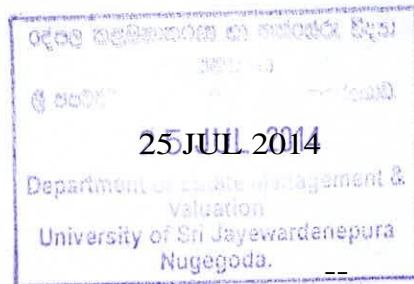
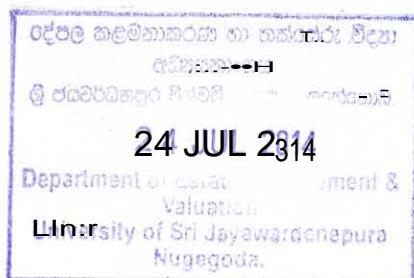


DETERMINANTS OF OFFICE RENT WITH SPECIAL REFERENCE TO THE CITY OF KANDY

Dissertation submitted to the University of Sri Jayewardenepura as a partial fulfillment for the requirements of the final examination of the M.Sc. in Real Estate Management and Valuation Degree



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The work described in this dissertation was carried out under the supervision of Prof. R.G. Ariyawansa, Professor of Department of Estate Management & Valuation and any report on this has not been submitted in whole or in part to any university or any other institute for another degree / examination or any other purpose.

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Signature of the supervisor

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Signature of the 2nd examiner

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Signature and the official stamp of the Head

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ABSTRACT

When goes with this study, the Real Estate for Office use was focused. An office is an architectural and design phenomenon; whether it is a small office such as a bench in the corner of a small business of extremely small size, through entire floors of buildings, up to and including massive buildings dedicated entirely to one company.

Commercial real estate markets, however, are characterized by spatial constraints, extensive product differentiation and information asymmetries that give rise to economically fragmented markets. A number of previous studies have demonstrated that such distinct submarkets do exist within urban office markets. The highly localized patterns of occupancy and rental rate determination found in these studies are indicative of market fragmentation.

This thesis analyzes determinants of variations in office rents in the city of Kandy. The theoretical background of this study is related to the hedonic methodology, which is extensively applied for explaining price or rental price variations of the office units. Given this theoretical framework, hedonic regression model is utilized for the estimation of hedonic price indices by using the cross sectional data of the office market in Kandy as for the year of 2013.

The study uses data, obtained from rating cards maintained by the Government Valuation Department for office properties and through a field survey. Out of 23 wards from Kandy Municipal Council area 06 wards has been selected considering the high concentration of population, labor force, and office activities. Out of 405 total number of office units, 198 units are selected as the sample of this study under systematic sampling and purposive sampling method.

The actual rental values have been applied as dependant variable along with 27 independent variables as predictors to run multiple regression analysis. The OLS estimation has been applied using SPSS for the analysis. The result generated from the analysis indicated that the floor area or size of the building, age of the building, availability of parking facilities and availability of lift facilities were among the significant predictors of office rent.

Finding of this study evidenced that Hedonic regression model is a quantifiable and justifiable method for office rent predictions, hence it is recommended to apply this technique for rating rent valuation of office properties by considering further improved rent models appropriate for different geographical areas. Consequently, delays on implementation of rent revisions could be minimized.

This study which identifies and quantifies the rent determinants on office properties recognizes the importance of study on local office markets and also it would be useful for the values to make aware of influence of significant attributes associated with office property on its rental value. Moreover, the results suggest that the capability of application of Hedonic Price Model for property valuation practices in the country as a rent prediction tool which would definitely accelerate the process involved with valuation and secure its consistency than it is done manually by professionals.

ABBREVIATIONS

AAGR	- Average Annual Growth Rate
CBD	- Central Business District
CPI	- Consumer Price Index
E/L	- Electricity
KMC	- Kandy Municipal Council
HPM	- Hedonic Price Model
OLS	- Ordinary Least Squares
UDA	- Urban Development Authority
VIF	- Variation Inflation Facator
W/S	- Water Service
Tp	- Telephone

Table of Contents

<i>Acknowledgement</i>	<i>i</i>
<i>Abstract</i>	<i>ii</i>
<i>Abbreviations</i>	<i>iii</i>
<i>Table of Contents</i>	<i>iv</i>
<i>List of Tables</i>	<i>vii</i>
<i>List of Figures</i>	<i>ix</i>

Contents	Pages
CHAPTER ONE – Introduction	01 - 07
1.1. Background of the Study	01
1.2. Research Problem	05
1.3. Objectives of the Study	05
1.3.1. General Objective	05
1.3.2. Specific Objectives	05
1.4. Significance of the Study	05
1.5. Thesis structure	06
CHAPTER TWO – Literature Review	08 - 38
2.1. General Characteristics	09
2.1.1. Physical Characteristics	09
2.1.2. Location Factors	14
2.2. Special Characteristics	16
2.2.1. Environmental Factors	21
2.2.2. Location Factors	22
2.3. Transfer (Lease) Characteristics	22
2.4. Hedonic Model	23
2.5. Summary	37
CHAPTER THREE - Research Design	39 - 50
3.1. Introduction	39
3.2. Research Design	39
3.3. Research Process	40
3.4. Identification of Variables	42
3.5. Empirical Model	47

