

VICTORIAN CIVIL AND ADMINISTRATIVE TRIBUNAL

CIVIL DIVISION

BUILDING AND PROPERTY LIST

VCAT REFERENCE NO. BP55/2015

CATCHWORDS

Retail Tenancies – rent review by valuer – whether Rent Determination vitiated by error – relevant principles

APPLICANT	Keriani Pty Ltd
RESPONDENT	Caroline Long
WHERE HELD	Melbourne
BEFORE	Deputy President C Aird
HEARING TYPE	Hearing
DATE OF HEARING	3 July 2015
DATE OF ORDER	7 August 2015
CITATION	Keriani Pty Ltd v Long (Building and Property) [2015] VCAT 1212

ORDER

1. The application is dismissed.
2. The Tribunal declares that the parties are bound by the Rental Determination dated 30 April 2014.
3. Costs reserved with liberty to apply. I direct the principal registrar to list any application for costs for hearing before Deputy President Aird.

DEPUTY PRESIDENT C AIRD

APPEARANCES:

For Applicant	Mr S Hopper of Counsel
For Respondent	Mr J McKay of Counsel

REASONS

- 1 The respondent tenant operates a pharmacy out of two shops in Whitehorse Road Balwyn which she leases separately from the applicant landlord pursuant to two Deeds of Assignment of Lease dated 19 July 2010, which are identical save for the premises. Rent reviews are to be to market rent at the times set out in Annexure A to the Deed of Assignment which included a number of variations to the Lease dated 7 September 2009.
- 2 When the parties could not agree on a new rental for the two shops they jointly requested the Small Business Commissioner of Victoria to appoint a valuer to determine the rent payable as at 1 August 2012, being the date of the first review.
- 3 Peter A Lawrence of Lawrence Commercial ('the valuer') was appointed by the Small Business Commissioner to determine the rent. His rental determination ('the Determination') which is dated 30 April 2014, determines the market rent for the period commencing 1 August 2012 as \$135,000 per annum for shop 1 and \$85,000 for shop 2 – both amounts being plus outgoings and plus GST.
- 4 On 16 January 2015 the landlord commenced this proceeding. The application was accompanied by Points of Claim wherein the landlord seeks a declaration that *the [rental] Determination is vitiated by error and not binding on the parties*. Amended Points of Claim were filed on 7 May 2015 wherein the landlord also alleged that the Lease was not subject to the *Retail Leases Act 2003* ('the RLA'). However, at the commencement of the hearing, the landlord conceded that the Lease is a lease of retail premises for the purposes of the RLA. Therefore, these Reasons are concerned only with whether the parties are bound by the Determination.
- 5 The landlord was represented by Mr Hopper of Counsel and the tenant was represented by Mr McKay of Counsel. I have been assisted by their thorough written submissions, and the oral submissions made at the hearing.

THE RENTAL DETERMINATION

- 6 In the Determination, the valuer records that the parties made the following submissions:

The Lessee provided a letter noting the current state of the market as seen from the tenant's perspective including rental evidence for a few properties as well as correspondence between the Lessee and Lessor regarding the market review prior to my appointment.

The Lessee believed the rental to be well above market levels.

The Lessor provided a copy of a rental submission prepared by Landmark White and second rental submission prepared by O'Briens.

Both submissions contained property information and details and a list of rental evidence considered comparable to the subject.

The rental level¹ put forward within the submissions are as follows

	Shop 1	Shop 2
Landmark White	\$151,420.00 pa	\$90,3000.00 pa
O'Briens	\$152,500.00 pa	\$93,500.00 pa

7 No details were provided in the valuer's reasons about the tenant's submissions as to the appropriate market rent.

8 The valuer has also recorded that:

The rentals at the commencement of the lease [in 2009] were \$132,186.04 per annum plus GST for shop 1 and allowing for the annual 4% increases, then the current passing rent up to the market review should be approximately \$142,972.42 per annum plus GST while the commencing rate for shop 2 was \$86,521.77 per annum plus GST and again allowing for the annual 4% increases then the current passing rent up to the market review should be approximately \$93,581.95 per annum plus GST.. [pg 6]

And, he determines the appropriate rental for each shop as:

Shop 1 - \$135,000 per annum plus GST

Shop 2 - \$85,000 per annum plus GST

9 The valuer relevantly states:

2. Statutory Requirements

The principal legislation governing this determination is the Retail Leases Act 2003 which superseded the former Retail Tenancies Act of Victoria.

