IMPACT OF THE RENT LAW ACT X OF 2009 ON VALUATIONS

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The rent law was amended on 1st January 2010. In view of this the Kamra tal-Periti is organizing an information seminar to explain these amendments and how these may be interpreted and viewed critically. The valuation of properties for rental purposes is one of the professional tasks Periti are entrusted with so it is essential to be updated on these issues.

This Course dwells on the impact, that the Rent Law Act X of 2009 has on the valuation of property. This course is based on Perit Denis H. Camilleri's 2010 presentation undertaken on *Upgrading of Market Values due to Rent Laws Act X of 2009.* As this Act deals with both the residential as well as the commercial market, this 3-hr course establishes standard and distinct methods for both of these property markets. It follows on the successful KTP Seminar on *Amendments to the Rent Law*, as undertaken on the 5th February 2010.

The Course initially outlines the important data in the Rent Law Act X of 2009 as impacting on valuation methods. This is then be followed by introducing the valuation mathematics necessary for these specific valuation methods. Finally, the specific procedure to be undertaken is to be spelt out in the form of a residential valuation format followed by a commercial property format.

Date: June 2012
Time: 17:00 – 20:30 hrs
Venue: The Westin Dragonara Resort

Course Content:

17:00 – 17:15 Registration and Coffee
17:15 – 17:45 “Introducing the rental updates”.
17:45 – 18:45 “Traditional vs. updated valuation models – noting valuation tables”.
18:45 – 19:00 Coffee break
19:15 – 19:30 “Residential valuation method for a rental property.”
19:30 – 20:15 “Commercial valuation method for a rental property.”

Speaker Profile:

- **Perit Denis H. Camilleri -** A practicing assessor of property value

D E T A I L S

MECHANICS TO
UPGRADING OF OPEN MARKET VALUES DUE TO THE
RENT LAWS ACT X OF 2009

(As referring to February 2010 Presentation)

Perit Denis H Camilleri

KAMRA TAL – PERITI

ACCREDITED COURSE

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IMMOVABLE LEASE AGREEMENTS – APPENDIX D

This Act for leases to be binding is now based on a written contract and relates to:

- ✓Main Residences
- ✓Summer Residences & Garages
- ✓Clubs
- ✓Commercial Premises +

Contract to include for period of lease, whether extendable & agreed use

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MAIN RESIDENCES - (Security of Tenure)

- ✓ Sitting tenant pre-1st June 1995 lease is defined as the person having title before or on 1st June 2008
- ✓ As from 1/01/10 right to continue lease after death of sitting tenant is given as a 1-time right only for the following beneficiaries – having lived the last 4 out of 5 years & after the 1/06/08 continues to live with the tenant until tenant's death (brother or sister/in-law, natural or legal child)
- ✓ This Act provides for restricted Security of tenure compared to previous 1995 Act

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MAIN RESIDENCES- (Rentals)

- ✓ Minimum rental amount imposed at €185 p.a. to increase on a 3-yearly basis according to Index of Inflation (Appendix G)
- ✓ A moving average for the 3 yearly interval increases works out at 8%, signifying doubling of rental value every 9 periods. This is below the present open market commercial leases increases, varying from 10% to 15% over a 3-yearly period (App G).
- ✓ Pre-1995 lease but contractual still running, the contract will apply till termination
- ✓ Post-1995 no protection beyond contractual period

RULE OF 72 FOR EXPONENTIAL GROWTH

The % growth rate for a value to double over a number of years is given by:

% growth rate pa = 72/No of years

Ex 1. – for an asset to double in value over a period of 10 years require an annual growth rate given by 72/10 years = 7.2 % p.a.

