

Valuations of Rural Leasehold and Licensed Land in Victoria, Australia

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Abstract

This article examines the leasing of land in Victoria, Australia, with a view to establishing appropriate valuation methodology for practitioners dealing with this area of practice.

Most agricultural land within the higher-rainfall, closely settled area of Australia is held under freehold title. Most land in the drier pastoral area that is used for some form of agriculture or grazing is held under various forms of lease and license from state or territory governments. Leases for a short term may provide little long-term security, and thus discourage significant improvements on or to the land. Many Crown leases, however, are for longer terms.¹ For example, much of the western lands in New South Wales are leased for 99-year terms.

Traditionally, freehold farms have been owner-occupied with little land leased on a market-rental basis, but there is now a trend to lease land from the owners of freehold land. This reflects (1) an aging farm population that does not necessarily want to divest ownership of the land, (2) the financial difficulties stemming from a decade of drought on the eastern seaboard, (3) a redefining of what constitutes economic farming units, and (4) in many districts, an uncertain market for rural land. Those wishing to remain efficient producers are actively looking at all options to increase productivity. This can take the form of leasing land from those no longer able to

farm or no longer willing to take the inherent risks associated with farming.

The valuation of less than freehold interests is of regional importance in Australian valuation practice, yet there has been comparatively little research in the area. This article seeks to initiate a dialogue with a view to achieving better outcomes in a practical sense for valuers. The key areas reviewed by the study are market rental valuations of rural land; valuation of land held under lease, on varying terms and conditions; and issues and complexities faced in relation to native title, claims for which may arise when land is held under less-than-freehold situations.

This article addresses two crucial questions: how do the parties bargaining in a fully informed, arm's-length transaction negotiate an overall price for a market rental of rural land, and how do valuers approach the task of valuing leasehold or license interests where the rental may be well-below market or economic rental levels?

Background

The area of leased and licensed land in the state of Victoria is a small portion of the total area given over

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1. Public lands are considered to be owned by the Crown. In Australia, each state is a Crown entity that may lease land.

to freehold or owner-occupied farms in Victoria. A total of 43,689 tenants control 1,064,004 hectares² of government-owned land—some 4.7% of the state's total area. As there is no central registry or database for private leases, it is not known how many private leases exist, or what percentage of the state is under lease. Anecdotal evidence suggests that only a small proportion is currently leased in the private market, but that the area is likely to increase as farm demographics and agricultural economics change. The study uses an area of North East region of the state of Victoria as its base for a practical review of the valuation of rural leasehold interests. Evidence suggests that a similar percentage of leased or licensed land holds throughout the region, although in the study

area there is a slightly higher concentration. Figure 1 shows a map of the study area.

At the time of European agricultural and pastoral settlement of the Australian interior, options were made available for settlers to take up the land either as freehold or as leasehold. The issue of title to land was a complex political one, and as a result of the hold established over vast tracts of land by a group called *squatters*, ordinary people were effectively locked out of rural areas until state governments enacted land legislation. By 1869, however, land was more freely available and the power and influence of the squatocracy was diminished.⁵ Sheep were ideally suited to the rich, native grasslands found in many areas of Australia, such as the plains to the west of Melbourne.

Figure 1 Study Area Location



2. About 2,628,090 acres (1 hectare = 2.47 acres).

3. Squatters were initially deemed illegal occupants of what was quaintly referred to as "waste lands of the Crown," which was the bulk of Australia outside the few coastal settlements in the early nineteenth century. By mid-century, they had managed to gain a form of recognition by way of theoretical leases to their pastoral runs (few were actually validated) and were referred to as *pastoral tenants*. Land alienation was a major problem for the fledgling state of Victoria in the 1850s. The squatters occupied the land and gained economic and political power, while others were demanding freehold access. The passing of land legislation in Victoria was delayed significantly as a result of the squatters gaining political power in the state's Upper House or Legislative Council. Not until 1869 was land legislation vaguely effective. Successive laws diluted squatters' land holdings, although many had by then managed, in various ways, to obtain freehold title to large tracts of land. The squatters were eventually disenfranchised, and the opportunity for land selection by ordinary citizens was made available. J. S. Baxter, "Rural Land Use and Value in Northern Victoria 1880–1960" (doctoral thesis, RMIT University Library, 73-44, 2001).

In time, the patterns of agriculture started to change, and mixed farming and the production of wheat and other cereals accompanied the spread of settlement into more distant areas of the country.

The North East region of Victoria was initially sparsely populated, but was engulfed by the spread of agricultural activity that followed the passage of the land legislation, in particular the *Land Act 1869*.⁴ The act set out the administrative procedures under which freehold title—or Crown leasehold in perpetuity or lesser terms—could be granted by the Crown. Would-be settlers selected the land they wanted and then applied for a license to occupy that land. In addition to paying an annual license fee, they were then required to undertake certain improvements to the land. Once these conditions were satisfied, settlers were able to take out a lease, which involved a purchase rental—initially over ten years, but later extended to twenty years. After the full amount was paid, freehold title was gained. The initial licenses were not transferable, but the leasehold interests were, as was the freehold once gained.

