AGRICULTURAL LEGISLATION AND LEASEHOLD LAND IN FIJI[1]

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INTRODUCTION

The system of land tenure in Fiji is such that the leasing of land,especially for agricultural purposes, is of considerable importance. Freehold land is limited to approximately 8% of the total land area, whilst Native land, owned by landowning units of indigenous Fijians, accounts for approximately 83% of the land area. This land is administered on their behalf by the Native Land Trust Board (NLTB) and is inalienable except to the Crown[2]. Native land is in fact divided into "reserves" set aside for the exclusive use of indigenous Fijians and "non-reserves" which can be leased to all races The great majority of tenants are Indo-Fijian, although some Fijians and a small number of other racial groups also enter into leases with the NLTB. The numbers and areas of Fijian and non-Fijian leases are itemised in Table 1.

Crown land accounts for the remaining 9% of the land area and land that is surplus to predetermined needs of the government is made available for leasing.

The intention of the present study was to look at the impact of the 1966 Agricultural Landlord and Tenant Act (ALTA) on leasehold land values, that is, the value of the tenant's interest in the land as opposed to the value of the landlord's interest, and to identify the imperfections in this particular market. In addition, the system of rent assessment legislated by ALTA is examined, and alternative systems considered.

TABLE 1: NATIVE LAND AGRICULTURAL LEASE STATISTICS[3]

	Number	Total Rent p.a.	Area (Ha)	Average Rent per Ha p.a.	Average Rent per unit p.a.	Average Size of unit (Ha)
Non-Fijian	11,166	$2,288,392	125,863	$18.18	$205	11.3
Fijian	2,463	$ 364,350	65,455	$ 5.57	$148	26.6
All	13,629	$2,652,742	191,318	$13.87	$195	14.0

Rents in Fiji dollars

AGRICULTURAL LANDLORD AND TENANT ACT

This was enacted in 1966, extensively revised in 1977, and is the most important piece of legislation affecting agricultural land because it applies to all agricultural land held in parcels exceeding 1.0 hectare (2.5 acres) except land in reserves. The act sets out the terms and conditions that must be contained, or will be implied in the absence of formal documentation by the courts, in all leases. Two of the main provisions of ALTA relate to the duration of the lease and the method for assessing, and periodically reviewing, rents levied by the landlords.

Following the revisions to the Act in 1977, all leases granted since 1st September 1977 must be for a minimum duration of 30 years. The holders of those leases granted before 1st September 1977, the great majority of which were for a term of ten years, are entitled to a single extension of twenty years. At the expiry of a thirty-year lease, or the twenty-year extension, there is currently no automatic right of renewal; in other words, there is no security of tenure following the expiry of the lease. In the event that a new lease is not forthcoming from the landlord, the Act states that the tenant must be compensated by a sum equivalent to the value of the improvements carried out by him to the land.

The provision relating to rent assessment restricts the rental that can be levied by the landlord to 6% of the unimproved capital value (UCV) of the land, which must be reviewed quinquennially. This percentage is not an unreasonable return to expect from land, although is dependent entirely on an accurate determination of the UCV. The process of UCV determination is not left to the discretion of the valuer, but falls within a range of values which are determined quinquennially for every class of agricultural land by a government-appointed committee of valuers[4], consisting of four land valuation experts. Following the UCV assessment by this committee, a schedule is made available which must then be used in conjunction with ALTA by the landlord when either assessing new rents or reviewing existing ones. When the committee drew up the schedule in 1982[5], virtually no changes were made on the 1977 schedule of UCVs owing largely to the depressed state of the sugar industry in the early 1980s. As a result, agricultural land rents have remained static, with a few exceptions, over the period 1977-1987.

The regulation of rents by ALTA has had several effects on the leasehold agricultural land market, of which two significant issues can be highlighted. Firstly, the market is unable to operate freely; in other words, the supply of and demand for leasehold land has not been balanced by the price mechanism, that is rent. However, markets inevitably find some other means of reconciling these two forces and, in this case, a degree of equilibrium is achieved through the payment of a premium (a capital sum) when an existing leasehold interest is purchased.

The second significant issue is that the landowners (the government in the case of Crown land) can legitimately claim that because ALTA prevents the operation of a free market they are not receiving a genuine return on their asset. Instead, a significant part of the value of the land becomes vested in the original tenant, either in the form of an annual profit rent (the difference between the open market rent and the contractual lease rent) or in the form of a premium when that tenant sells his interest.