3.6. Population and Sample	48
3.7. Questionnaire design, Survey Instrument and Data collection Procedure	49
CHAPTER FOUR - Background of the Study Area	51 - 60
4.1. Introduction	51
4.2. Frequently Visited Places by Foreign and Domestic Tourists/Visitors in the Kandy	52
4.3. Commercial Activities in Kandy	55
4.4. Demographic Profile	55
4.4. Distribution of Building Units	58
4.5. Land Use Profile	59
CHAPTER FIVE - Data Analysis	61 - 96
5.1. Introduction	61
5.2. Comparison of Office Rent Determinants	62
5.2.1. Age of the Building	62
5.2.2. Floor Finish	63
5.2.3. Wall Covering	63
5.2.4. Reception Area	64
5.2.5. Zoning	65
5.2.6. Type of Building	66
5.2.7. Building Appearance	66
5.2.8. Air Condition Facilities	67
5.2.9. Staircase	68
5.2.10. Lift Facility	69
5.2.11. Security System	69
5.2.12. Facilities for Customers	70
5.2.13. Provision for disable peoples	71
5.2.14. Garden of the office	72
5.2.15. Floor Area	72
5.2.16. Vertical Location of the office	73
5.2.17. Total Number of floors of the building	74
5.2.18. Attached Bath Room & Toilet	75
5.2.19. Distance to Town Centre	76
5.2.20. Parking	76

5.2.21. Historical City Band	77
5.2.22. Scenic View	78
5.2.23. Heritage Control & Architectural Design	79
5.2.24. Weather/Climate	79
5.2.25. Cultural Factors	81
5.2.26. Topography	82
5.3. Estimation Results	83
5.3.1. Validation of Measurement Properties	84
5.3.2. Tests of Normality	84
5.3.3. Normality Test Results	88
5.4. Hypothesis Testing	90
5.5. Estimation results for Model	91
CHAPTER SIX - Conclusions & Recommendations	97 - 102
6.1. Conclusion	97
6.2. Recommendations	102

List of Tables

Table	Pages
Table 1.1. Average office rent in different district in Sri Lanka	3
Table 3.1. Variable Description	45
Table 3.2. Office units selected for the population.	48
Table 3.3. Distribution of the Sample among Selected Wards	49
Table 4.1. Historical Growth of Population In Kandy Municipal Area 1871 - 2011	56
Table 4.2. Population Distribution by Wards –Kandy Municipal Area 2001 And 2011	57
Table 4.3. Distribution of buildings of Architectural value by street	58
Table 4.4. Distribution of buildings of Architectural value by streets	59
Table 4.5. Existing Land Use Kandy Municipal Council Area – 2013	59
Table 4.6. The Zoning of land for different uses 2002 – 2016	60
Table 5.1. Age of the Building	62
Table 5.2. Floor Finish	63
Table 5.3. Wall Covering	64
Table 5.4. Reception Area	64
Table 5.5. Zoning	65
Table 5.6. Type of building	66
Table 5.7. Building Appearance	67
Table 5.8. Air Condition Facilities	67
Table 5.9. Staircase	68
Table 5.10. Lift Facility	69
Table 5.11. Security System	70
Table 5.12. Facilities for Customers	70
Table 5.13. Provision for disable peoples	71
Table 5.14. Garden of the office	72
Table 5.15. Floor Area of office	73
Table 5.16. Vertical Location	73
Table 5.17. Number of floors of office building	74
Table 5.18. Attached Bath Room and Toilet	75
Table 5.19. Distance to Town centre	76

Table 5.20.	Parking	76
Table 5.21.	Historical City Band	77
Table 5.22.	Scenic View	78
Table 5.23.	Heritage Control & Architectural Design	79
Table 5.24.	Weather/Climate	80
Table 5.25.	Cultural Factors	81
Table 5.26.	Topography	82
Table 5.27.	Estimation Results	83
Table 5.28.	Tests of Normality	85
Table 5.29.	Test of Normality Syntax	86
Table 5.30.	Model Summary	86
Table 5.31.	ANOVA Table	87
Table 5.32.	Normality Test Results	87
Table 5.3.1.	Normality Test Model Summary	89
Table 5.3.2.	ANOVA Normality Test	89
Table 5.3.3.	Results of hypothesis testing for City Image and Office Rent	90
Table 5.5.1.	Estimation results for Model	92
Table 5.5.2.	ANOVA Table Model 1	94
Table 5.5.3.	Coefficients	94
Table 5.5.4.	Co linearity Statistics	95
Table 5.5.5.	ANOVA Table Model 2	96