From the initiation of leaseholds, a market for land was established in the developing frontiers. Although there was initially some market for leased freehold land—with auctions being held to attract takers and conditions attaching as to land use—during the course of the twentieth century most land in rural Victoria became freehold owner-occupied land. Also, as machinery became more sophisticated, farm sizes increased, district populations decreased, and there was a complete change in the size and hierarchy of the small agricultural service towns.

The North East region of Victoria has been developed for mixed farming, with three major urban centers and numerous smaller townships. The region covers some 20,000 square kilometers and has a population of 87,000 people. Approximately 61% of the region is public or Crown land, used for forestry, conservation, and recreation. This area is generally not leased out to individuals, although there is some commercial activity within it, either tourism-related or timber-related. The remaining 39% of the area is private, or freehold, land used for beef, dairying, and horticultural enterprises. Sheep grazing is found on the western slopes and plains of the region, where the growing season is shorter. It has a large area of

undeveloped, mountainous country, and Victoria's only winter snowfields.

The mountainous areas have an important water harvesting function, with a number of reservoirs providing water for irrigation and environmental flows within the Murray Basin. The Murray River—Australia's longest—has its headwaters in the North East, and it forms the border between the states of Victoria and New South Wales. Broad hectare cropping is carried out in the drier northwest portion of the region, adjacent to the Murray River. Then there is a belt of dryland pasture used for sheep and beef cattle grazing, with some limited dairying. Within the river valleys there are some irrigated areas, used for dairying and horticulture, especially vineyards for wine production.

February is the peak of summer in Victoria, and there is rarely much effective rainfall during that month, with high temperatures and evaporation experienced. February is also the month presenting the greatest wildfire danger, and much of the North East can be affected by fierce fires.

The Ovens-Murray Statistical Division encompasses the North East region. It contains five of the seven municipalities (local government areas) that make up the region. Table 1 clearly shows that the largest economic contributor is livestock production (sheep, beef cattle, and dairying). Horticulture is significant, as is shown, although it should be noted that tobacco was a sunset industry, with production ceasing in 2006. It has largely been supplanted over several decades by grape production. The major grain crops are wheat, oats, canola, triticale, barley and lupins. In addition to the land uses listed in Table 1, forestry contributes \$215 million per annum.

The case study area for this research is around Lake Hume, upstream of the cities of Albury and Wodonga. It has a mean annual rainfall of some 715 millimeters, although over the last ten years (from 1999 to 2009) rainfall has been significantly below average, with quarters of severe and serious deficiencies recorded. The study area is broadly within the Murray Valley,⁵ but this plain leads into other, broad river valleys including the Mitta Mitta River and Kiewa River valleys. Soils in the North East region are diverse; within the study area, soils are shallow in the more elevated parts, and elsewhere are generally

4. 33 Vict. No. 358.

5. In Australia, the term *valley* is used loosely. It often refers only to a large, almost flat plain, through which the river runs. The whole of the Murray-Darling Basin is relatively flat, with little elevation above sea level.

Table 1. Gross Value of Agricultural Product (GVP) in the Ovens-Murray region and Victoria in 2004-05.

	Ovens-Murray Statistical Division (GVP \$'000)	Victoria (GVP \$'000)	Ovens-Murray GVP as % of Victorian GVP
Livestock Slaughtering			
Cattle and calves slaughtered	111,652	1,292,775	9%
Sheep and lambs slaughtered	15,419	675,034	2%
Total value of livestock slaughtering	127,741	2,526,991	5%
Crops			
Tobacco	26,155	26,339	99%
Grapes – Wine	17,351	229,097	8%
Pastures cut for hay	15,502	364,248	4%
Apples	15,026	251,760	6%
Cereals for grain	7,222	669,287	1%
Strawberries	3,418	40,287	8%
Cherries	2,711	16,532	16%
Other nuts (excluding Almonds)	2,467	15,098	16%
Hops	2,366	2,366	100%
Blueberries	2,059	2,651	78%
Total value of crops	101,537	3,261,542	3%
Livestock Products			
Milk	64,649	2,079,874	3%
Wool – Total	7,833	472,856	2%
Total value of livestock products	72,483	2,644,694	3%
Total value of agriculture	301,762	8,433,228	4%

Source: (Australian Bureau of Statistics 2008c)

cracking clays or vertosols. In this lower section, gradational soils form a minority.

This particular part of North East Victoria has been chosen as the case study area because there is a higher aggregation of rented land compared to other parts of Victoria, where rented land tends to be scattered. That means that greater levels of comparison between rented and freehold land can be achieved within this geographic area, and outcomes from the study can then be applied elsewhere.

Native Title

In relation to any Crown land, native title and any potential for claims must be taken into consideration. Native title is the recognition by Australian law that some indigenous people have rights and interests to their land that come from their traditional laws and customs. Native title rights and interests differ from indigenous land rights in that the source of land rights is a grant of title from government. The source of native

title rights and interests is the system of traditional laws and customs of the native title holders themselves.

The *Native Title Act 1993* was affected following the 1991 landmark High Court of Australia case, *Mabo v. Queensland (No. 2)*.⁶ This case tested whether native title to land was extinguished by annexation by the Crown, as well as other important principles such as the concept of *terra nullius* (a belief that the unoccupied land taken in the name of the Crown in the late-eighteenth century belonged to no one and that no rights to land existed at that time), tenures and estates in real property, the effect on native title, and land over which native title exists.

