

COPY

IN THE MATTER of the Arbitration
Act 1908 and its
Amendment

AND

IN THE MATTER of a Submission to
Arbitration

BETWEEN FLETCHER DEVELOPMENT
& CONSTRUCTION
LIMITED

Lessor

AND

WHITCOULLS LIMITED

Lessee

Hearing: 10, 11 & 12 September 1990

Appearances: Miss J M Suhr & Mr McIntyre for Fletcher Development &
Construction Limited

Mr A J Forbes & Miss S Lennon for Whitcoulls Limited

Award 18 January 1991

AWARD OF UMPIRE

FLETCHER DEVELOPMENT & CONSTRUCTION LIMITED ("Fletchers") is the head tenant and WHITCOULLS LIMITED ("Whitcoulls") is the sublessee in respect of a sublease granted to Whitcoulls by the then head tenant, McKenzie (NZ) Limited (McKenzies) on the 10 February 1986 which sublease was subsequently assigned by McKenzies to Fletchers in respect of premises comprising some 16,275 sq ft being part of the first floor of the building situate at 222 Willis Street Wellington and including 8 carparks.

The head lease was varied by Fletchers and Whitcoulls by way of a variation of sublease dated 30 September 1986.

Under the Deed of Variation the term of the sublease which was for two years from 8 November 1985 was extended to 29 September 1994 and a rent review clause was added which also included a ratchet clause.

The first rent review fell due on 8 November 1988.

The parties being unable to agree to the rental for the first review period from 8 November 1988 to 8 November 1991 appointed myself as the sole arbitrator by a Deed dated 14 August 1990 to hear and determine the rental dispute.

I record that after the hearing I inspected the subject premises on 19 September 1990 in the presence of Mr Quinn and Mr Horsley.

HISTORY

There has been a considerable time period between the date the rent fell due for review, namely 8 November 1988 to the date of my appointment as sole arbitrator, namely 14 August 1990.

I do not propose to traverse the reasons as to why the parties took so long in making an arbitral appointment, the history was traced in the evidence of Mr Grounsell a witness called by Fletchers.

Also, the hearing was delayed because of some interlocutory matters that had to be first dealt with by myself after my appointment.

THE LEASE

I have already briefly referred to the sublease as being in respect of premises comprising some 16,275 sq ft (1512 sq metres) being part of the first floor of the building at 222 Willis Street Wellington inclusive of 8 carparks together with the right to use the vehicle docks, freight and passenger lifts.

The term as varied by the Deed of Variation is for a period from 8 November 1985 to 29 September 1994.

There is no right of renewal.

The Deed of Variation provided for rent reviews.

Under the Deed of Variation the rent for the first three years of the term commencing 8 November 1985 was to be \$71,864 p.a.

Clause 3 of the Deed of Variation relates to the rent reviews as follows:

"3. THE following clause shall be included as Clause 39 of the said Lease:

"39. AT any time being not earlier than Thirty (30) days prior to the expiration of a period of three years from the date of commencement of this Lease and not earlier than Thirty (30) days prior to the expiration of each succeeding period of three years thereafter the Lessor/s may by notice in writing to the Lessee/s fix the rent (subject as herein provided) at an amount which in the opinion of the Lessor/s represents the then current market rent of the Premises and the amount so fixed shall be the rent payable by the Lessee/s from the date specified in such notice PROVIDED HOWEVER that the date so specified shall not be earlier than the third anniversary of the date of commencement of this Lease or the anniversary thereof occurring at the expiration of successive periods of three years thereafter AND PROVIDED FURTHER:

(i) If the Lessee/s considers the rent fixed by the Lessor/s pursuant to this sub-clause not to be the current market rent of the Premises the Lessee/s may by notice in writing to the Lessor/s within twentyone (21) days after being notified of such rent require the rent to be determined by arbitration in the manner herein provided. The current market rent so determined shall subject to sub-clause (ii) of this Clause be the rent payable by the Lessee/s in lieu of the rent fixed by the Lessor/s as aforesaid.

