazumping", a landlord may not offer a subsequent tenant a lease under the same permitted use unless the parties have had the opportunity to sell the goodwill on the forward assumption of another 8 + 8 year lease, offered at market value;</li><li>▪ Less tenure can be requested by the tenant;</li><li>▪ Shorter tenure may be offered by a landlord if there is a genuine extension or redevelopment. It will force landlords to plan ahead;</li><li>▪ The Franchisee and the Tenant are the same person; they are the leaseholder (they do not own/operate a business under licence and are removed from any dealings with the Landlord).</li></ul>
Disruption to trade, maintenance of centre, misrepresentation	<p>Generally, the provisions and principles are already established and must simply be enforced. I understand that in Canada, if centres renovate, extend or upgrade, business owners are sent away on holiday and come back to their shops either having been relocated or able to trade. It is cheaper for all concerned.</p>
End of lease & rent review principles	<p>The ACT end of lease dispute resolution mechanisms must be mandatory and the market review principles embodied in the Queensland, NSW and Victorian Acts should apply, with the permitted use and reasonable rent principles embodied.</p>



The latter two principles are critical in the retail arena.

**Representations  
relied on at the  
time of leasing**

All material representations relied on at the time of leasing must be included in special conditions at the end of each lease to avoid any arguments and costly litigation.

**Fitout & pre-fitout  
works**

To reduce or avoid significant cost burdens and third line forcing, requiring tenants to do fitouts with only one supplier (a related company belonging to the Landlord) should be outlawed.

**Sales data;  
business closures  
and why**

A commissioner should be appointed in every state:

- To collate sales data (excluding GST) for all centres from a Supermarket based centre upwards, perhaps on a quarterly basis in line with BASS (maybe off that data base);
- To ensure sales turnover is presented and available on the Web for each centre on a "User Pays" basis;
- To ensure all Lessor Disclosure Documents (which have essential lease rent data vs whole leases) are "Registered", including incentives if any granted. This to include leases that do not proceed;
- To note all business closures over three years with the reasons why.

**Outgoings Code  
of Conduct**

Say no more, it is ready to go, simply attach it to the law as mandatory – simple rules just make it happen.

**Enforcement**

- State Tribunals are geared to retail. Compensation limit to \$750,000 is adequate for most retail disputes and to avoid having to go to more expensive jurisdictions to settle disputes **[larger organisations can avoid or limit loss through better business practice, forward planning etc]** and enforcement in equity to avoid one party subsidising the other's "business". If one plays by the rules, there will be no need for it.
- Tribunals may not depart from decisions of other jurisdictions or higher authorities.
- Tribunals should be able to hear any matter, including matters about rent.
- No party should have to pay the other's legal expenses unless there is a judgement awarded against them.
- In Tribunals, no costs may be awarded unless a claim is frivolous and vexatious.

**When changes  
come into  
operation**

New tenancy law can come into operation:

- at any time by mutual agreement;
- at the end of a lease or beginning of a new option period.

**Guarantees**

- Personal guarantees limited to three months gross rent (the principle behind this is that businesses if paying current market rent ought to be able to pay the rent) ;
- Business owner should not have to disclose more about their personal assets than a simple letter from the bank, showing that the proprietor has sufficient equity to cover the rent, paying current market rent;
- On sale of business (assignment of lease), that party has no further obligations under the lease including personal guarantees.

In closing, intra-state migration to Queensland has all but ceased. Why not give stakeholders a real reason to bring their capital and intellectual property to this state via new business start-ups by having the best tenancy law in Australia (amongst a myriad of other cohesive things that Governments must do), i.e. a distinct competitive advantage? Without tenants or demand for retail space buildings also devalue. Substantially.

I look forward to playing a positive role in the 2012 review of the RSLA.

Yours sincerely,

 P.E. Gilbert

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CC Shopping Centre Council and other industry stakeholders

Encl Attachment A



## The “love affair” with the Square Metre hence the Misallocation of Stakeholders’ Capital in the Retail Property Sector, by Don E Gilbert

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Don Gilbert is a Specialist Retail Valuer (“SRV”), a 3D Economist and an Arbitrator. He provides independent, impartial advice to tenants, landlords and prospective investors. He is also the inventor of the GEM Method of evaluating current market rent.

### Background

Note: This is an extract from a three part series for publication for the valuation profession. My research shows there are major flaws on how rents are assessed and risk is evaluated, hence there are flaws in the valuation of income producing property and how Business Capital is being matched to Property Capital when one negotiates leases. Two further articles will cover the topic.

The most “popular” method of assessing retail rents is to use the “*Method of Comparison; that is*

**The FACTS behind this article are about the stakeholders’ reliance on using \$/M2 rental data i.e. “derived data” – as the basis of the Comparison Method of assessing “current market rent” which State Tenancy laws also require to be the “reasonable rent”.**

**ALL STAKEHOLDERS whom I have witnessed over my career have transplanted a \$/M2 rate, without explanation or adjustment, from totally unsuitable “comparables”, including those from: different business categories, different types of locations with vastly different volume/business opportunities, situations in which the negotiations were subject to duress, etc.; a list as long as your arm.**

**Frequently, these \$/M2 “comparisons” are used as the basis for further calculations that magnify the effect of any inaccuracy or error, thereby providing “evidence” that supports spurious conclusions that may favour one party.**

**It is often “engineered data”; used to value leases (set rent), and therefore can result in a gross MISALLOCATION OF ALL STAKEHOLDERS’ CAPITAL with ruinous consequences in the short term for some parties, but disaster in the long term for ALL concerned.**

**Unfortunately, this systemic failure has been aided and abetted by our legislators, regulators and court systems, few seem to understand the economics behind it or the consequences.**

*wherever there is evidence of comparable transactions on which to base current valuations”* (Millington, A. 1996) as a reference. In regard to rental value, the comparison is usually made on a dollar per square metre basis (‘\$/M2’). Whilst this is customary practice, one must ask: “Is it correct?”