Ex. 2 – for an asset with a growth of 5%, it requires 72/5% = 14.4 years to double in value

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MAIN RESIDENCES- (Maintenance)

- ✓ External ordinary maintenance to be now within tenant's remit
- ✓ Structural repairs by landlord as required through no fault of his own, may now be recouped at 6% instead of 10%, although no doubling restriction in place?
- ✓ Tenant can opt to carry out repairs at his expense, with no right for compensation at termination. Amount spent may be deducted from rent

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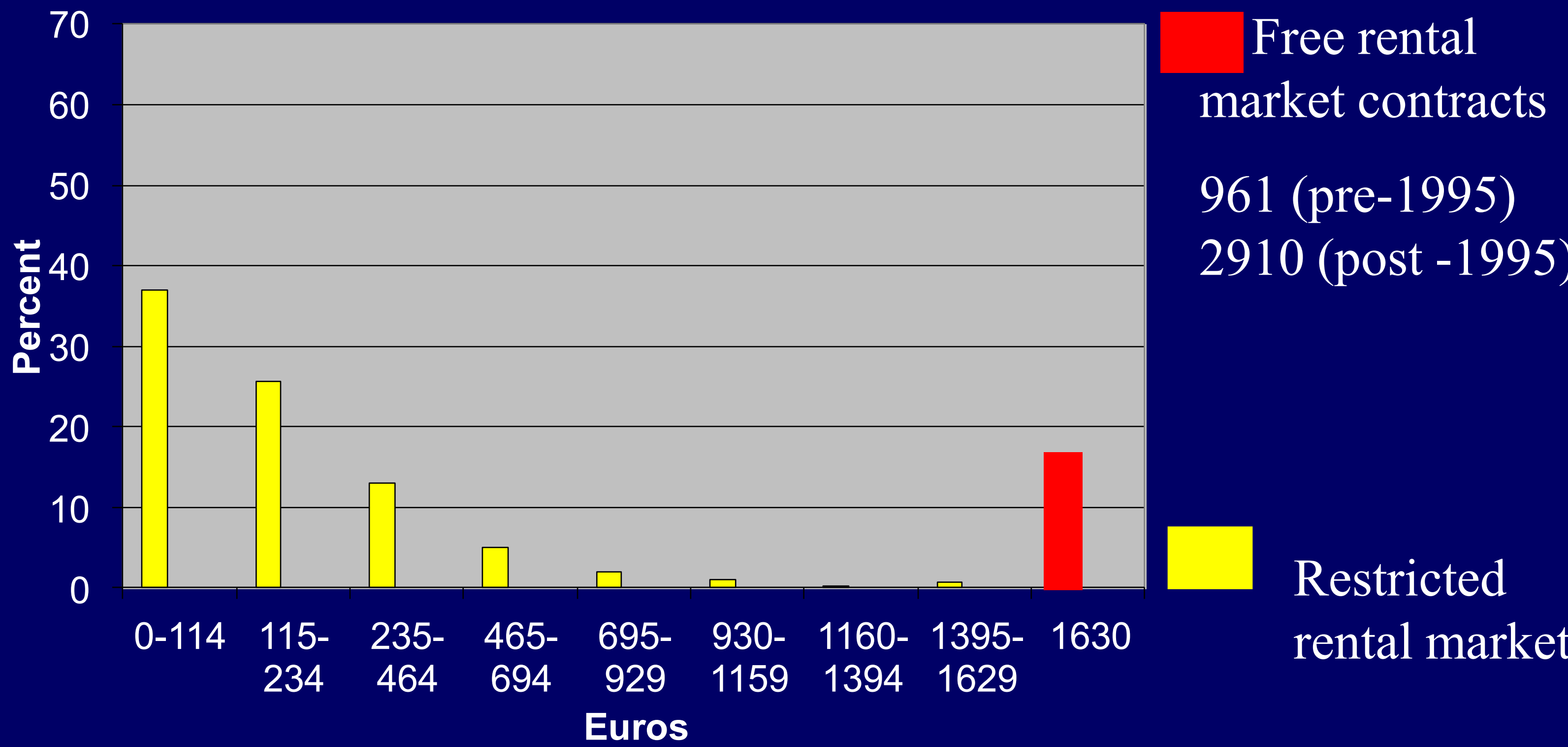
MAIN RESIDENCES – Rent Paid



This min rental of €185 is to effect just over 50% of existing leases given at 28,760 (2005) 33,781 (1995)

Source: Census of Population & housing 2005 Vol 2 Dwellings & Rent Laws pre-submission document