The 1998 case of *Members of the Yorta Yorta Aboriginal Community v. Victoria & Ors*⁷ also dealt with native title and the *Native Title Act 1993*. In this case, application was made for a determination of native title over some 98 parcels of land in Victoria and 55 parcels in New South Wales, which is the state

6. [1992] HCA 23; 175 CLR 1 (3 June 1992).

7. [1998] 1606 FCA (18 December 1998).

immediately to the north of Victoria. The land, near the Murray River, included some forests, state parks, reserves (water, water supply, flora and fauna, forest, and scenic reserves), Aboriginal freehold land, vacant Crown land, reserved land, and a mine. The court determined that native title did not exist in relation to the areas of land and waters identified. A subsequent appeal to the High Court of Australia⁸ also failed.

Most private land is freehold within Victoria, and therefore the issue of native title does not exist. However, within the study area some of the leasehold and licensed land is subject to native title claims, so the situation is different. In this area, some of the principles laid down in the *Yorta Yorta* case would apply—although it is noted that the study area is somewhat to the east of land subject to that group's claim. What is important, however, is that subsequent to the failed case, the state government entered into agreements with members of the Yorta Yorta community in respect of land management and involvement in decision making. It has to be assumed that much of the Crown land being discussed in this article could foreseeably be the further subject of some form of claim.

The study area is on the edge of the area occupied by the Wiradjuri people, who were the largest Aboriginal group in New South Wales. It has not been established whether there are any current land claims affecting any of the area under investigation; however, it is likely that the remnant Wiradjuri people in the area would be in a similar situation to those of the Yorta Yorta people whose country lies to the southwest of the study area.

Literature Review

In his research, Eves observes that “rural property in Australia has received minimal attention by property researchers in comparison to the extensive research attention given to Australian commercial and residential property markets.”⁹ Although any review of available literature shows that to be the case, parallels can be drawn from those works aimed at commercial markets.

Crosby and Murdoch trace the history of legislation in relation to commercial leases, a responsibility that lies with state and territory governments in Australia.¹⁰ All have legislation or mandatory codes. In Victoria, leases in shopping centers are covered by the *Retail Leases Act 2003*, but there is no specific legislation for rural leases or licenses, nor is there a code of practice regarding the renting of rural lands. One of the important issues attaching to any lease situation is the matter of rent reviews and the practice to be adopted in the case of dispute.

The research by Squirrell and Hockley concentrates on lease incentives and rental valuations in the major commercial markets.¹¹ Their work, particularly in relation to the valuation principles applied, and their observations on the impact of supply and demand, is of interest in this research. It was cited by the Victorian Supreme Court in *Eureka Funds Management Limited v. Freehills Services Pty Ltd.*,¹² where there was extensive discussion as to the distinction between current market rental (or face rent) and current market rental value (or effective rent). The precedent provided is of relevance in this research, given that the face rent is that which appears in the lease documentation, while the effective rent is the market rental discounted for any incentives offered. In deciding on the question of whether these two terms have the same meaning, the *Eureka* court held them to be different and upheld the principles attaching to the different definitions and meanings.

In a rural property rental review, the lease terms and any incentives given to a lessee would require careful consideration, and clear instructions to the valuer would be required. In the past, the concept of lease incentives in the rural market has not apparently existed to any extent, if at all. In difficult financial times the matter may well arise. What is highlighted from the *Eureka* decision and the work of Squirrell and Hockley is that the definitions of lease terms and the intention of the parties when they struck the bargain are of paramount importance to the valuer.

8. *Members of the Yorta Yorta Aboriginal Community v. Victoria* [2002] HCA 58 (12 December 2002).

9. Chris Eves, “Developing a NSW Rural Property Investment Index,” paper presented at the 6th Annual Conference of the Pacific Rim Real Estate Society, Sydney, January 23–27, 2000.

10. Neil Crosby and Sandi Murdoch, “Australian and UK Small Business Leases—What Can We Learn from Each Other?” paper presented at the 13th Annual Conference of the Pacific Rim Real Estate Society, Fremantle, Western Australia, January 21–24, 2007.

11. M. D. Squirrell and J. J. Hockley, “Lease Incentives and Rental Valuations,” *Australian Property Law Journal* 1, no. 1 (1993): 31–60.

12. [2006] VSC 461 (8 December 2006).

Taking that sentiment, the analysis by Martin¹³ of *Spencer v. Commonwealth of Australia*¹⁴ is pertinent. Martin looks at that court decision from a rental viewpoint rather than the acquisition case it actually was, taking the premise that there was no specific definition of *market rent* existing. While at that time the assertion was correct, the points and analysis made are of particular interest to this research and are not apparently at variance with the *Eureka* decision.