All property practitioners and lessors know what \$/M2 means; it is the annual rental sum divided by the leased area of the premise. How does it link back to the performance of the business; the businesses’ Annual Financial Statements; one’s Business Plan, etc.?

This \$/M2 figure tells one *absolutely nothing* about the specific lease, or the site and location, or the specific business being conducted there eg. pharmacy or newsagent!

#### The Pitfalls & Limitations of Using Derived \$/M2 Rental Data

Professor Alan Millington B.Sc. (Est Man), FRICS, IRRV, FI Mgt., FVLE, observes in his paper that some valuers seem to have a "love affair" with the "comparable" and suggests that this method holds many dangers. He questions how it is possible to transplant "evidence" from one location to another, or from one business use to another, when there are different personal and business circumstances surrounding each transaction, as well as underlying economic conditions that may have changed since the previous transaction occurred. He says that comparisons "*may be helpful*" but only "*if comparable transactions are sufficient in number and sufficiently comparable to be acceptable evidence and to give a reliable indication of either general levels of value or trends in value*".

In other words, the problem isn't with the Comparison Method per se, but with the use of \$/M2 rental data as the sole basis of comparison in a valuation, without considering the impact of the resulting rent, and without linking it to other factors that might influence "value" such as the type and size of business opportunity presented by the lease.

An example from my files demonstrates the issue well; I have records of one business category that has a trading range of between \$3,000 and \$30,000 per square metre per annum. That's a factor of ten! However, average sales for this category is roughly \$10,000 per square metre per annum, and a reasonable "benchmark" rent is documented as 4% of turnover *at that level of sales*, or \$400/M2 per annum. But would it be reasonable for the operator that is turning over just \$3,000 per square metre per annum to pay the same \$400/M2 per annum, which is 13% of turnover? What about the operator trading at \$30,000 per square metre per annum? Paying \$400/M2 per annum would equate to rent of just 1.3% of turnover; surely this is not fair to the landlord or property owner?

And these synopses *ignore a wide range of margins often linked to a permitted use advantage or disadvantage*, linked back to competition within a catchment, or a centre or socio-economics of the catchment<sup>1</sup>.

In the first instance you have a business that will be struggling to cover operating expenses, let alone amortise set-up costs or make a profit on the "Business Capital" invested; in fact, it is likely to fail, thus reducing the revenue generated by the "Property Capital" invested in the location, at least temporarily. In the second instance you have a business that will thrive, providing a healthy return on Business Capital, even if it were paying a much higher rent that would also provide a healthy return on the Property Capital invested.

In other words, on opposite sides of these equations there is always another Stakeholder who has invested Capital in the mix; **in every instance where rent is not set properly at the "current market rent," Capital is being forcibly transferred from one stakeholder to another.** Ultimately, this leads to a highly dysfunctional and damaging misallocation of ALL Stakeholders' Capital.

<sup>1</sup> In Robinson Brothers (Brewers) Ltd v Houghton and Cheser-Le-Street Assessment Committee [1937] 2 KB 445 at 468 – 471, Scott LJ stated "*This kind of estimating is a skilled business and it is here, especially, that the role of the skilled valuer comes in*". Wise words considering they were used in 1937.

Part 2 Section 2 of the Retail Shop Leases Act of Queensland states: *"The object of this Act is to promote efficiency and equity in the conduct of certain retail businesses in Queensland."* It is firmly submitted, that the Object of the Act would be failing if Business Capital is not being efficiently matched to Property Capital.

Professor Millington goes on to suggest that a major determinant of retail rental values is the perceived potential profitability of various retail activities. This point was made repeatedly by landlord representatives during the 1997 Fair Trading Inquiry (Hansard, 1997). According to Millington *"...it is the present and future trading potential of a property which determines its present rental value, and in the same way it is the anticipation of future rental returns which determines the present capital value of a property."* But Millington also points out that the *"quasi-monopolistic supply"* of retail properties in Australia results in limited bargaining power for the tenant, especially at end of lease.

Needless to say, this is the mechanism that has led to what I believe is a substantial retail property asset bubble in parts of a range of properties in Australia, one that is exemplified by the 2012 sale of Top Ryde City, a Regional Shopping Centre in Sydney, to Blackstone in the USA (Schlesinger, L. 2012). This one centre alone was overvalued by around \$500,000,000 dollars.

### Conclusion

In my next article we will cover the Comparison Method in some detail followed by the Profits Method. In fact most of the problems caused by using the Comparison Method could be resolved by combining it with other methods that "test" any derived "evidence" by linking it back to the actual performance levels of the specific business and site. Or, as Professor Millington suggests, *"the Profits Method of valuing leases should be applied"*.

However, one mystery remains: why do so many business owners commit to poorly structured leases and/or leases that lock them into unsustainably high rents?

I suggest that there are many reasons. Astonishingly, many are supported by their accountants and solicitors who are required to sign off on a "Financial Advice Report" or a "Legal Advice Report" before the business owner signs the lease in Queensland.

Owners of Business Capital; I suggest negotiate *all leases on an annual sum basis* including deferred rentals i.e. lease incentives and link them back to your Annual Financial Statements (Profit and Loss).

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Millington, A. 1996 'The Shopping Centre Industry – Issues Affecting Property Values' The Valuer & Land Economist November 1996 pg. 321 - 328