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SUMMER RESIDENCES, GARAGES & CLUBS

- ✓ Summer residences & garages not connected to leased premises or not considered commercial as from 1/06/10 may be terminated.
- ✓ These premises should be valued at their full open market value unless an agreement exists
- ✓ Clubs As licensed by Commissioner of Police (political, social, sports, musical, philanthropic) are to retain their security of tenure. No capital appreciation to occur

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COMMERCIAL PREMISES - Lease Amendments

- ✓ Lease contracted prior to 1/06/95, a 20-year period is in place to protect existing tenure
- ✓ Sitting tenant includes also for spouse, not legally separated, is defined as tenant who had a valid lease since 1/06/08. Hence 20-year period extends up to 31/05/28.
- ✓ Sub-letting is now not allowed – for prior sub-letting to 1/06/95, lease terminates at 1/06/18.
- ✓ These old leases are to increase by 15% p.a. for 4 years and then by 5% p.a. thereon, unless a rent index introduced by 1/01/14, or by agreement between parties.
- ✓ These increases will not apply if other conditions specified in original contract

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MECHANICS of FREEHOLD INVESTMENT VALUATIONS

Suppose a freehold property has a rental income R of €13,000 p.a.

An appropriate investment yield rate Y for the property is 7%,

C= R/Y = R x YP

YP = 100/7 = 14.286 years is a multiplier similar to applying a P/E ratio to the earnings of a quoted company to arrive at market price for investment

Capital value ignoring transaction costs

C = €13,000 X 14.286

= €185,718

YP at 4% = 100/4 = 25 years, **thus the lower the risk the lower the yield**

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MECHANICS OF PRESENT VALUE

$PV = [I-\{1+i\}^{-n}]/i$

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e.g. What is the PV of receiving €1,000pa for the coming 5-year period, at a 4% rate of interest – (banking scenario) as compared to 100/4 = 25 years in perpetuity

YEAR 1	$1/1.04$	=	0.9615 X 1000 =	961.50
YEAR 2	$1/1.04^{2}$	=	0.9246 X 1000 =	924.60
YEAR 3	$1/1.04^{3}$	=	0.8890 X 1000 =	889.00
YEAR 4	$1/1.04^{4}$	=	0.8548 X 1000 =	854.80
YEAR 5	$1/1.04^{5}$	=	0.8219 X 1000 =	821.90
PV -				€4,451.70
YP at 4% over a 5 year period given by =				4.4518
YP at 8% over a 5 year period given at =				3.993

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MECHANICS OF PRESENT VALUE PV – II (goto Excel:Formulas:Financial:PV)

e.g. What is the PV of receiving €1,000pa for the coming 5 – year period at a 4% rate of interest – rental scenario 1st payment to occur immediately

YEAR 1		1,000.00
YEAR 2	$1/1.04 = 0.9615 \times 1000$	961.50
YEAR 3	$1/1.04^{2} = 0.9246 \times 1000$	924.60
YEAR 4	$1/1.04^{3} = 0.8890 \times 1000$	889.00
YEAR 5	$1/1.10^{4} = 0.8548 \times 1000$	854.80
PV		€4,629.90

YP at 4% over a 5-year period (rental scenario)

= I + YP (for 4 years at 4%) = 1 + 3.6299 = 4.6299

As compared to 4.4518 in the banking scenario

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MECHANICS OF DISCOUNT CASH FLOW ANALYSIS - DCF

e.g. What is the present value of receiving €1,000pa for the coming 3-year period & then increased by 10% for the coming 3-year period (rental scenario)

YEAR 1		1,000.00
YEAR 2	$1000/1.08$	925.93
YEAR 3	$1000/1.08^{2}$	857.93
YEAR 4	$1000 \times 1.1/1.08^{3}$	837.22
YEAR 5	$1000 \times 1.1/1.08^{4}$	808.53
YEAR 6	$1000 \times 1.1/1.08^{5}$	748.64
NPV		€5,213.65

DCF (8,1,000,{1,000,1,000 X 1.1}{2,3})

(Goto Excel Formulas:Financial & highlight NPV)

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MAIN RESIDENCE – Appraisal Lease Levels