(ii) The yearly rent payable by the Lessee/s after any variation pursuant to this Clause shall not in any circumstances be less than the yearly rent payable by the Lessee/s during the period of Twelve (12) months immediately prior to the date of such variation."

By Clause 4 of the Deed of Variation Clause 37 of the sublease was varied by way of Fletchers having the right to take back no more than 4 carpark spaces, with an appropriate reduction in rental.

The evidence before me was that Whitcoulls still retained the eight carparks.

The sublease is in effect a net sublease.

Whitcoulls in addition to the rent is responsible for the payment of outgoings in terms of the sublease as follows:

i) Clause 2 -

"... all rates, levies, taxes, duties and assessments (including the Lessor's land tax) ... apportioned ... at 18% of the total ..."

ii) Clause 3 -

"... 18% of every insurance premium together with all valuation fees and expenses incidental to maintaining such insurance ..."

iii) Clause 4 -

"... promptly pay and discharge all charges or levies for water, gas, telephones and electricity supplied to or used on the premises and all other charges for utilities and services payable chargeable or assessed in respect of the premises, and in addition shall pay 18% of the cost of cleaning and lighting common areas and servicing the lifts in the building of which the premises form part."

iv) Clause 5 -

"... will and sufficiently repair maintain cleanse and keep the interior of the premises and all electrical and other installations, telephone service and floor coverings belonging to the Lessor ..."

v) Clause 7 -

"The Lessee will ... cause all rubbish and garbage to be removed from the premises ..."

The Lessor under Clause 21 of the sublease is responsible for exterior repairs and maintenance.

There was no dispute that the rental to be fixed was to be the then current market rent. More shall be said about that later in this Award.

ZONING

The land is zoned Industrial B1 under the City of Wellington's District Scheme which is the central area industrial zone. The area covered by the zone is known as the Te Aro Flat area which has a mixture of uses dominated by various industrial and warehousing uses.

PREMISES

The premises are located at 222 Willis Street Wellington and are known as the "McKenzies" building. It stands on the western side of Willis Street between its intersections with Ghuznee and Vivian Streets.

The building was variously described by several of the witnesses who gave evidence but it can probably be summarised as a building originally erected for warehousing purposes probably more than 50 years ago comprising a five level structure which was amalgamated with a six level annexe in the 1950's.

The buildings now form one fully integrated entity of reinforced concrete foundations, floors and frame with the exterior walls comprising cement plastered brick infill panels.

The building is serviced by a passenger lift located within the older building and by a goods lift along the southern side of the newer structure. Two smaller goods lifts (one of which is redundant) are situated towards the rear of the older building. Men's and women's toilets are located either side of a central light shaft on each floor.

The ground floor contains three loading bays, one in the annexe, a smaller one beside in the original structure and a third at the rear of the older building.

The premises under review comprise the entire first floor of some 1512m².

The Whitcoulls tenancy I was told is typical of all internal floors, being leased as bare storage space of now concrete finish, having numerous offices to the front and warehouse storage behind. The office partitions being owned by Whitcoulls and forming no part of the rental assessment.

WITNESSES

The witnesses who were called to give evidence before me on Fletcher's behalf were Mr W E Quinn a Registered Public Valuer and Mr M W Grounsell a Property Manager with Baillieu Knight Frank (New Zealand) Limited as the Property Manager on Fletcher's behalf of the McKenzie Building.

For Whitcoulls the witnesses were:

- i) Mr M A Horsley - a Registered Public Valuer
- ii) Mr C E O'Brien - an Employment Consultant, formerly employed by Brierley Cromwell Property Limited in Wellington being responsible for marketing properties for sale and lease in the Wellington Region of which the subject property was one
- iii) Mr M R Hanna - a Registered Public Valuer
- iv) Mr P J Mahoney - a Registered Public Valuer
- v) Mr D C Taylor - Managing Director of Wellington Realty Brokers Limited
- vi) Mr G R Corlieson - a Registered Public Valuer and a Real Estate Salesman
- vii) Mr R J Edney - a Senior Economist employed by Business & Economic Research Limited

I shall now refer, so far as I believe to be necessary to the evidence given by each of those witnesses, commencing with the evidence called by Miss J M Suhr and Mr McIntyre on behalf of Fletcher's.