Although over a century old, the *Spencer* case has been an important basis on which the concept and definition of *market value* has been derived, hence the ability to realistically look at it from different angles. The key elements then observed by the High Court of Australia are now present in the International Valuation Standards Council definition of *market value*, adopted internationally by the valuation professional bodies. Martin asserts that “market rent is the best rent which might reasonably be expected,”¹⁵ assuming the following:

- A willing lessor and lessee (neither party acting under duress)
- A reasonable period in which to negotiate the letting
- Values remain static throughout the period
- The property is freely exposed to the market
- No account is taken of any higher price or rent that might be paid by a party with a special interest

There is no reason to assume that these terms would not apply equally to both urban commercial property and rural property.

In this current research, what is of particular interest is how the parties actually agree on a particular sum of money to represent the lease; what impact the actual ownership has, or does it matter if the lease is of Crown land from the government or freehold land from a private lessor; and how a valuer should approach the matter of undertaking the valuation of such a lease when required, including what instructions would be required from the client. At issue is the meaning of *best rent* suggested by Martin.

In a recent decision, *Programme Holdings Pty. Ltd. v. van Gogh Holdings Pty. Ltd.*,¹⁶ the issue was

whether a rent review should be based on the highest and best use of a property or on the restricted current use. The court decision noted that the valuer was required to take into consideration three matters: (1) the best current open-market annual rental value that can reasonably be obtained for the premises, (2) the current open-market annual rental values of comparable commercial premises, and (3) any permanent structural or other improvements to the premises installed at the lessee’s expense that the lessee is not permitted to remove at the expiration of the lease.

The court decision also set out guidelines that are relevant to the interpretation of a lease or license document. The court stated as follows:

- The interpretation of a written contract involves “the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.”
- The meaning of the terms of a contractual document is to be determined by what a reasonable person would have understood them to mean. That normally requires consideration not only of the text, but also of the surrounding circumstances known to the parties, and of the purpose and object of the transaction.
- An instrument should be construed so as to avoid it making commercial nonsense or giving rise to commercial inconvenience.
- Where different parts of a contract appear to be inconsistent, a court will attempt to construe the contract in a way that avoids any inconsistency and renders those parts harmonious.
- There is or may be a question as to the status and content of a requirement of ambiguity in order for evidence of surrounding circumstances to be admissible upon the construction of a written contract.
- In reconciling apparently conflicting provisions of a written contract, the court should strive to give meaning to each paragraph.

13. L. D. J. Martin, “Determination of Market Rental,” *The Valuer* 30, no 1 (January 1988): 42–47 (Australian Institute of Valuers).

14. (1907) 5 CLR 418.

15. Martin, “Determination of Market Rental,” 44.

16. [2009] WASC 79 (31 March 2009).

The rent review was to be decided on the highest and best use of the property, not its current use. The inference from this for rural property is where a lease may restrict land use, for example, to only grazing of livestock and no cropping. The highest and best use may be precluded in the lease document, but legally that use may have to be considered.

None of this appears to be at odds with the work by Martin or others in looking to understand precisely what was in the minds of the parties. It also underscores the importance of getting the drafting of a lease done correctly. Valuable principles of lease term interpretation were enunciated in the *Programme Holdings* case and serve to illuminate difficulties in disputes in the case of a rural lease or license.

It would not be unreasonable to expect that the lease value should reflect the earning capacity of the land. In that respect, one of the most authoritative series of works has been those by Eves.¹⁷

Eves suggests that for New South Wales, rural land investment (based on sales for the period 1991 to 1999) has an average return of 5.3%, although there are regional variations to this figure. Land values are underpinned by net returns, so it could reasonably be expected that there would be a close relationship between land values and market rentals, and that over a period where land values rose, rentals should follow.¹⁸

In 2005, Eves returns to the theme, analyzing capital and income performance of the New South Wales rural land market. Using farm-survey results for 1990–2000, he reports that net income per hectare varies from \$5.14 in 1995 to \$14.73 in 1999. When the capital growth is added to the income return, the total return varies from -0.31% in 1999 to 24.02% in 2000. There is clearly an indication here as to the volatility of farming in Australia.¹⁹

This theme was expounded again by Eves in 2002, when ownership is also examined. It had

been suggested that less than 1.6% of Australian farms were owned by institutional investors, thus reinforcing the anecdotal understanding that farms in Australia still cling to the family-owned model. In comparing rural land to other investment vehicles, Eves finds that rural land in New South Wales for the period 1990–2000 has an annual average weighted return of 9.25%—higher than property overall at -2.52%, bonds at 1.61%, or shares at 8.16%. Allowing for the annual income to be added, rural land achieves a return of 10.75%, against overall property with a return of 5.12%, bonds at 11.3% and shares at 12.72%.²⁰ It will of course be of great interest to see how returns for the various categories perform in the period 2000–2010, although one of the real issues for rural land will be the long term drought as well as the global recession.

In 2008, Eves turns his attention to the impact of property title type on land values for residential land in New Zealand. He finds that the highest median price attached to freehold titles, compared to cross leases and unit sales. Importantly, he finds that cross leases for the period 1992–2006 have a higher annual capital return when compared to freeholds. Again, there is no reason to suggest that the findings would not apply to other types of land, including rural.²¹

Jeffries explores fair annual ground rental, and expresses it as a percentage of land value within real world market restraints and returns.²² This is relevant to the current research as it is an important method of assessing the market rental of rural land in the absence of a strong leasing market. In presenting a model utilizing the present value of freehold and leasehold interests, including an adjustment for risk, Jeffries claims that the model can be applied to market rentals for rural land, but an understanding of productive techniques and rates of return would be required in order to apply it.