- ✓ **Present open market values**

  Basic/depressed area 50 sq m @ €225/sq m= €11,250
  At a €185 rental rate of return = 1.64%

  Fairly Good Area 90 sq m @ €350/sq m = €29,250
  At a €185 rental rate of return = 0.625%

- ✓ **A Housing Investment is not expected to obtain a much better return than safe investments such as Government Bonds**

- ✓ **A real return of 4% from capital value rents has long been settled upon**

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MAIN RESIDENCE – Open Market leases & Values Appraisal

Basic/depressed area €11,250 @ 4% = € 450 p.a. (€185)
Fairly Good Area €29,250 @ 4% = €1,170 p.a. (€185)

- ✓ Due to restricted security of tenure, these rent-restricted premises are considered to revert to owners in 25 years' time – thus presently attracting a value less than the present open market value in vacant possession

mainly €11,250
€29,250

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MAIN RESIDENCE Appraisal 02/10 – Increase in Market Value

- ✓ The present open market value of these premises is given by Present Worth of 1 per Period Factor for 25 years, as well as by reducing the present open market value by the Present Worth Factor over 25 years

- ✓ Basic/Depressed area – 2.75% for 25 years

  €185 X 18 + (450 X100/4) X $\frac{1}{1.04^{25}}$ = € 7,500 (66.67%)

- ✓ Fairly Good area – 25 years @ 0.5%

  €185 X 23.50 + (1170 X 100/4) X $\frac{1}{1.04^{25}}$ = €15,000 (50%)

- ✓ Pre 2009 rental amendments – Market Values

  Basic - € 75 @ 2% €3,750 (33.33%)

  Fairly Good - €150 @ 2.25% €6,667 (22.25%)

- ✓ A doubling in market value is indicated

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Capitalization Rate to be adopted at end of lease Termination

YP is the discounting years' purchase figure taken at the relevant rate of interest, as below:

4.00% for leases greater than 30 years.
4.25% for leases greater than 25 years.
4.75% for leases greater than 20 years.
5.25% for leases greater than 15 years.
5.75% for leases greater than 10 years.
6.00% for leases greater than 5 years.
6.50% for leases less than 5 years.

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YP appraisals for Main Residence

Basic/depressed YP – 18 years works out at a 2.75% rate of interest over 25 years

DCF (5.85%,1,{1,025……,1.025^{8}}{3,………,3})

Fairly good area YP – 23.50 years works out a a 0.5% rate of interest over 25 years

DCF (3.35%,1,{1,025……,1.025^{8}}{3,………,3})

Initial yield = DCF – annual growth

2.75% = 5.85% - 3.1%

as compared to 8%/3=2.67%pa

0.5% = 3.35% - 2.85%

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MAIN RESIDENCE Appraisal catering for property increase

- The housing market has historic annual growth rates over the past 30-year period averaging at 7.2%pa. Over the past 4-year period, the residential market has shed 7% of its values

- Over the coming 25-year period property increase is estimated to average out at 3.5%pa

- Basic/depressed premises is now to be capitalized at 3.75% rate of interest over 25 years

- Fairly good premises is now to be capitalized at 2% rate of interest over 25 years

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AFFORDABLE PROPERTY RATES €/SQM FOR THE MALTESE ISLANDS OVER A 30 YEAR PERIOD

Locality	1982	1987	1992	1997	2002	2007	2012	%growth rate Pa 1982-2011
Fgura / Paola / Zabbar	105	128	256	408	466	987	893	8.26%
M'scala	116	175	373	373	505	1001	881	7.31%
Mosta / Naxxar	186	198	291	478	524	1242	1167	7.23%
San Gwann	151	175	256	431	557	1092	962	7.40%
Sliema inner prime	210	338	443	710	883	1373	1402	6.78%
St. Julians	186	233	408	547	687	1321	1186	7.06%
Swieqi	198	245	419	641	785	1473	1443	7.54%
Malta	163	212	349	512	629	1144	1134	7.23%
Trend	161	232	335	484	698	1007	1452	
Gozo						857	903	