Mr M W Grounsell as I mentioned earlier gave general evidence relating to the history of matters leading up to this arbitration.

I have noted the following from Mr Grounsell's evidence.

Mr Grounsell referred to the fact that he was aware that Mr Quinn's valuation for the premises was \$156,698 p.a and that Mr Hyder the Development Consultant for Fletcher's had sought a rental review figure from Whitcoulls of \$161,000 p.a (allowing for negotiation down to Mr Quinn's valuation). From the evidence, that information was contained in a letter from Mr Hyder dated 19 January 1989 to Whitcoulls.

Whitcoulls responded to Fletchers by way of a letter dated 28 March 1989 from Mr Barry Smith the Executive Director of Brierley Cromwell Property Management, the property managers for Whitcoulls as follows:

"The research that we have carried out suggests that the market rental that should apply to these premises is \$110,130 per annum. Consequently our client is prepared to pay a rental at this level for the three year period commencing 8 November 1988.

As you are aware our client has been endeavouring to obtain an assignment of lease for the above premises and has been endeavouring to assign this lease based on the existing rental of \$71,864 per annum. There has been no interest whatsoever in anyone leasing the premises.

I trust you are in agreement with our client's counter-offer and we look forward to receiving your acceptance in the near future."

Mr Grounsell advised Mr Smith by way of letter dated 28 April 1989 that his offer of \$110,130 was unacceptable.

Mr Grounsell also informed me that he had been employed in property management for 8 years including one year as a commercial real estate agent and that based on his experience of the market at 8 November 1988, properties in the central business district and on the fringe of the central business district, were still able to be tenanted without great difficulties. Further, that the impact of the 1987 stock market crash did not significantly affect the property market in his view until in or about the middle of 1989 and that he endorsed Mr Quinn's evidence.

The only other witness called by Miss Suhr and Mr McIntyre was Mr W E Quinn a registered public valuer employed by Richard Ellis (Wellington) Limited who gained his registration on 7 March 1983 and associateship to the New Zealand Institute of Valuers on 7 November 1984. He has practised as a valuer in Wellington since that date.

Mr Quinn informed me that in accordance with written instructions received from Mr A Hyder of Fletchers on 20 October 1988, he carried out a valuation of the premises for the purpose of assessing the "then

current market rent" for the three year period commencing 8 November 1988 and that his conclusion as to a rental for the new three year period was \$154,618-56.

It subsequently transpired during the course of his evidence that Mr Quinn had made an error in his outgoings figure and as a result his figure was increased to \$158,568-33 p.a.

Mr Quinn then described briefly the premises and their location noting that during the 1980's highrise office buildings have crept further south along Willis Street so that the subject property can now be considered on the southern fringe of that high rise extension.

He then described the zoning of the subject site.

His description of the premises was basically as I have already outlined in this Award. His description of the lease was also basically as I have earlier outlined.

Mr Quinn then went on to outline to me his basis of valuation and informed me that when arriving at his valuation he had adopted the accepted method of comparing the subject premises to other space of similar characteristics.

Before proceeding to his analysis Mr Quinn covered some of the market history over the last few years.

He informed me that demand for commercial and industrial space was almost insatiable prior to the October 1987 stockmarket crash. That since that time demand for all types of space had contracted considerably so that now (today) an over supply situation exists and a large amount of vacant space is available for lease. That, that situation had been slowly developing over the last 18 months so that current rental levels are showing little increase over those achieved three years earlier. Vacant space is difficult to lease due to general lack of demand.

It was Mr Quinn's view that he could not concern himself with the present state of the market and that he was required to assess the current market rental as at the time of the rent review in November 1988.

It was his opinion, the market at that time had not fallen to any large extent, but that from early 1989 the situation began to deteriorate so that rental levels had fallen by the end of that year. Landlords had also by then realised that the market was not going to improve and more readily accepted lower rentals both for review and new leasings. The market as it was in November 1988, however, had not yet reflected that situation.