The issue of rates of return for rural property in New Zealand and elsewhere is the subject of Eves's

17. Eves, "Developing a NSW Rural Property Investment Index"; Chris Eves, "The Influence of Farm Management on NSW Rural Property Income and Total Average Annual Returns," paper presented at the 9th Annual Conference of the Pacific Rim Real Estate Society, Brisbane, Australia, January 19–22, 2003; Chris Eves, "NSW Rural Land Performance: 1990–2005," paper presented at the 13th Annual Conference of the Pacific Rim Real Estate Society, Fremantle, Western Australia, January 21–24, 2007; and Chris Eves, "The Impact of Property Title Type on Residential Property Returns," paper presented at the 14th Annual Conference of the Pacific Rim Real Estate Society, Kuala Lumpur, Malaysia, January 20–23, 2008.

18. Eves, "Developing a NSW Rural Property Investment Index."

19. Eves, "The Influence of Farm Management on NSW Rural Property Income and Total Average Annual Returns."

20. Chris Eves, "The Role of Rural Land in Mixed Asset Portfolios," paper presented at the 8th Annual Conference of the Pacific Rim Real Estate Society, Lincoln University, New Zealand, January 21–23, 2002.

21. Eves, "The Impact of Property Title Type on Residential Property Returns."

22. Rodney L. Jeffries, "Valuing Ground Rentals—Modelling the Land Value Percentage Rate," paper presented at the 11th Annual Conference of the Pacific Rim Real Estate Society, Melbourne, January 23–27, 2005.

later work.²³ He observes that there has been a declining significance of the rural sector in economic terms; that there has been a low level of institutional ownership of rural land in Australia; and that there has been a lack of performance indices for rural property. In combination, this means that rural industries have a declining political significance, and do not attract a reasonable proportion of available investment funds. It perhaps follows that investment in research and development may also decline. Eves's views appear to fully support anecdotal evidence available to valuers in the field.

The government of Victoria by and large has moved well away from the level of agricultural support and research offered in the past. However, its Department of Primary Industries still undertakes an annual Wool Industry Farm Monitor Project, which provides net income and capital returns for the livestock industries, and the Australian Bureau of Agricultural and Resource Economics still undertakes its series of farm surveys. These are very useful studies, but from a property perspective, Eves's work in relation to capital and income performance in New South Wales is perhaps far more useful. Unfortunately it only covers one of the Australian states. It is clear that there is an opportunity for far more research in this area.

An important court decision that needs to be considered in relation to the case study area is *Bullivant v. The Minister*,²⁴ which was handed down in 1936 just after the completion of the Hume Dam. The judge in *Bullivant* sought to quantify the impact of flooding on land, basing his compensation assessment on the amount of time that the land was inundated.

Flooding is an ongoing productivity issue for leased land on the edge of the Hume Dam, and while recent seasonal conditions have caused the problem to be remote, it can still occur. In *Bullivant*, land located below the full-supply level was held to be permanently damaged and compensation for the full value of the land was awarded. There may be some seasonal grazing possible on the land, but improved pasture would not survive periodic inundation. Another part

of the land was higher than the full-supply level and only affected by peak floods. In *Bullivant*, this area was valued on the basis of lost grazing time and detrimental effect on pasture, and compensation was assessed on the basis of one-third of market value. There was a third section of land at a higher level that would not flood, but the easement applied to the land caused a "blot on title." Compensation for this area was assessed at ten percent of the market value. There have been no known cases in the area altering the *Bullivant* decision.

In summary, it is clear that in Australia, at least, there is a dearth of research being done into rural property, including in relation to leasehold interests. While there has been work done in this area overseas²⁵ there are structural and legislative reasons why the parallels cannot be as easily drawn as might otherwise be apparent.

Case Study Area Resources

North East Victoria's water resources remain under the control of a statutory body, Goulburn-Murray Water. The Hume Dam is the main operating storage for the Murray River system,²⁶ with a capacity at full supply level of 3,035,500 megaliters and a surface area of some 20,000 hectares. It is supported by a number of other dams on the river's tributaries, such as Dartmouth Dam on the Mitta Mitta River. The Hume Dam has been jointly managed by Victoria and New South Wales since it was commissioned in 1936, as the Murray River is the boundary for these states. Goulburn-Murray Water controls 835 leases and licenses. These land leases adjoin water storages, are subject to flooding, and are generally used for cattle grazing.

The riverine nature of the land prior to flooding has left a dam with a series of arms. The Murray arm is that along the original river, running to the northeast from the dam. The Tallangatta or Mitta arm runs to the southeast, along the course of the Mitta Mitta River. The area around both of these arms is the subject area for this research.

23. Chris Eves, "Developing a Rural Land Investment Performance Index for New Zealand," paper presented at the RICS Rural Research Conference, Cambridge, England, March 23–24, 2009; and Chris Eves and Marvin Painter, "A Comparison of US, Canadian, Australian and New Zealand Rural Property," *Australian and New Zealand Property Journal* 1, no. 7 (September 2008): 588–598.