Source: DHI Periti in-house valuations: Camilleri (2012) updated table

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MALTA AFFORDABLE PROPERTY RATES IN €/SQM OVER THE PAST 30 YEARS

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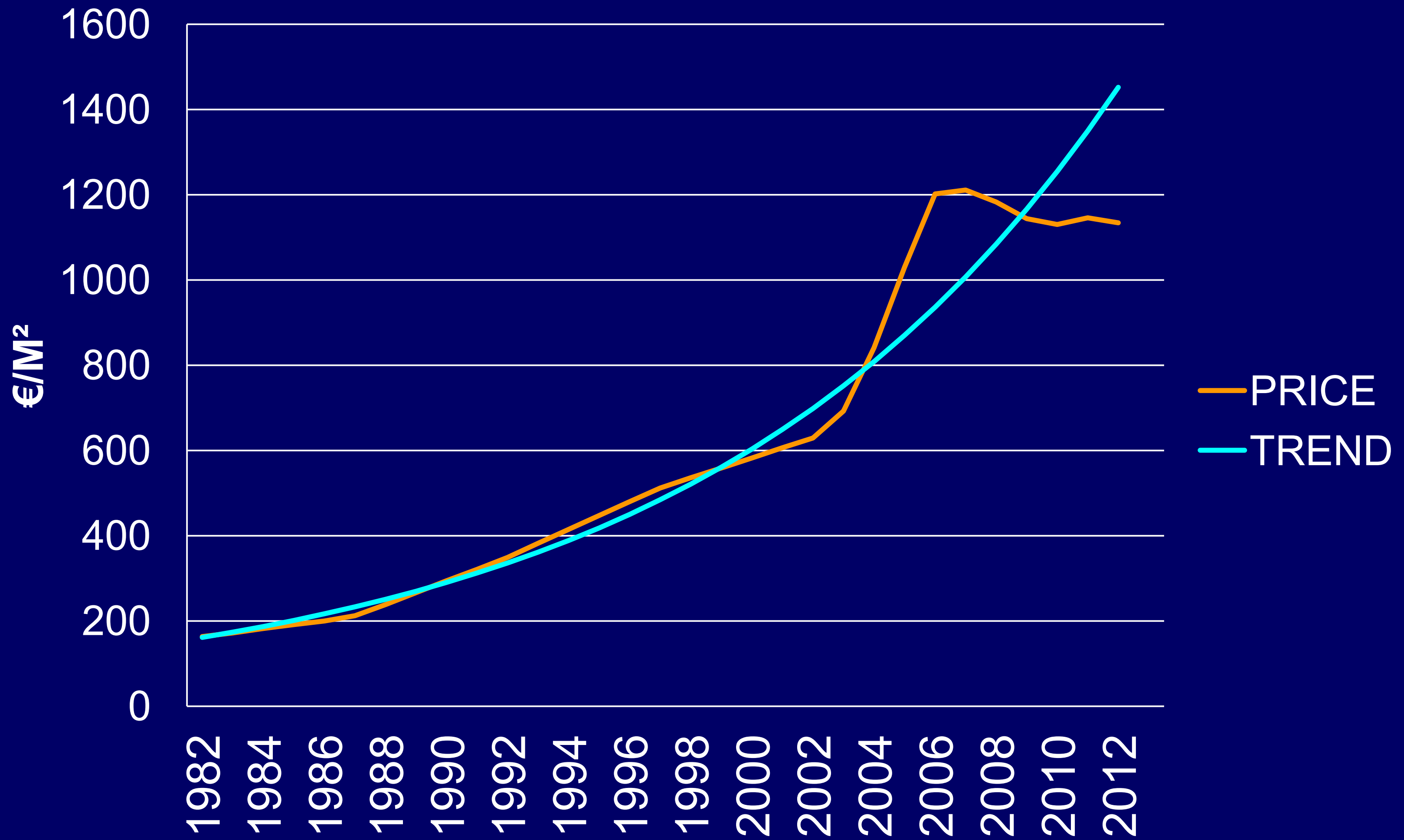

Source: DHI Periti in-house valuations: Camilleri (2012) updated table

SCENARIO testing of Basic/Depressed & Fairly Good Residences Tenancies

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- Basic/depressed area - YP @ 3.75% & 3.5% annual property growth

€185pa X 16.64 + €11,250 X $1.035^{25}/1.065^{25}$ = € 8,585 (as compared to €7,500)

- Fairly good area – YP @ 2% & 3.5% annual property growth

€185pa X 19.91 + €29,250 X $1.035^{25}/1.065^{25}$= €18,000 (as compared to €15,000)

6.5% is taken from the present Bank lending rate.