To illustrate that he had analysed rental settlements within the same building at various intervals either side of the review date on the same or very similar lease terms and conditions.

He had analysed rentals in 1987, 1989 and 1990 to highlight the fall in the market that had occurred since 1989 and produced a graph pinpointing when the market began to fall, namely early-mid 1989. He had also considered rental evidence of other buildings within the greater Te Aro area that contained upper floor warehouse space.

His summary was, that the rental evidence within the same building was strong and supported by other rental settlements throughout the Te Aro Basin. That was 'obvious, as the market place had already considered those comparisons and adopted a level within the building that had been accepted, up until now, without referral to arbitration.

That the same level had been tested and agreed upon on at least five separate occasions and between different tenants each time.

The Head Lease rental level had been accepted between the lessor (the AMP Society) and the Head Lessee (Fletchers) both experienced property owners, developers and managers and had been further confirmed by the subtenants either directly themselves or through their valuers in respect of their subleases.

He informed me that it was presently the practice of some valuers to use new leasing evidence only in determining the current market rental of a premises at rent review for a sitting tenant. That approach followed the principles of Dr Whipple. However, he did not concur with Dr Whipple's theories. Nor did a large number of practising valuers including Mr Greg McNamara, a respected practising valuer in Australia and a past President of the Australian Institute of Valuers. Mr Quinn then referred me to an article by Mr McNamara in that area.

Mr Quinn informed me that he had therefore considered all the evidence; be it new leasings, rentals set by arbitrations or agreements between lessee and lessor. He believed the more evidence on which to draw, the more accurate the final valuation, provided the appropriate analysis and adjustments had been made.

Mr Quinn then informed me that in his rental valuation for the purposes of making adjustments to comparable occupancy cost rentals he had made the following allowances:

a) Rent review Frequency

With regard to the frequency of the rent review he made no allowances for that. It was his opinion that since the October 1987 sharemarket crash there was no advantage in having a three year term over a two year term.

b) Quality of Space

Adjustments had been made for service lifts, sprinkler systems, high stud, light and air etc.

c) Adjustments for Size

He had adjusted those comparable premises which were either significantly larger or smaller than the subject premises by using percentage allowances.

d) Adjustment to Location

Percentage locational allowances had been made where considered appropriate.

Outgoings

Mr Quinn then dealt with the level of outgoings and informed me that he had made the required adjustments in that the total occupancy cost had been considered for each comparable. That he had been supplied with the operating expenses for the July 1988 to June 1989 year which totalled \$178,139-26, Whitcoull's share being 18% = \$32,065-07 which equated to \$21-21 p.s.m on net lettable area.

Mr Quinn then submitted what he termed rental settlements within the subject building - some 10 in all.

Mr Quinn also submitted rental evidence within other buildings - some seven in all.

He explained each one and then summarised them later in his evidence.

I insert those summaries here for ease of reference.

SUMMARY OF ADJUSTED RENTALS by Mr Quinn

<u>Address</u>	<u>Floor</u>	<u>Adjusted T.O.C.</u>	<u>Date</u>
<u>Evidence within subject building</u>			
1) Worleys	5	106.04	Aug 87
2) Freelance Publications	4	101.38	Apr 88
3) AMP Head Lease	1	112.14	Mar 88
AMP Head Lease	2	112.14	Mar 88
AMP Head Lease	3	112.14	Mar 88
AMP Head Lease	4	112.14	Mar 88
4) CJC Commercial	2	112.22	Jul 88
5) BNZ	3	116.90	Feb 89
6) NZ Wool Testing	2	115.24	Jun 89
7) Quality Transfer	2	92.94	Oct 89
8) Andrew Hawley	4	79.92	Jan 90
9) Weinsteins	3	91.03	Feb 90
10) Education Department	1	57.83	Mar 90
<u>Evidence within other buildings</u>			
11) 3-9 Walter Street National Library	1	107.57	Oct 88
12) Dominion Construction		99.45	Jul 89
13) 12 Sages Lane Mike Clare		129.59	Apr 88
14) 11-13 Ghuznee Street G Webster & Co	1	101.81	Mar 89
15) 4-8 Adelaide Road Watson Victor		109.47	May 88
16) 302 Taranaki Street Tasman Print		110.66	Nov 88
17) 135-143 Taranaki Street 5 storey building	1	113.50	Aug 89
	2	111.50	Aug 89
3 storey building	1	109.25	Aug 89
	2	105.75	Aug 89