...

The rental determination in the subject case and according to Clause 12 of each lease is described as "the current market rent" of the premises while under the Deed of Variation of Lease, it is now referred to as the "new rent".

Under the Retail Leases Act 2003, Section 37(2) it states "The current market rent is taken to be the rent obtainable at the time of the review in a free and open market between a willing landlord and willing tenant in an arm's length transaction having regard to these matters-

- (a) the provisions of the lease;
- (b) the rent that would reasonably be expected to be paid for the premises if they were unoccupied and offered for lease at the same, or a substantially similar, use to which the premises may be put under the lease;
- (c) the landlord's outgoings to the extent to which the tenant is liable to contribute to those outgoings;

¹ All amounts are plus GST

- (d) rent concessions and other benefits offered to prospective tenants of unoccupied retail premises...

But the current market rent is not to take into account the value of goodwill created by the tenant's occupation or the value of the tenant's fixtures and fittings and being known as the tenant's goodwill.

There is also a locational goodwill that attaches to the premises itself and is not the result of some special work by or a special feature of the tenant, which shall be taken into account by the determining valuer, however, the locational goodwill would normally be reflected in the rent paid for other comparable and similarly located premises.

It is also assumed that in fixing the rent obtainable that:

- (a) The parties have each acted knowledgeably, prudently and without compulsion;
- (b) The retail premises were vacant and to be let on similar terms and conditions as contained in the current retail premises lease
- (c) All other relevant factors, matters and variables used in a proper land valuation practice have been taken into account.

...

- 10 The landlord identifies a number of statements made by the valuer under the heading 'Valuation Rationale' on page 11 of the Determination which it contends demonstrate that the valuer has not determined the *market rent* on the basis required by s37(2) of the RLA. It is helpful to set out this section of the Determination in full, so that these statements can be considered in context. For ease of reference I have underlined those statements relied upon by the landlord ('the statements').

9. Valuation Rationale

My determination is based upon my assessment of the current market rental value of each of the subject premises within the meaning of the relevant legislation and upon the terms and conditions as noted in the lease agreements.

Although the subject premises are used as one tenancy, given that there are two separate lease and deed of assignment of lease documents, then for the purposes of this determination, we have assessed a rental to each shop.

Having regard to Section 37 (2) of the Retail Leases Act, we noted that the area is very tightly held with very few vacancies so we have therefore had regard to the limited new lettings as well as current lettings to which we have then made necessary adjustments.

We have noted from our investigations those shops that have had market reviews, because while the shop was not vacant, the Lessee had the opportunity to vacate while in some cases the Lessor had the opportunity of placing the premises on the market with vacant

possession and therefore this type of review would appear to satisfy the definition of “Current Market Rent or New Rent”.

In tightly held retail areas such as Whitehorse Road, Balwyn, we know that in numerous cases the leases are sold with the shop never becoming vacant.

If a shop does come onto the market with vacant possession, it is often leased at a rental above market due to limited supply and leasing opportunities and with the Lessee desperate to get into the area and therefore willing to pay the landlords asking price rather than miss out.

However, we are aware that some of these inflated forms of rental evidence or asking rentals do not create the market but reflect the strength and demand for an area.

Under the Retail Leases Act, we are also to rely upon retail rentals for shops that have “the same or substantially similar use” which could be interpreted as being either a retail use or the specific type of use such as the subject being a chemist/pharmacy.

Again in the stronger and sought after retail precincts distortion can occur with landlords asking above market rentals because of limited supply and excessive demand to get into a retail area.

To obtain a greater number of rentals for the same use may require going out of the immediate retail area, which then requires we believe too many adjustments and opens up the interpretation of the evidence to numerous assumptions and therefore we believe this evidence to be secondary.

We have had regard to rentals of shops for similar type uses nearby and have also considered the level of rentals being paid for shops along Whitehorse Road within the Balwyn shopping strip of which many are of different use albeit of a comparable retail nature.

...