In order to ascertain the way in which the market was affected by ALTA, it was necessary to calculate what the levels of rents would be if the market was able to operate freely. This would reveal the extent to which lease rents fall short, if at all, of open market rents. Additionally, a range of UCV's could be calculated by simply capitalising the hypothetical open market rents. This would not only provide an interesting comparison to the schedule of UCV's produced by the committee of valuers, but would also reveal the degree of deviation in unit values reflected by the sale of leasehold interests in the case study.

To achieve these objectives, a field study was undertaken to analyse recent transactions of leasehold interests in agricultural land, which also provided the basis for a review of the efficacy of the method of rent assessment laid down in ALTA.

METHODS

To ascertain the open market rental of agricultural land, the normal procedure adopted is to accumulate data relating to current leasing of land, provided the rents under these leases were negotiated freely by the landlord and tenant, and were unaffected by legislation. However, owing to the virtual absence of an open

market in Fiji, this approach cannot be used and an alternative method is required. A commonly-used alternative is to analyse sales of existing leasehold interests to determine what part of the purchase price represents the physical improvements on the land (e.g. buildings, plant), which would leave a balance reflecting the capital value of the anticipated annual profit rent[6] that the tenant expects to enjoy. Using an appropriate rate of interest[7] (or "discount rate"), this premium can be converted into an annual equivalent, that is the profit rent. The addition of the lease rent and the profit rent can then be said to reflect the hypothetical open market rental (HOMR) in a particular transaction. In other words, the tenant purchasing an existing leasehold interest should theoretically be indifferent to paying either the capital premium together with the low lease rent, or just the hypothetical open market rent.

The survey was restricted to transactions of leasehold interests in sugar cane farms because the importance and extent of cane farming ensured a volume of sales sufficient to test these ideas. In practice, however, there appeared to be relatively few genuine transactions, so a two-year period from January 1985 was used. Data for forty sales were considered but, owing to inconsistencies in the data, such as family sales, the final sample consisted of twenty sales.

The data were extracted from the records of the NLTB and Lands Department in Lautoka, and consisted principally of the size of the farm, the price paid for the leasehold interest, the contractual lease rent and the date of the lease expiry. Each farm was then visited to assess the quality and productivity of the land, employing parameters such as topography, fertility, drainage, extent of cultivation, and to value the physical improvements that were part of the purchase, for example the costs of clearing land, the value of buildings, mechanical plant and crops. The opportunity was also taken to interview the farmer who had purchased the interest to determine how he had valued it, his perception of ALTA, and through what medium he had discovered that the farm was for sale.

Finally the purchase price was analysed to determine what part of the price reflected the physical improvements, and what part reflected the capitalised profit rent. The annual profit rent and HOMR could then be calculated for each farm, and recapitalising this figure produced a hypothetical UCV of the land.

DATA INTERPRETATION

Owing to the size of the sample, the results of the analysis could be considered only as indicative of the market value of agricultural leasehold interests rather than providing a definitive statement. However, in every transaction in the sample, the premium paid by the purchaser was considerably in excess of the value of the improvements. The immediate conclusions that can be drawn from this are that demand for agricultural land outstrips supply and that current lease rents are below the open market level.

Two issues that were of particular interest were firstly the degree to which current lease rents fall short of the open market rents and, secondly, whether it is the low lease rents that give rise to the high premiums, or whether there are other contributory factors. At this point it is necessary to clarify that should a tenant pay a full open market rent for land there is no inherent value in his interest, excluding the value of his own improvements to the land. The leasehold interest becomes of value only when the contractual lease rent is fixed at a level below the full open market rent, and obviously the greater the tenant's profit rent the greater the value of his interest (assuming no imminent rent reviews). The corollary however is that the increase in the value of the tenant's interest is at the expense of the value of the landowner's interest.

Table 2 indicates the substantial difference between the mean lease rents and the mean hypothetical open market rents per farm. For Western Viti Levu, the mean HOMR is more than ten times the mean lease rent. It should be emphasised that the HOMR is not actually paid by the farmer but is the annual equivalent reflected by the premium paid for the leasehold interest. It would be difficult, if not impossible, to claim that the market could sustain a tenfold increase in lease rents. The only conclusions that can really be drawn from this are that lease rents are below open market levels and the levels of premiums being paid for leasehold interests are excessive and do not reflect the true value of the interest. Furthermore it raises doubts as to whether the conventional method of leasehold premium analysis serves any useful purpose.