Under the summary headed "Evidence within subject building" Mr Quinn in response to a question from myself informed me that he placed

reliance on items 1, 2, 3 & 4. That he believed Items 5 & 6 to show a trend. That items 7, 8, 9 & 10 were of no great relevance

"Evidence within other buildings". Under that head Mr Quinn informed me as follows:

- i) He placed some weight on Item 11
- ii) That Item 12 showed a trend
- iii) That Item 13 should be disregarded
- iv) That Item 14 showed a trend
- v) He placed some reliance on Items 15, 16 & 17, while Item 17 also showed a trend, drawing a relationship between that building (135-143 Taranaki Street) to the subject building.

Mr Quinn then concluded by informing me that in arriving at his valuation he had considered all the above evidence, placing most weight on the evidence within the subject building. That evidence was most persuasive.

That within the building a total of 13 upper warehouse floors had been assessed over a 31 month period from August 1987 to March 1990 involving ten different tenants.

He referred again to his graph, to the effect that it was not until 1989 before the market began to decline.

Accordingly he had assessed the current market rental value of the Whitcoull's tenancy in accordance with the lease as follows:

1512 square metres @ \$113.70 psm	171,914.40 pa
plus 8 carparks @ \$45 per week each	18,720.00 pa

Total Occupancy Cost:	\$190,634.40 pa
Less outgoings	36,015.84 pa

CURRENT MARKET RENTAL VALUE: \$154,618.56 pa

Mr Quinn then adjusted his figure for outgoings by substituting \$32,065-07 pa for the figure shown as \$36,015-84 resulting in an adjusted current market rental of \$158,568-33 pa plus GST if it be payable.

That was the end of the evidence for Fletchers.

Fletchers' case as presented to me was on the basis that I should assess the current market rent as at 8 November 1988 at no less than \$158,568-33 plus GST if it be payable.

I here refer to the fact that Mr Forbes for Whitcoulls had produced a Schedule 1 which contained Whitcoulls assertions as to the relevant principles of rental valuation. That Schedule was referred to Mr Quinn for his comment and he was cross-examined on it by Mr Forbes. I shall deal with that Schedule 1 and Mr Quinn's cross-examination on it later in this Award.

I turn now to the evidence (so far as I believe it necessary) called by Mr Forbes and Miss S Lennon on behalf of Whitcoulls.

The first witness to be called was Mr M A Horsley an associate of the New Zealand Institute of Valuers, being registered in 1979 and having practised continuously since then in private practice. He is principally involved in commercial and industrial valuations throughout the Wellington region.

Mr Horsley informed me that in accordance with written instructions received on 3 May 1989 from Mr B Smith, Executive Director Brierley Cromwell Property Limited, he inspected the Whitcoulls premises for the purpose of assessing its market rental in terms of the existing lease and reported on 1 June 1989 concluding that the contract rental for the three year period from 8 November 1988 be \$129,600-00.

That figure was subsequently corrected by Mr Horsley in evidence to \$128,375 pa plus GST.

Mr Horsley then went on to explain to me the nature of the premises - bare warehouse space - its locality being situated close by the Wellington urban motorway on and off ramps and therefore well located for businesses servicing the city and surrounding areas.

Mr Horsley then described the premises and informed me that the subject premises provided dated older style functionally obsolete upper floor warehouse accommodation of well above average proportions in terms of size.

Mr Horsley then went on to describe the occupancy arrangements, noting that the lease permits the transfer or assignment of the premises subject to certain terms and conditions.