24. *Bullivant v. The Minister*, Land & Valuation Court, Sydney, 13 May, 1936.

25. R. G. Whitehead, *How Are Farm Tenancies Working?* Royal Institute of Chartered Surveyors January 1997.

26. The Murray River is Australia's longest river, but relatively short by international comparison. The Hume Dam is 302 river kilometers downstream from the Murray River's mountain source and 2,225 river kilometers from its mouth in South Australia. The river winds and snakes through flat country for the majority of its length and this accounts for the greater distance involved between river kilometers and straight line distances.

Within the district around the Murray arm there are very productive flats, with stocking rates of one cow per two to two and a half hectares, or 6 to 7.5 dry sheep equivalents²⁷ per hectare. From Granya Bay to Talgarno, however, the productivity deteriorates. Some areas display bad soil erosion or minimal pasture cover. The capacity of this land is to the order of 2.5 dry sheep equivalents or less. From Talgarno to the Bethanga Bridge there are only a few grazing licenses, with low productive value. Flooding and erosion is progressively more severe in this section, especially where there is little or no tree cover. A typical lease in this section would have only a few dead and living eucalyptus trees on its area. There is scant bush or lower-story vegetation. The grazing pasture is generally of native species, with some subterranean and native clovers and trefoils. This land is generally not fertilized, and therefore the legume cover is sparse, and weeds are an ongoing problem.

On the western side or bank of the Mitta arm there is significant variation in land quality and hence productivity. The area from the weir wall to Tallangatta has poor grazing capacity, but areas to the south of the Murray Valley Highway have excellent capacity. To the east of Tallangatta township, licensed areas suffer from less annual flooding, and there are good grazing areas to be found. This section is predominantly flat. One of the most productive licenses is found in this section. Others are enhanced by excellent tree cover, although there is still some risk of flooding from both the Murray storage as well as peak flows released from the Dartmouth Dam down the Mitta Mitta River. There are, however, many areas with sparse or dead tree cover in this area, and on these leases the land is exposed and weed occurrence is problematic.

On the eastern bank of the Mitta arm, there are steep banks, with eroded and rocky areas, leading down to sloping areas. There is sparse grass cover, although some of the licenses are of a better standard. Again there is sparse tree cover, with most trees dead, and troublesome weeds.

Because of the proximity of the area to the large regional center of Albury-Wodonga, and the existence of a number of small towns, including Tallangatta and Bellbridge, there is a distinct market

for what are termed *lifestyle blocks*, another for larger blocks termed *hobby farms*, and the main market for rural land, delineated by holdings of more than 40 hectares.

Methodology

In respect of rentals or leasing of land in the area, four approaches have been traditionally applied. The first approach uses a percentage of the market value of the land; the second approach relates to agistment rates;²⁸ the third approach examines productive value of the land; and the fourth uses a gross margin or income approach. While clearly the analysis of the productivity of leased land is the preferred option, the real difficulty is that there is generally a dearth of current comparable information, as there is not an organized leasing market. In the early years of settlement, it was common to hold public lease auctions,²⁹ but this practice ceased by the beginning of the twentieth century as owner occupation of farmland became the norm.

In the following discussion, the analysis will provide an insight into how valuers in the region—and indeed those involved in the process of leasing land either from the government or private individuals—undertake the task of establishing fair or best rents, and what issues arise in respect of disputes.

Data and Analysis

Analysis of recent sales and transactions within the study area reveals the following bases:

- Value of freehold land per hectare, excluding buildings: Values range from \$2,050 per hectare for marginal farming land and \$6,200 per hectare for good average grazing country (typical of good licensed areas fronting the Hume Dam), up to \$17,800 per hectare for good country with a lifestyle component and good water views.
- Freehold leases (AUD per hectare per annum, plus rates, plus a requirement to topdress with superphosphate annually): Values range from \$67 per hectare for marginal farming land (predominantly timbered hill with exposed granite) to the highest figure, on the highly productive Buffalo Creek flats, at \$284 per hectare. Average farming land within the study area leases for \$95 per hectare.

27. *Dry sheep equivalent* refers to the amount of feed a 42-kilogram Merino wether requires over the course of a year. Scientific comparison allows for conversions to be made for other classes of livestock. Depending on breed and therefore size a beef animal would equate to 10–12 dry sheep equivalents or DSE.

28. An *agistment* is money paid for grazing stock on land owned by another person. The owner of the land is responsible for the feeding and care of the livestock. Agistment is for a short term and is quoted as dollars per head per week, e.g., \$5.00 per cow per week.

29. Baxter, "Rural Land Use."

- Rental returns: Historically, returns range from 5% to 6% per annum based on market value.⁵⁰
- Agistment values (AUD per head, all inclusive): Values for 1 cow and calf at \$5 per week; sheep at \$0.50 per week. This has been up to \$9 per head for cow and calf, depending on demand, due to the drought conditions experienced over the past few years.
- Gross income per year (AUD): Gross income for 1 cow and calf equals \$500; for 1 cow and calf equals 15 dry sheep equivalent.
- Gross margin per hectare: Margins average \$140 per hectare for the North East region.⁵¹ It is estimated that this would not exceed \$120 in 2009, due to seasonal factors.