TABLE 2: ANALYSIS OF DATA RELATING TO LEASEHOLD TRANSACTIONS

	Western Viti Levu		Northern Viti Levu	
	Mean	Standard Deviation	Mean	Standard Deviation
1. Total purchase price	$28480	$9520	$23780	$8890
2. Purchase price less improvements[1]	$25100	$8520	$18840	$6760
3. Annual lease rent per farm	$230	$90	$145	$60
4. Hypothetical annual market rent per farm[2]	$2430	$880	$1600	$730
5. Potential annual gross receipts[3]	$6700	$2250	$6150	$2375
6. Hypothetical UCV per acre:				
i) Good first class arable	$2850	$790	$2000	$700
ii) Fair second class arable	$1780	$500	$1250	$440
iii) Third class arable	$1070	$300	$750	$260
iv) Marginal arable	$710	$200	$500	$180
	Sample: 13		Sample: 7	

Notes for Table 2

1. This is the total purchase price of the leasehold interest, i.e the premium less the value of the tenant's improvements to the land.

2. This is the annual lease rent plus the annual profit rent reflected by the purchase price.

3. This assumes the land is fully cultivated. The net receipts depend on several factors, e.g. whether the crop is new plant or ratoon, the extent of family labour used and the amount of fertiliser used. These figures are based on a cane price of $25.00 per tonne. Costs of cultivation, harvesting and the transport of cane appear to be approximately 50% of gross receipts.

It was therefore necessary to develop some rational explanation for the size of premium changing hands at the purchase of these interests. From discussions with the farmers and NLTB field officers and by examining trends in the data, the following factors appear to be the principal determinants (excluding physical improvements):

(a) Productivity, and therefore profitability of the land, that is, the potential yield per hectare;

(b) Location of the farm, particularly in relation to the sugar mill as proximity reduces cane transport costs at harvest. Additionally, proximity to an urban area, especially Nadi and Lautoka, appeared to increase value as it would present employment opportunities for the farmer's family and greater provision of amenities.

(c) The identity of the landlord, that is whether the land was Native or Crown owned; the latter results in higher values as a result of lower rents charged under Crown leases and a perception amongst tenants of greater security of tenure;

(d) Lack of knowledge regarding the operation of ALTA, especially the rent review provisions. This was perhaps the most significant issue and will be discussed in more detail below;

(e) The value to the tenant of a site on which, if required, a large family could be housed;

(f) The negotiating strength of the parties involved in the transaction. This should be qualified in that it does not affect value *per se* but rather the price paid by an individual purchaser. It is rare for a leasehold interest to be sold after advertising in newspapers; sales would more often be the result of word of mouth. This creates inconsistencies because those who are party to a transaction seldom have sufficient knowledge of comparable transactions on which they can base their own negotiations.

There are other factors which affect leasehold values less directly; for example, the state of the sugar economy, in that the cane price affects profitability of the farm. Availability of finance from both commercial banks and the Development bank is another factor. However, the date of the lease expiry did not appear to affect value as long as the expiry was sufficiently far away, that is more than ten years. Farmers did indicate that they considered it would be difficult to sell their lease when the expiry was imminent.

P. Prasad (1984), commented that responses to enquiries about cane production and lease expiries varied. One category of

respondents stated that production did not decline at all, even when the expiry was imminent, whilst the second category maintained that production did decline as the lease expiry approached, in some cases as early as six years before the expiry date.

TENANTS' PERCEPTION OF ALTA

In this study, the majority of the farmers had only a superficial grasp of the application of ALTA. This is understandable, given the level of education of many of the tenants yet ignorance of the rent review provisions appears to have been one of the principal determinants of the excessive premiums being paid for leasehold interests. Failure to understand the basis of the rent review and the fact that rents have remained constant over the last ten years (at least) appears to have lulled tenants into thinking that rent is a fixed outgoing, or perhaps just subject to normal levels of inflation. The majority do not realise that, should lease rents increase sharply, their profit rent is reduced, or may even disappear. In the latter case, there would be no inherent value in their interest; in fact the interest may become a liability.

The tenant farmer therefore ignores the ALTA rent review provisions at his peril. as it invariably leads to the over valuation of the interest and the payment of an excessive premium.