VALUATION PRACTICE FOR TENANTED RESIDENCES

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Method to be undertaken determined by valuation use:

* For tax purposes property growth not prudent, as doubt to always be passed onto taxpayers side)

** Owner of tenanted properties are to be advised of all options

- OPEN MARKET VALUE of basic/depressed area
  €11,250 (€8,575)
- OPEN MARKET VALUE of fairly good area
  €29,250 (€18,000)

- MARRIAGE VALUES €11,250 - € 8,575 = € 2,675
  €29,250 - €18,000 = €11,250
- Tentative asking prices
  Basic/depressed area €8,575 + 30% of €2,675 = € 9,250
  Fairly good area €18,000 + 50% of €11,250 = €23,500

COMMERCIAL PREMISES - Revaluation Appraisal Exercise 02/10

- ✓ A premises leased out at 66% of present open rental value, experienced a 50% increase in market value
- ✓ A premises leased out at 25% of present open rental value, experienced a 100% increase in market value
- ✓ Premises leased out at nominal rent experienced a 300% increase in market value
- ✓ Premises leased out at market value but experiencing rental increases over specified period at 1/3 of the market norm experienced a 33% increase in value

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DCF Appraisal for Commercial Premises presently leased out at 25% of its OPEN MARKET VALUE - 1

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Present lease given at €1,000pa as opposed to €4,000pa with 10% increases every 3 years.

OPEN MARKET VALUE prior to lease amendments

€1,000pa X 100/4.5 = €22,,222

OPEN MARKET VALUE ignoring present lease restrictions in place

For this good office location capitalization rate taken at 5.75%

€4,000pa X 100/5.75 = €69,565 say €70,000

DCF Appraisal for Commercial Premises presently leased out at 25% of its OPEN MARKET VALUE - 2

For the present lease agreement in place a DCF analysis undertaken with a discount rat at 7.5%

Lease agreement commencing in 2010 with market value as at 2028 estimated at:

(€4,000pa X 1.03^{18}) X 100/6.5 = €104,765 (as opposed to €70,000)

DCF (7.5%, 1.15{1.15^2, 1.15^3, 1.15^4, 1.75 X 1.05…………1.75 X 1.05^{14}, 104.765})

NPV = €50.212 Market Value : NPV X 1,000 = €50,212

OPEN MARKET VALUE prior to lease amendments

€1,000pa X 100/4.5 = €22,222

Increase to MARKET VALUE due to lease amendments

€50,212/€22,222 = 2.25 i.e. 125%

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DCF Appraisal for Commercial Premises presently leased out at Market Rate, however market increases at ⅓ of MARKET RATE – 1

- ✓ Present lease given at €4,000pa with 5% increase every 5 years (as opposed to 10% increase every 3 years)

- ✓ Open Market value prior to lease amendments

  €4,000 X 100/7.5 = €53,333

- ✓ Open Market Value ignoring restrictive lease updates in place

  For this good location capitalization rate @ 5.5%

  €4,000 X 100/5.5 = €72,727

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DCF Appraisal for Commercial Premises presently leased out at Market Rate, however market increases at ⅓ of MARKET RATE – 2

DCF analysis now undertaken at 8.5% with stipulated increases in place

DCF (8.5, 4, {4, 4, 4.1.05, 4. 1.05^2 , 4.105^3, 4. 1.03^{18} X 100/65},{2, 5, 5, 5, 1}) = €65.28

Market value: €65.28 X 1,000 = €65,280

Increase to MARKET VALUE due to lease amendments

€65,280/€53,333 = 1.224 i.e. 22.5%

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Thank

You….