From a lease perspective, this data is substituted into calculations, using the four methodologies for average farmland within the study area with a market value of \$6,200 per hectare excluding buildings, to achieve a rental valuation as follows.

Method 1: Percentage of Market Value

\$6,200 per hectare at 6% indicates a rental amount of \$370 per hectare per annum. At 3% it would be \$186 per hectare per annum.

Method 2: Agistment Rates

The land would carry 1 cow and calf to 2 hectares; indicates a rental amount of \$150 per hectare per annum.

Method 3: Productive Value/Gross Income Approach

The land carries 1 cow and calf per 2 hectares, with a productive value of \$500 per annum. Rental value would then be \$125 per hectare, using the industry norm of 50% of the productive value representing the return to land.

Method 4: Gross Margin Approach

The gross margin for this land would be \$140 per hectare, and allowing a rental value of 50%, this would represent \$70 per hectare per annum.

Discussion

What is shown by the four approaches is a significant variation in what the indicated rental value would be if any one method were relied on alone. Valuers would normally use rental evidence derived from district investigation, but it may not always be readily available or exist. The real question is how do the parties agree on the amount to be paid, and in the absence of market rental information how might the task be best

approached? Clearly those aware of what the farm is worth in the market would try to base negotiations on the first method to achieve a reasonable return to their investment. The question then would be at what rate of return?

What is shown by analysis of the study area is that there are other factors driving land values. These largely relate to lifestyle options and reflect a society willing to invest in land with views or scenic rural attractions as a way of improving lifestyle. Another factor involved in the trading of rural real estate has related to the capital gains experienced over time, and these are clearly indicated in Eves's 2009, 2007, and 2003 works. Application of this method as a stand-alone is therefore likely to lead to erroneous results.

That leaves the other methods, which vary on the theme of relating rental value to productive return from the land. The second method (agistment rates) is a gross return, with the owner of the land responsible for maintenance of the land and pasture, the supply of water, and stock-proof fencing. Disease control is also required. The difficulty in this method also relates to the fact that agistment tends to be seasonal, with stock carried on the home farm in times of good growth, and being moved onto agistment as an emergency measure. Income for this approach cannot therefore be guaranteed: there is a distinct element of risk. Agistment should therefore be seen as a short-term return, whereas what is at issue here is a value for long-term leased land.

The third method is favored by farmers over the fourth. The question asked in the marketplace by farmers is what is the productive capacity of this land? What they may well also ask, however, is for more detail on the overheads and investment in capital equipment in order to realize the return.

Simply assuming an all-up return ignores the importance of equipment, overhead costs, and labor. For these reasons, the gross margin approach, dealing with gross returns less variable costs is more realistic. There is an element of risk taking in simply looking to the productive value. For leased land, many of the overheads that have to be accounted for in the normal sense to arrive at a net return for farming operations are borne by the lessor and not the lessee. Leasing land can be seen, therefore, as a good way of achieving an

30. This is approximately 50% of the returns found for New Zealand by Eves; see Eves, "Developing a Rural Land Investment Performance Index for New Zealand."

31. Farm Monitor Survey, Department of Primary Industries (Bendigo, Victoria, 2005), *Victorian Resources Online*, <http://new.dpi.vic.gov.au/vro> (accessed May 2009).

increase in production without standard overheads associated with land ownership.

In a series of interviews with farmers in northeastern Victoria, it was found that all interviewees agreed that the agistment basis for determining rental was not relevant. Most farmers favored the productive or gross income approach as it depends on the assessment of the productive capacity of the land. Due to tough seasonal conditions the range of gross income in the region was found to be \$440 to \$500 per cow and calf, with a common stocking rate found to be 1 cow and calf per 2 hectares, at a rental value of 50% equals a range of \$110 to \$125 per hectare. All farmers interviewed said that the gross margin approach was too general, as data is not available for specific farms.

There were two variations to the productive method revealed in the interviews. One farmer said that an estimate of the productive capacity should be calculated as dry sheep equivalent per hectare. The factor used by the farmers is generally 15 dry sheep equivalent to 1 cow and calf, meaning that there was a general acceptance that much of the study area carries 7.5 dry sheep equivalent per hectare. This would show a rental of \$115 per hectare, assuming a gross profit of \$460. This is shown at method three above. Another farmer estimates his ability to pay for leased land on the basis of \$15 to \$20 per dry sheep equivalent, with the variation due to seasonal conditions. The 2009 estimate was \$16 per dry sheep equivalent. When this is multiplied by the productive capacity of the land, a rental of \$120 is indicated.

Similarly, interviews with valuers responsible for setting Crown leases and licenses showed that they generally assess the productive capacity of the land, with the common denominator being the dry sheep equivalent rating for the land being valued. This is multiplied by a dollar figure per dry sheep equivalent formulated by the Office of the Valuer General. A total of 20,000 grazing licenses (mainly unused roads and water frontages) and 600 leases (generally old improvement leases, perpetual leases, and other leases dating back to the early settlement period) are managed by the Department of Sustainability and Environment. Many of the 600 leases have nominal rentals under the terms and conditions of the lease itself.