11 In its Amended Points of Claim dated 7 May 2015, relying on the statements I have underlined in the Determination, the landlord alleges:

7. Accordingly, the Determination expressly disregards the inflationary effect on rental caused by a property being unoccupied and available for rent and has, in so doing, failed to give effect to the assumption that the premises is ‘*unoccupied and offered for lease*’ as required by s37(2)(b) of the RLA 2003...
8. Further, the Determination does not have regard to rent concessions and other benefits offered to prospective tenants of unoccupied retail premises as is required by s 37(2)(d) of the RLA 2003.
9. Alternatively to 8, the Determination fails to disclose consideration of rent considerations and other benefits offered to prospective tenant of unoccupied retail premises and,

accordingly, does not contain detailed reasons for the specialist valuer's determination and specify the matters to which the valuer had regard in making the determination as is required under s 37(6) of the RLA 2003.

10. Accordingly, the determination is vitiated by error and liable to be set aside.
- 12 On 2 July 2015 the valuer provided a supplementary report which I will consider later in these Reasons.

When can an expert Determination be set aside?

- 13 It is clearly established that an expert determination may only be reviewed by courts and tribunals where there has been fraud, collusion or mistake arising from the failure of the valuer to carry out his task in accordance with the contract. There is no suggestion of fraud or collusion here. The landlord contends that the Determination is vitiated by error because the valuer has not determined the market rental for each of the premises taking into account the matters set out in s37(2) of the RLA. The tenant does not agree, and submits that the valuer has not made an error, alternatively, *...any error in the Valuation did not amount to a failure by the Valuer to comply with the task conferred by the Lease and/or the Act.*²
- 14 As the authorities referred to below demonstrate, expert determinations can only be set aside in exceptional circumstances.
- 15 In *Legal & General Life of Australia Ltd v Hudson Pty Ltd*³ McHugh JA said at 335 to 336:

...the question whether a valuation is binding depends upon the terms of the contract, express or implied (at 335)

...

While mistake or error on the part of the valuer is not by itself sufficient to invalidate the decision or the certificate of valuation, nevertheless, the mistake may be of a kind which shows that the valuation is not in accordance with the contract [for example, where the valuation relates to the wrong premises] (at 335)

and

But a valuation which is the result of the mistaken application of the principles of valuation may still be in accordance with the terms of the agreement. In each cases the critical question must always be: Was the valuation made in accordance with the terms of the contract? If it is, it is nothing to the point that the valuation may have proceeded on the basis of error or that it constitutes a gross over or under value. Nor is it relevant that the valuer has taken into consideration matters which he should not have taken into account or has failed to take into account matters which he should have taken into account. The

² Respondent's submissions at [61]

³ (1985) 1 NSWLR 314

question is not whether there is an error in the discretionary judgement of the valuer. It is whether the valuation complies with the terms of the contract. (at 335-336) [underlining added]

- 16 Further, in *Eureka Funds Management Limited & Anor v Freehills Services Pty Ltd*⁴, Hargrave J said:

In the case of mistake, the Court will only intervene where the expert's determination is not made in accordance with the contract. In particular, subject to limited exceptions which are not relevant to this case, a court will not intervene where the expert has made a mistake in the process of reaching his or her determination. [underlining added]

- 17 In *Epping Hotels Pty Ltd v Serene Hotels Pty Ltd*⁵ Croft J described the Tribunal's task as:

As the authorities make clear, the Tribunal's task was to consider whether the Rental Determination answered the contractual description of what the Valuer was required to do. For present purposes, it is sufficient to note that, by virtue of s37(1) of the Act, sub-s (2) is taken to be a term of the lease, that is, a term of the contract between the parties. Therefore, the Valuer was required to make a determination that accorded with the requirements of that subsection.

- 18 In *Commonwealth v Wawbe* [1998] VSC 82 Gillard J said at [17]

The parties to a contract agree that the value is to be determined by an expert acting as such and using his own skill, judgement and experience. He is not a lawyer. His authority derives from the contract. The terms of the contract are to be considered by him. It would be contrary to the parties' common intention to expect the valuer to construe the contract and apply it as a court would. The parties have entrusted the task to an expert valuer, not a lawyer. They must be taken to accept the determination "warts and all" and subject to such deficiencies as one would expect in the circumstances. The parties put in place the procedure, they must accept the results unless it was contrary to their common intention. [underlining added]

and at [44]

The trend of the authorities establish that the mistake must be of a kind which demonstrates that the valuer did not perform his task as required by the contract making allowance for the fact that the valuer in construing the agreement, where necessary, is a valuer not a lawyer.