Mr Horsley then went on to outline to me his basis of valuation and informed me that in arriving at the market rent for the subject premises he had adopted the widely accepted method of comparing the premises on an occupancy cost basis with other similar premises in the near area. That those comparable rentals were made up of the contract rent and generally the estimated outgoings for either the current financial year within which the rent review fell or ideally the budgeted outgoings for the ensuing twelve month period.

For the purpose of making adjustments to comparable occupancy cost rentals he had made some quantitative allowances, these being:

a) Rent review frequency

With regard to rent reviews he had made an allowance of 3% for the difference between a two year and three year lease term.

While other aspects to which he had given consideration to in arriving at the rental for the premises included:

- i) Quality and amenity of space
- ii) Method of measurement net vis-a-vis gross
- iii) Physical appearance
- iv) Stud height

b) Time

That he had made a subjective adjustment for time noting a trend towards reduced rental rates for larger upper floor warehouse premises particularly those entered into in 1990. That there was direct evidence of that in the subject building with the fourth floor rent review fixation of January 1990 at an overall

occupancy cost of \$101 per square metre before adjustment, vis-a-vis part of the third floor fixed at \$112.48 per square metre from July 1989 and part of the second floor at \$112.27 from June 1988. Those settlements reflected a tracking back in rental levels over that period.

c) Size

That he had made a subjective allowance on account of the reduced demand for large upper floor warehouse premises in the periphery of Wellington city for premises greater than 900 square metres in area.

d) Operating expenses

That as the quantum of operating expenses remained unresolved, he had adopted \$27.41 psm which was consistent with the agreed outgoings for the CJC tenancy.

Mr Horsley then detailed to me leasing arrangements in respect of various premises together with his analysis of same and then summarised them later in his evidence.

I insert Mr Horsley's summary here for ease of reference.

Leasing arrangements in respect of various premises
as analysed by Mr Horsley

	Date Set	Occupancy Cost before Adjustment \$ psm	Occupancy Cost after Adjustment \$ psm
29 Webb Street 505.86 square metres	09/88	115.15	107.18
74 Kent Terrace 425.95 square metres	05/88	73.72	68.56
204-210 Willis Street 455.48 square metres	11/89	110.35	92.13
302 Taranaki Street 331.09 square metres	11/88	107.96	101.51
3-9 Walter Street 906.61 square metres	10/88	110.32	102.83

3-9 Walter Street 552 square metres	07/89	102.00	92.85
222 Willis Street Part second floor 1235.57 square metres	07/88	112.22	109.67
222 Willis Street Part third floor 824.39 square metres	07/89	112.48	112.34
222 Willis Street Part fourth floor 872.7 square metres	01/90	101.00	91.94
191-193 Thorndon Quay First floor 2503 square metres	05/90	69.62	71.35
135-143 Taranaki Street First floor 1170.72 square metres	08/89	95.00	95.00

Under this summary Mr Horsley as a result of questions from myself gave me his views as to the following particular buildings and their occupancy cost after adjustment as follows:

29 Webb Street	The figure of \$107.18 psm - Set an upper limit - It was a superior building and had better natural light. (9/88)
204-210 Willis Street	At \$92.13 psm - He placed particular reliance - but it was well after the review date. (11/89)
3-9 Walter Street 906.61m ²	At \$102.83 psm - He placed more reliance. It was a signpost. (10/88)
3-9 Walter Street 522m ²	At \$92.85 psm - same as for above. (7/89)
222 Willis Street Pt second floor "CJC"	At \$109.67 psm - That was the most comparable. (7/88)
135-143 Taranaki Street First floor 1170.72m ²	At \$95 psm - He would give lesser weight - but he would not ignore.

Mr Horsley then referred me to the Head Lease of the entire McKenzie building which is subject to two head leases between the AMP Society as Owner and Fletchers.