There is pressure on the lessees to convert leasehold interests to freehold interests on payment of a grant fee to the government. It is important to note, however, that this process may involve a native title claim in some areas, although it this would likely

be tested by the lessees. The approach taken by government-appointed valuers in respect of the other licenses uses a commercial view, that is, based on a dollar value per productive unit (dry sheep equivalent); however, the rating is reduced from its optimum due to the following special factors:

- The licenses do not offer exclusive possession of the land and may be subject to public access.
- Lessees have to pay the rates.
- Pest, plant, and animal issues are responsibilities of the lessee, which means the lessees are required to control weeds and vermin on the land.
- The lessee provides a benefit to the Crown through land management.
- The lessee assumes full management responsibility for those parts of the land that are nonproductive.

Negotiations are currently underway between state government agencies and the Victorian Farmers Federation (a political lobby group representing farmers) to achieve an agreed outcome for the basis of the rental of Crown land in Victoria. The indicated position at the time of this writing is that approximately one-third of the capacity of the total area should be used as the basis of assessment of the rental value. This takes into account the factors noted, but is also in line with the *Bullivant* decision, which attempted to quantify the impact of flooding on the productive capacity of land.

Goulburn-Murray Water, the statutory authority controlling land on the Victorian side of the Hume Dam (84 grazing licenses in the study area) has a similar view, but is perhaps more commercially oriented. Its valuations take into account similar factors to those listed and also the impact of flooding on the lands. Weed infestation on land affected by regular flooding can be severe, and this is a compulsory expense to the licensee in terms of cost of land management. Because of the environmental impact, fertilizer cannot be used on these licenses, again restricting potential productive capacity. A typical license in 2009 was valued on the basis of 7.5 dry sheep equivalents per hectare, at the rate of \$11 per dry sheep equivalent, less an allowance of 25% to reflect potential flooding for two months per annum, and a further month for the land to recover before grazing can re-commence.

There are two other forms of lease value assessment undertaken by the Office of the Valuer General in conjunction with the Department of Sustainability and

Environment, assessed on a per-head basis, which impact the north east region. Significant forest areas with limited seasons (approximately a four-month period) are rented at \$4.40 per head (beef cattle) per week. Subalpine leases, renewable annually, used to be put out to tender, but are now reviewed by the government on an annual basis. This review is also based on productive capacity, using a common denominator of \$4.40 per head per week. In both cases, the short season and annual nature means this is more like an agistment rate than a lease value.

Other issues may arise with rural leasehold land and rentals. First, although rare, a dispute may arise as to the interpretation of terms and conditions in a lease. This may require legal expertise.

Second, the rental, at a review date may be in dispute. How are the impacts of restrictive conditions in a lease to be treated? What impact do such conditions have on any new rental? These are difficult questions to resolve. Disputed rentals are usually resolved with the appointment of a valuer acting as an expert to determine the market rental or to advise on the lease terms and conditions. It is rare for valuers to be appointed for each party. Lease documents for rural land are less complicated than commercial leases. The quantum for commercial leases is generally much higher than a rural lease. This provides the economic viability to sustain legal disputation. These factors may well explain why disputation is rare for rural leases.

Third, valuation expertise is required to value the leasehold interest. The methodology is to discover if the current market rental is greater than the rental reserved under the lease. If it is, the difference is the profit rental. That is, if the rental is \$100 per hectare and the market rental is \$150 per hectare, the profit rental is \$50 per hectare. This is multiplied by the area to give a total profit rental. The resulting amount is then capitalized at a safe rate of interest for the unexpired portion of the lease. This method has been used for a long time, and is accepted in the marketplace.

Conclusions

There remains uncertainty within the market, government agencies, and the valuation profession as to the most appropriate, or correct, approach to take in performing valuations of a rental for leasehold interests. It is clear from the research that much depends on the terms and conditions of the lease. It is also clear that within the marketplace there is reliance on estimates of the productive capacity of the land.

Farmers are taking seasonal and economic conditions into account when making their estimates of productivity and return, and the rental amount that can be afforded. Their preferred method of assessing rental is therefore the productive capacity multiplied by the dollar rate per productive unit. Evidence from government agencies also indicates that this is the method currently used to determine rents for Crown leases and licenses, and also for rents attaching to land controlled by statutory bodies. There is clearly a reticence on the part of lessees to be involved in leases that are reflective of a return to the capital value of the land.

There is no database for leases or licenses that can be readily accessed by valuers; therefore, information is particularly difficult to obtain and comparisons hard to make. While the current method of assessment reflects the earning capacity of land, once other value drivers are taken into account, the return from leasing land for agricultural purposes may be very low compared to other forms of investment. At a time when return to property investment is being closely examined, this area remains an important one for further research.

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Additional Reading

- Collins, H. G. *Rural Land Utilization*. Commonwealth Institute of Valuers, 1966.
- Eves, Chris. "Total Farm Performance in a Free Trade Economy." Paper presented at the 7th Annual Conference of the Pacific Rim Real Estate Society. Adelaide, Australia, January 21–24, 2001.