DISCUSSION

- 19 For the applicant to succeed I must be satisfied that the valuer did not carry out the task he was required to carry out. It is not enough that the applicant is unhappy with the Determination. The parties agreed to be bound by it, and they will only not be bound by it if it is vitiated by error. As seen from

⁴ [2006] VSC 461

⁵ [2015] VSC 104

the authorities referred to above, the error must be fundamental.⁶ Here, the landlord contends that the valuer has not determined the market value of the rent by considering the rent that could be achieved *if the shops were vacant and offered for rent on the open market*. The tenant contends this is not an accurate description of the valuer's task. As set out in her submissions, the tenant contends his task was to:

45....

- (a) Ascertain the 'current market rent; and
- (b) To do so having regard to certain matters, including (relevantly) the rent that would reasonably be expected to be paid for the premises if they were unoccupied'..

20 The applicant focuses on selected extracts from the Determination. However, in considering whether the valuer has carried out the valuation in accordance with the requirements of s37(2), these extracts must be read in context, and as part of the total Determination.

21 In *Wawbe*⁷ Gillard J set out the three questions to be considered by a court [or tribunal] in considering whether an expert determination is vitiated by mistake:

- (i) What did the parties agree to remit to the expert?
- (ii) Did the valuer make a mistake, and if so what was the nature of the mistake?
- (iii) Is the mistake of such a kind which demonstrates that the valuation was not made in accordance with the terms of the contract and accordingly does not bind the parties?

22 I will adopt the same approach.

What did the parties agree to remit to the expert?

23 It is common ground that in requesting the Small Business Commissioner to appoint a specialist valuer the parties agreed the valuer was to determine the market rental for the two properties in accordance with s37 of the RLA and the terms of the lease.

Did the valuer make a mistake?

24 As noted above, the applicant contends the valuer has made a mistake because his Determination does not reflect the *rent obtainable at the time of review in a free and open market between a willing landlord and a willing tenant in an arm's length transaction*. For the reasons which follow, I am not persuaded that the valuer has failed to carry out his task in accordance with the terms of his retainer.

⁶ such as where the valuation relates to the wrong premises, as suggested by McHugh JA in *Legal & General Life of Australia Ltd v Hudson Pty Ltd*, supra

⁷ supra

25 Section 37(2) requires the valuer to take a number of factors into consideration. On a careful reading of his Determination and the supplementary report, I am satisfied he has done so. I accept Mr McKay's submissions that s37(2) does not preclude a specialist valuer from taking into account any other factors which he considers relevant, *other than the value of goodwill created by the tenant's occupation or the value of the tenant's fixtures and fittings*, which is expressly excluded by s37(2). Rather, it mandates those factors which must be taken into account.

26 Even if the valuer has taken into account factors which he was not entitled to take into account, and I am not persuaded that he has, as Mason P observed in *Holt v Cox*⁸ at [49]

A close reading of McHugh JA's judgment in *Legal & General* indicates that his Honour was not propounding the view that a valuation will stand regardless of error. Rather he was making the point that mistake is not itself a ground of vitiation: see also *Wamo Pty Ltd v Jewel Food Stores Pty Ltd* (1983) ANZ Conv R 50. A valuation may contain factual error or embody consideration of matters which should not have been taken into account, but it does not follow that the result is outside that which the contract contemplated would be within the realm of determination by the valuer. As McHugh JA makes plain, "in each case the critical question must always be: Was the valuation made in accordance with the terms of [the] contract? *If it is*, it is nothing to the point that the valuation may have proceeded on the basis of error or that it constitutes a gross over or under value" (emphasis added).