He informed me that the subject lease did not differentiate between the parts of the premises demised under one headlease as against the other. The headlease in respect of the subject premises of "The Old Building (McKenzie's)" had eight year review periods with the last review being in 1986. The second headlease of the "New Building (Whitcoulls)" had its rental fixed for the six year period commencing from 31 March 1988 by agreement between the parties at a basic net rental of \$95 per square metre for the first through to fourth floors inclusive further adjusted at 12% to allow for the difference between a three year and a six year lease term, those rentals being net of outgoings. In addition 20 on site carparks had their rental set at \$50 per week.

Mr Horsley then referred to the history of the subject premises. He reminded me, as I had already heard in evidence, that the premises had been widely offered in the market place since February 1988 and had been listed with a number of reputable and active commercial agents at an asking rental of \$4-41 per square foot (\$47-47 per square metre) plus outgoings indicating an asking occupancy cost of \$69.94 per square metre. That the premises were subsequently sub-leased for one year with two further rights of renewal of three months from 19 March 1990 at \$102,000 per annum inclusive of eight carparks on a gross lease basis and assuming a rental of \$15,600 for the carparks it indicated a residual sum of \$86,400 attributable to the warehouse floor or \$57.14 per square metre (Gross).

Mr Horsley then informed me that he considered the best form of market evidence was that of new leaseings where all information is known and that greater weight should be placed on new leaseings than rentals settled on review. (In that he concurred with the Umpire Mr Smith in his 120-126 The Terrace Award.)

Mr Horsley then emphasised to me that it was important to establish whether each transaction constituted a willing lessee/willing lessor arrangement and in that respect he seriously questioned the Head Lease AMP, Fletchers settlement where in his opinion Fletchers ~~had settled a rental in the belief that it could pass the same directly on to the~~ sublessees. Further, that that Head Lease settlement had then had a domino effect on subsequent rental review settlements throughout the building.

Furthermore, it was important to establish whether in any new letting an inducement was available. If so, the sum should be decapitalised over the term of the lease with the adjusted rental reflective of the market rent. That would also be true of any inducement offered on review.

Finally, when turning to his evidence as submitted to me, Mr Horsley informed me that the adjusted comparable rentals ranged in occupancy costs from \$68.56 per square metre to \$107.18 per square metre. That ignoring those settlements within the subject building, only 135 Taranaki Street and 191 Thorndon Quay were similar in size. That it was his view that the subject premises could not reasonably be compared with new upper floor warehouse accommodation and that there was strong evidence for a discount for size on account of the reduced demand for large upper floor warehouse premises. That was further reinforced by the lengthy period the subject floor was offered on the open market.

Having regard to the above, he assessed the rental for the subject premises to be:

1511.94 square metres @ \$102 psm	154,217
8 carparks @ \$37.50 per week each	15,600
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Occupancy cost	169,819
Less operating expenses	41,442
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Contract rental	\$128,375 pa

That figure was, Mr Horsley believed, an appropriate net rental for the three year review period from 8 November 1988 for the subject premises plus GST.

Mr Horsley then in his evidence referred to a Schedule 1 which contained a series of assertions put to him by Whitcoulls' Counsel as to the relevant principles of rental valuation.

I shall at this stage put that matter to one side as I intend dealing with it in another section of this Award as I have earlier intimated.

The next witness called by Mr Forbes was Mr C E O'Brien who as I earlier mentioned was formerly employed by Brierley Cromwell Property

Limited in Wellington where from November 1987 to December 1989 he was its Wellington Sales and Leasing Executive.

His evidence was to the effect that:

- i) In 1988 there was a substantial proportion of newly available and existing leased space (office and warehouse) available in Wellington following the October 1987 crash.
- ii) During 1988 he would have had 10 or so properties in the Wellington region available to lease at any one time, including existing and new leases.
- iii) It was Brierley policy to adopt a pro-active role in regard to the sale and leases of properties although it was not Brierley's general policy to advertise the availability of commercial premises.
- iv) During 1988 within zones 1, 2 & 3 there was on Brierley's estimate a vacancy factor of approximately 13-15% and that the subject premises were in zone 2 bordering on zone 3 and further that the vacancy factor related to all types of leased properties in the three zones.

Mr O'Brien then traversed the marketing of the subject premises from February 1988 with the asking rental being the then existing rent (pre-review) which was \$4-41 psf plus outgoings.