ALTA RENT ASSESSMENT: THE NEED FOR A CHANGE

A brief explanation of the present method of rent assessment has already been given; however, it is opportune to consider whether the system adopted in ALTA is most suitable for Fiji. The advantages of UCVs being determined by the committee of valuers, and rents being limited to 6% of the relevant UCV, are simplicity and consistency. It reduces the responsibility of the individual valuer, who simply has to assess the quality of land, and then apply the appropriate UCV. The real responsibility for accurate rental values therefore falls on the committee of valuers. However, the simplicity of this system is outweighed by the disadvantage of rigidity, as the legislated rentals cannot keep in line with market rentals on an annual basis.

The main effects of this have been discussed. Upon assignment of an interest, no part of the premium finds its way to the landlord; it is simply the consideration paid from the purchaser to the vendor of the leasehold interest. Technically, as soon as a new lease is granted by the NLTB, the tenant can sell his interest and pocket the premium; a healthy profit is the result.

The rigidity of the system could be reduced through refinement. For example, the UCVs for sugar cane land could be altered annually in line with an index based on cane prices and costs of inputs. Alternatively, greater discretion could be given to the valuer negotiating the review with the tenant, with a greater use of independent tribunals to resolve disputes.

It could however be argued that merely refining the current method of rental assessment is insufficient, and that the basis of valuation itself should be changed. Under ALTA, the UCV of land is defined as the capital value of land assuming the land is held for an estate in *fee simple* (i.e freehold) and that the tenant's improvements to the land do not exist. The committee of valuers should therefore technically ignore that the land is leased and base their valuations on comparable sales of freehold agricultural land. However, freehold land accounts for only 8% of land in Fiji, and this scarcity creates a distorted market, with land being sold for prices quite unrelated to its productivity. Furthermore, sales are few and the committee of valuers face the practical problem of finding a sufficient number of freehold sales from which accurate unit values can be determined.

The second assumption relating to the disregarding of improvements applies to both the committee of valuers and the valuer in the field dealing with rent reassessments. This assumption can lead to even greater problems as the valuer has to disregard both visible and invisible improvements to the land. The former are quite straightforward as they would include buildings, roads, fences and wells but the latter include the original clearing of land, excavation, levelling and protective works. The valuer therefore has to imagine the land in its virgin state.

This presents the practical difficulty of determining the exact nature of the invisible improvements, especially where these were carried out several decades ago. Where records do not exist, anomalies can occur. For example, two similar pieces of land, both

cleared, level and well drained, should have widely differing UCVs if one of the pieces of land had been in this state originally whereas the other piece of land has had to be improved to reach this state, but this is not always the case.

ORIGINS OF THE UNIMPROVED CAPITAL VALUE

UCV as a basis for land valuation was developed primarily for taxation purposes at the end of the 19th century in the United States, and subsequently adopted around the turn of the century in Australia and New Zealand. It reflected a philosophy espoused by Henry George, in his book "Progress and Poverty" (1880), which advocated the taxation of any unearned increment in land values. George considered that the state rather than the landowner should benefit because any increment in land value was usually the result of expenditure by the state on infrastructure and services.

This system of valuing land in its unimproved state for taxation purposes became popular for several reasons in Australia, and to a lesser extent, in New Zealand. It was considered that it encouraged an intensive use of land by the occupier because the tax on the UCV remained constant regardless of improvements undertaken by the owner. The taxpayer could therefore reduce his tax burden, in relative terms, by maximising the use and therefore profitability of his land. Furthermore, this system was considered more equitable because the owner was not penalised for his improvements, which would be the case if "improved value" was adopted as the valuation basis. Speculative holding of undeveloped land was discouraged as the tax was levied on the potential use of land rather than the existing use.

However, some Australian states became dissatisfied with this system in the 1960s and 1970s, and several refinements were made in a bid to reduce its inherent anomalies, especially the practical problems of establishing the nature of invisible improvements. Provisions were made whereby the improvements merged with the land after a period of time, usually fifteen years, or when the ownership of the land changed. This produced a new definition, that of "site value", which assumed that any invisible improvements had merged with the land.

The alternatives to the UCV basis, in addition to the concept

of site values, are the use of improved values (rents being a percentage of this) or annual values, that is the rental value that would be determined by market forces.

The advantage of the use of improved value is that it is considerably more practical for the valuer as land is valued in its current state. The system is easier for land users to understand and for landlords to administer. Furthermore, if the land user invests capital and expertise in improving land, he will probably have a greater ability to pay rent. There is still an element of inequity in this system which could be reduced through the provision of relief to the land user who has undertaken the improvements, possibly on a sliding scale. For example, for five years following the improvements, the landlord could be prevented from reflecting their value in the rent, and in the subsequent five years half the value of the improvements is reflected, and from the tenth year the total value could be reflected.