List of Figures

Figure		Pages
Figure 3.1.	Theoretical frame works	40
Figure 3.2.	Conceptual Framework	41
Figure 4.1.	Location Map	52
Figure 5.1.	Age of the building	62
Figure 5.2.	Floor Finish	63
Figure 5.3.	Wall Covering	64
Figure 5.4.	Reception Area	65
Figure 5.5.	Zoning	65
Figure 5.6.	Type of building	66
Figure 5.7.	Building Appearance	67
Figure 5.8.	Air Condition Facilities	68
Figure 5.9.	Staircase	68
Figure 5.10.	Lift Facility	69
Figure 5.11.	Security System	70
Figure 5.12.	Facilities for Customers	71
Figure 5.13.	Provision for disable peoples	71
Figure 5.14.	Garden of the office	72
Figure 5.15.	Floor Area of the office	73
Figure 5.16.	Vertical Location of the Building	74
Figure 5.17.	Total Number of floors	75
Figure 5.18.	Attached Bath Room and Toilet	75
Figure 5.19.	Distance to Town Centre	76
Figure 5.20.	Parking	77
Figure 5.21.	Historical City Band	78
Figure 5.22.	Scenic View	79
Figure 5.23.	Heritages Control & Architectural Design	80
Figure 5.24.	Weather/Climate	81
Figure 5.25.	Cultural Factors	82
Figure 5.26.	Topography	83
Figure 5.3.1.	Normality Test	88
Figure 5.5.1.	Dependent Variable	93

Figure

Pages

Figure 5.5.2. Regression Standardized Residual

96

CHAPTER ONE

Introduction

1.1. Background of the study

Infinite wants of human beings originate with the limited needs. According this is very common for Real Estates which can be defined as "Property consisting of land and the buildings on it, along with its natural resources such as crops, minerals, or water; immovable property of this nature (Eda Ustaouglu, 2003). Real properties are overvalued when it goes beyond the limits of the bond of natural and manmade creature. The legal interest gives it another position called "Real Property" creating a new value than previously.

Dunse et al (2003) stated that , Depending on the nature of the property, an owner of property has the right to consume, alter, share, redefine, rent, mortgage, pawn, sell, exchange, transfer, give away or destroy it, or to exclude others from doing these things, as well as perhaps to abandon it; whereas regardless of the nature of the property, the owner thereof has the right to properly use it (as a durable, mean or factor, or whatever), or at the very least exclusively keep it. . Accordingly the usages of these Real Properties, they can be distinguished basically from Residential, Commercial, and Office as well as Factories, Agriculture and many more. These can be existed with Freehold or Leasehold interests. Each of these has its own value. In the real property market, the problem of determining value is more complex. The reason is related to the heterogeneity of the market. Each property possesses specific characteristics or attributes such as location and physical characteristics of the property. The value of each property varies widely and systematically with these characteristics.

When goes with this study, the Real Estate for Office use has to be focused. An office is an architectural and design phenomenon; whether it is a small office such as a bench in the corner of a small business of extremely small size (see small office/home office), through entire floors of buildings, up to and including massive buildings dedicated entirely to one company. In modern terms an office usually refers to the location where white-collar workers are employed (Delik Pekdemir, 2009). While the interest for real property is either freehold or leasehold most of the Office uses are leasehold due to the inheritance of this usage. Considering the leasehold property,

both landlords and tenants are interested in the 'rental price' and the 'rental value' of the property. Ring, (1972, 161) has expressed the Rent has been defined as a "definite periodic return, in terms of money or other provisions, for the use of property". Based on this definition, it can be stated that rental price of the property is important as it indicates the amount of rental payment that must be paid by tenants and the amount of rental income that will be received by landlords. Rental price is primarily determined in the market due to the supply and demand relationship. Expectations about future interest rates are major fundamentals underlying the pricing of bonds with various contract terms, resulting in a clearly observable term structure of interest rates. A similar phenomenon is likely to exist in the rental market, where expectations about the future development of spot rents would result in different rent levels for lease contracts with different lengths of tenure. If observable, the term structure of leases should reveal the expectations in the rental market, thus supplying a true market fundamental for the valuation of portfolios of leases, i.e. property values. Furthermore, the rental term structure is likely to indicate rental market turning points, and thus become a lead for turns of the property cycle.

The determining factors of office rental values are researched and documented by empirical studies in different countries. (Greer and Farrell, 1993) stated that a property's rental value is related to "its capacity to satisfy the needs of prospective tenants and its locational advantages relative to those of competing rental properties". In other words, the ability of a property to satisfy a tenant need is generally reflected by the level of rental income that the property is capable of generating. This ability is referred to as property's 'functional utility' and is related to the measure of its productivity. In Greer and Farrell's explanation, "both natural and manmade features contribute to productivity, as does location" (Greer and Farrell, 1993: 89). Hence, property's ability to command rents is basically related to its Physical or general and Special characteristics.

Commercial property has an important role in real estate markets. Ring (1972) stated that commercial property as a property-related issue affects everyone in the sense that it shapes the built environment. Furthermore, the importance can be related to three different factors: First, as a factor of production, commercial property provides the space to house the activities of business and industry. Second, as a financial asset,