27 When read carefully, it is clear that the valuer has taken into account the information which he considers to be readily obtainable and relevant to his market rental determination. He clearly states that he has had regard to the *limited new lettings* as well as to the rent reviews of other shops in the precinct. He confirms that he has had regard to these tenancies and rent reviews because of the *very limited new lettings*. Further he has made it clear that in considering the rents paid by sitting tenants that *We have noted from our investigations those shops that have had market reviews, because while the shop was not vacant, the Lessee had the opportunity to vacate, while in some cases the Lessor had the opportunity of placing the premises on the market with vacant possession.* [underlining added]

28 The parties did not refer me to any authorities as to the meaning of *market rental* in the terms provided for by s37(2) of the RLA. In *756 Glenferrie Road Pty Ltd v Mountfords Shoes Pty Ltd*⁹ SM Riegler stated at [22]:

In my view, s.37(2) requires a specialist valuer to look at what the Tenant is permitted to do under the Lease and to determine the highest rent that would reasonably be expected to be paid for the Premises...[underlining added]

⁸ (1997) 23 ACSR 590

⁹ [2013] VCAT 640

- 29 I was not referred to any authority as to the meaning of the terms *willing tenant* and *willing landlord* specifically in relation to s37(2) of the RLA. However, guidance can be had from *Spencer v The Commonwealth of Australia*¹⁰ where the High Court of Australia considered the concept of market rental and recognised the principles of:
- the willing but not anxious vendor and purchaser;
 - a hypothetical market;
 - the parties being fully informed of the advantages and disadvantages associated with the asset being valued (in the specific case, land); and
 - both parties being aware of current market conditions.
- 30 Although *Spencer* was concerned with land valuation the comments are, in my view, equally applicable to a market rent review. Isaacs J stated at (441)
- ... to arrive at the value of the land at that date, we have ... to suppose it sold then, not by means of a forced sale, but by voluntary bargaining between the plaintiff and a purchaser willing to trade, but neither of them so anxious to do so that he would overlook any ordinary business consideration. We must further suppose both to be perfectly acquainted with the land and cognisant of all circumstances which might affect its value, either advantageously or prejudicially, including its situation, character, quality, proximity to conveniences or inconveniences, its surrounding features, the then present demand for land, and the likelihood as then appearing to persons best capable of forming an opinion, of a rise or fall for what reasons so ever in the amount which one would otherwise be willing to fix as to the value of the property.
- 31 In my view the word ‘reasonably’ in s37(2)(b) qualifies the meaning of market value such that when determined having regard to this qualification it means *the rent obtainable at the time of the review in a free and open market between a willing but not anxious tenant and a willing but not anxious landlord*.

The supplementary report

- 32 As the valuer had not specifically indicated in the Determination that he had taken into account *rent concessions and other* benefits as required by s37(2), the respondent’s solicitors wrote to the valuer on 1 July 2015 :

As you know we act for Ms Caroline Long, the tenant of the above premises for which you provided a rent determination on 30 April 2014.

We ask that you provide us with a letter:-

- (1) addressed to the Landlord, Keriani Pty ltd and to the Tenant, Ms Long; and

¹⁰ (1907) 5 CLR 418

- (2) which details your consideration of rent concessions and other benefits offered to prospective tenants of unoccupied premises as required by s 37(2)(d) of the *Retail Leases Act 2003 (Vic)*.

You are permitted to do this, and our request is, in line with the Supreme Court of Victoria's recent decision in *Epping Hotels Pty Ltd v Serene Hotels Pty Ltd [2015] VSC 104*. The decision permits expert valuers to amplify or clarify aspects of their valuation report by issuing a supplementary report.

We would appreciate it if you could provide your supplementary report to us by tomorrow.

- 33 The valuer responded by letter dated 2 July 2015 ('the supplementary report'):

Further to your letter dated 1 July 2015 and your request for clarification regarding our rental determination in relation to Section 37(2)(d) of the Retail Leases Act, we advise as follows:

1. Lease incentives are very much a result of the demand for a property or area with the stronger retail centres that have minimal supply and extensive demand generally offering no lease incentives whereas in the poorer performing retail areas that have vacancies and limited Lessee demand, lease incentives are used to try and attract tenants.
2. The Whitehorse Road, Balwyn shopping strip is one of the stronger retail areas, which is evident by the very limited number of shops that become available for lease and the limited time they remain unleased.
3. From our evidence and investigations all those properties that had market reviews as part of an exercise of an option for a further term, none of these lease negotiations had any incentives paid.
4. In one piece of evidence a shop in the same strip had the rental determined by another valuer as part of the determination process with the rent assessed on a net effective rent basis.
5. From our evidence and investigations, we noted that even with new leases that occurred for an incoming tenant, the majority involved no lease incentives.

