

## AASB 138: Watch this Space for Leases

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### Background

AASB 138 is the Australian equivalent of IAS 38 (International Accounting Standards) pertaining to the quantification and reporting the intangible assets of the business on the balance sheet. Intangible assets: include brand names, patents, trade marks, etc, and of course leases.

The concept came to my attention at the first World Valuation Congress (WAVO) in Singapore in 2006. I incorporated and expanded the thinking into my paper "Settling rental disputes by expert determination" – see Google which I presented the following year at the second World Valuation Congress in Beijing – see extract below.

### **"Factors adding or decreasing the "value" of a lease**

The Table below lists and suggests some concepts that would add or detract from the intangible asset value on a lease agreement and below that is an example of the same.

<b>Factors adding "value"</b>	<b>Reducing or negative value</b>	<b>Comment</b>
Long tenure say 5+5+5+5 years	Shorter tenure say 4 – 6 years	Leases in the UK can be 10+10+10 years, with automatic renewals. With less tenure, one must amortise set-up costs over shorter term
"Market rent" can be ordered by court in UK	Rent well above "market rent"	Rent established using principles in tenancy legislation and definition of market rent vs gazumping viz. duress, misrepresentation etc
Low set-up costs	High set-up costs	Affects amount to amortise over term and residual available for rent
Flexible lease terms, regular reviews to market rent	Inflexible lease, rigid rental structure viz. CPI + 1.5% pa	Flexible leases result in market rental outcomes and lower risk on income streams. Rents must be able to rise and fall without a ratchet
A combination of the above	Same	With no options or renewal opportunity, business must selling down stock and close
<b>Other factors which will increase and decrease the value of a lease</b>		
Good and poor management of tenancy mix		Diminution of cash flows must be taken into account under AASB 138, eg. failure to manage tenancy mixes, causing higher risk.
Valuers who do not adopt market rental into rental valuations or cannot interpret "evidence"		A valuer who cannot adopt or "test" evidence and separate the business and site goodwill should not determine market rents and produce inflated valuations which often require forensic financial analysis.
Failure to provide quiet use and enjoyment		Reduces business potential and decreases value of lease
Failure by Tribunals and Courts to enforce legislations and make decisions in equity		This will put pressure and force our judicial systems to award damages in equity
Investment in a court or tribunal action		An "investment" to protect one's position viz. a director of a retail business, forced to protect their asset under corporations law via a court action, might see a favourable outcome as an "asset" on the balance sheet

### **Two scenarios, two businesses in two similar centres with similar business potential:**

- First, the landlord with flexible leases and security of tenure; who manages tenancy mixes; procures, apportion, charges and audits outgoings and utility charges efficiently; properly promotes and allows market forces to drive development;
- Secondly, the landlord who develops centres he owns and manages; duplicates tenancy mixes; erodes the cash-flow via profit on management fees, outgoings and utility charges; inflates refits via subsidiary

*companies before they are depreciated; whose leases are inflexible, have fixed increments and limited/short tenure.*

*Comparing and contrasting the two is easy. Dough nut franchise one has a strong balance sheet and goodwill whereas franchise two, which also cost \$250,000 to set up, will have little/negative value because AASB 138 requires the value of the lease to reflect negative value of the intangible assets, including the lease.*

### ***Double whammy – intellectual property and goodwill***

*The double whammy will be the adverse affect on intellectual property, trademarks and goodwill of a business.*

*Staff with limited employment, because the business has no tenure, will move on; intellectual property associated with the business or customer lists and addresses, shown as an “asset”, must be given negative “value”.*

*A business making no net return has negative goodwill, so the host that houses it – a shopping centre will have significantly diminished value!*

*AASB 138 will become an important consideration, from a valuer’s point of view, to determine rents and asset valuations and will provide a “check and balancing factor” for the professional valuer to lean on.”*

### **Conclusion**

AASB 138 in my opinion will force both Landlords and Tenants to significantly lift their game insofar as negotiating fair, flexible and longer leases are concerned.

A negative “bundle” of leases on a Landlord’s balance sheet could be highly detrimental to valuations. Valuation standards will have to lift and Landlords will have to plan ahead as to when they want leases to terminate to renovate/refurbish, etc.

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