The use of the annual value as a basis for valuation also employs the current value of the land and assumes that the land is leased. The advantages of this method are simplicity and accuracy; no assumptions have to be made by the valuer as to the extent of improvements undertaken by the lessee, and no capital valuation is required. This also makes redundant the requirement for a fixed percentage return on the capital value.

The problem of assessing annual values in the absence of a genuine open market still remains. The use of leasehold premium analysis is possible, although it has been shown to be unreliable in an imperfect market (witness the disparity between lease rents and HOMR's in this study). However, greater use could be made of the productivity method of assessing annual value whereby lease rents could be linked to the productivity (actual or potential) of the land. This is really the concept of economic rent, where rent is defined as the return that accrues to land for its use in production, that is the surplus income generated by the productive use of the land. This should ensure that the landowner receives a fair return, and the tenant would not be required to pay a rent that he could not afford. It would naturally stimulate the tenant to use the land profitably and discourage its underuse.

It is therefore apparent that no single method is perfect, although the use of either the improved value basis or annual

value basis appears to offer a more workable, understandable and equitable basis for a rent-controlling statute.

CONCLUSION

The market for leasehold land will continue to be the most significant land market in Fiji simply because of the extent of leasehold land, and it will doubtless continue to be unsophisticated for some years. However, this study has indicated that there are areas where improvements could be made, notably parts of ALTA and the dissemination of more information to agricultural tenants relating to this Act.

It is clear that the current system of rent assessment under ALTA is both rigid and archaic. Although the committee of valuers meets every five years, a lease rent may be reviewed six months prior to a meeting of the committee. The rent that is fixed for that particular lease for the ensuing five years will therefore be at a level prescribed four years and six months earlier. It is evident from this study that agricultural land rents are currently below open market rents, although the degree to which this is so is difficult to determine.

From the lessees' viewpoint, the greatest need appears to be one of increasing levels of knowledge of legal and valuation concepts, which would reduce the existing problem of lessees overvaluing leasehold interests. Lessees should be fully acquainted with the features of leaseholds, especially the concepts of regular, periodic rent reviews and leasehold interests being wasting assets. It appears that some lessees are under the mistaken belief that when they purchase a leasehold interest, they are purchasing the land itself rather than a legal right to use the land for a finite period. The NLTB and Lands Department could possibly increase their roles as advisors to their lessees without a conflict of interest occuring. These bodies contain both the legal and valuation expertise, and also the administrative capability, to disseminate necessary information. If a more active role was adopted, some of these market imperfections could be reduced.

Lessees purchasing leasehold interests in land who seek mortgages would also benefit from greater liaison with the mortgagee, that is the lending institution. Again, this places responsibility on these institutions, whether commercial banks or

the Development Bank, to meet this need. This would also benefit the bank in the possible reduction in risk exposure should the market gradually accept that leasehold interests are currently being overvalued.

The government could take steps to provide greater cohesion in the market to reduce disparities in unit values of leaseholds by promoting the greater use of professional land valuers and financial experts in rural areas. These professionals could also play a greater role in the marketing of leasehold interests which would result in a more satisfactory balance of supply and demand for these interests and transactions based on more accurate valuations.

Finally, further studies are needed to review in greater detail the existing use of UCVs in rent assessment under ALTA. Other sections of the Act also require revision, although were outside the scope of this particular study. However, these matters should be taken up by the government in an effort to introduce a more efficient and equitable system, from both the landlord's and tenant's point of view.

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ENDNOTES

1. This study was undertaken in March 1986 and therefore the results should be viewed in light of the economic conditions prevailing at that time.

2. Following Fiji's departure from the Commonwealth, "Crown" should read "state".

3. Source: Native Land Trust Board 1985 Annual Report. Figures as at 31.12.85.

4. The members of the Committee of Valuers are appointed by the Minister responsible for land matters, and consists of:

   (a) a chairman, having sufficient knowledge and experience in agricultural matters,
   (b) a valuer who is also a public officer,
   (c) a valuer from the NLTB,
   (d) a valuer engaged in private practice.

5. A schedule of revised unimproved capital values of agricultural land dated 24th September 1987 was gazetted on the 29th September 1987.

6. Profit rent in the term that describes the difference between the tenant's contractual rent and the open market rent. It is effectively an annual rent saving enjoyed by the tenant.

7. This would usually be linked to the cost of borrowing.