However, there were a couple of leaseings that did involve incentives which was generally a rent free period.

6. In the cases where an incentive was paid, the face rent is then adjusted to arrive at an effective rent.

We trust the above clarifies your query.

- 34 Mr Hopper submitted that the words *even with the new leases that occurred for an incoming tenant*, in paragraph 5, confirmed that the valuer had not had regard to the rentals for those tenancies. Further, that paragraph 6 is curiously worded as a 'hypothetical' and that if considered with a critical eye that it means that *if the valuer did have regard to the incentives then the*

face rent [for the premises the subject of this proceeding] would be adjusted to arrive at the market rent. In other words he suggested that the valuer was saying Had I taken into account new leases I would have adjusted the rent to arrive at an effective rent.

- 35 I reject this and prefer the interpretation suggested by Mr McKay which I consider more accurately reflects a plain reading of ‘6’ – *In cases where an incentive was paid, the face rent [was] adjusted to arrive at an effective rent.* In other words, the incentive was taken into account in determining the effective rent for premises let with incentives.
- 36 Accordingly, I am satisfied that the valuer has had regard to any *rent concessions and other benefits* paid to other *incoming tenants* when considering the comparative rentals and rent reviews for other shops in the retail precinct.

Are the valuer’s Reasons adequate?

- 37 The applicant contends that the valuer’s Reasons are inadequate because he fails to clearly set out his reasons for making various adjustments.¹¹ I disagree. Once again, the applicant has taken statements made by the valuer on page 11 of his Determination out of context.
- 38 At page 12 of the Determination the valuer states that his valuation is based on the valuation methodology, which *follows primarily direct comparison of the comparable rental evidence and noting any vacancies and asking rentals within the immediate area.* He explains the methodology before stating:

In analysing the rentals, I have then made allowances in each instance for differences in physical character, building style and design, specific location, frontage, visibility, exposure to passing traffic both vehicular and pedestrian, tenancy fitout and condition and the least terms and condition.

...

I also again advise that in accordance with Section 37(2) of the Act, the current market rent is not to take into account the value of the goodwill created by the tenant’s occupation of the premises or the tenant’s fixtures and fittings.

Locational goodwill we believe will be reflected in the level of rental being paid. For example, rental levels for shops nearby or adjoining a supermarket that attracts large volumes of pedestrian traffic in the form of passing potential purchasers will in most cases pay a higher \$rental rate per square metre compared to a similar shop that is further from the supermarket and having less passing foot traffic.

- 39 The valuer then sets out other matters he has taken into account including the condition of the premises, the assumption that their condition has not changed since the review date, the type and style of various areas within the

¹¹ At pages 11 and 16

tenancy¹², his calculations as to the lettable area because an agreed lettable area was not specified in the lease agreements, and that he has:

... assessed the various areas of the total premises in order to apply varying \$rates per square metre rentals with the most valuable rental area being the main retail area close to the Whitehorse Road frontage and the least valuable rental being for rear office, toilet and staff amenity area.

CONCLUSION

- 40 In my view, despite the statements on page 11 of the Determination which I consider the applicant has taken out of context, it is clear when the Determination is read as a whole, that the valuer has taken into account the factors mandated by s37(2) together with a number of additional factors which he has explained. He has set out a range of rentals for the area, taking into account *limited new lettings* and market rent reviews for other tenancies where *the Lessee had the opportunity to vacate, while in some cases the Lessor had the opportunity of placing the premises on the market with vacant possession*.
- 41 I am not persuaded that the valuer has failed to carry out his task in accordance with the contract, nor that his Reasons for his Determination are inadequate. Therefore the application will be dismissed. I will reserve the question of costs but draw the parties' attention to s92 of the RLA.

DEPUTY PRESIDENT C AIRD

¹² Including main retail area to the front, and staff and toilet facilities to the rear