He informed me that throughout 1988 there was virtually no response at all and he considered that that reflected in part the dramatic change in ability to lease properties in Wellington after October 1987 which he conceded occurred within two to three months of the October 1987 crash.

Mr O'Brien's perception of the difficulties with the Whitcoulls premises, based on particular discussions with the various agents at the time, as to the lack of tenant response were due to:

- i) A rapid increase in the number of warehouse tenants vacating the Te Aro area in favour of more strategic locations which trend was certainly evident by November 1988.
- ii) The availability of some newly completed competitive warehouse and office space within Te Aro which he believed was evident by November 1988.
- iii) The very poor standard of the premises.
- iv) A weak and steadily declining warehouse tenant market evident in the Te Aro area.

He further informed me of some interest expressed in the Whitcoull space in December 1988 which came to nothing and the fact that he was aware that Whitcoulls itself was also attempting to market the premises.

Further, that in June 1989 a special newspaper campaign was conducted through Harcourts.

He also informed me that Whitcoulls was willing to either assign or sublet the premises but that in fact an assignment was always going to be very difficult because of the exposure to the rent review as at November 1988.

He further informed me that he did not consider the premises were price sensitive in the sense that the asking rental of \$4.41 psf was the reason why there was no significant tenant response, but that in his view in 1988 there was a virtual absence of prospective central city area industrial and warehouse tenants.

Finally, that the lack of response with regard to the premises was in his view symptomatic of a stagnant tenant market for warehouse space of that nature in 1988 and 1989.

Mr Forbes' next witness was Mr M R Hanna.

Mr Hanna is a very experienced Registered Public Valuer registered under the Valuers' Act 1948 who has several professional qualifications, and who has been practising as a valuer in Wellington city for many years.

Mr Hanna at the outset of his evidence informed me that having inspected the premises, perused the lease documents and made such enquiry as had been necessary, that he had formed the opinion that the current market rent for the subject premises should be set at an annual amount of \$132,308 plus Goods & Services Tax and all building operating expenses as specified in clause 1(b) of the Deed of Lease.

Mr Hanna then generally described the premises to me, noting that generally it was storage space of a fairly basic nature.

Mr Hanna then dealt with the question of the building operating expenses and adopted a more conservative indicator than either Mr Quinn or that resulting from the CJC review and fixed them at \$27.50 psm.

Mr Hanna then, in considering the rental worth of the subject premises for the current review period under the head "Comparable evidence", informed me that he had examined his firm's records and made other enquiry to establish current market rates for similar upper floor warehouse premises around Te Aro Flat and that for ease of comparison he had quoted them in his evidence on the basis of gross occupancy cost which is the sum of the tenant's liability for whatever share of building operating expenses is required under the terms of his lease together with the agreed contract rental.

Mr Hanna then cited to me under the heading "Contemporaneous data" four examples and under the heading "Amongst post-date leases" three examples.

~~Mr Hanna then finally, and possibly most relevantly, in his view turned to other rentals agreed within the subject building.~~

In his analysis under all heads he informed me that he had some doubt as to the credibility of detailed adjustments of comparables not precisely similar to the subject premises but that it was certainly revealing to analyse the other rentals at 222 Willis Street ~~in order to establish commonality~~.

It was his view having regard to the renewal date (I have assumed he meant the "review" date) the following adjustments were appropriate:

- "1. Time: Nil
 2. Lease Term 2:3 years: plus 3%
 3. Fitout: Bare space less 6%
 4. Part Floor : Full Floor Tenancy: less 5%
 5. Building Position: The Ground Floor appears to have a premium or margin at the original leasings of about 20% and looks to have increased to about 25% by late 1988."

Mr Hanna then noted the other internal tenancies against the subject premises as outlined in the following table:

Mr M R Hanna's Table of Other Internal Tenancies
 rated against the subject premises

<u>Assessed Adjustments</u>								
<u>Tenancy</u>	<u>Date</u>	<u>Tenant</u>	<u>GOC</u> <u>psm</u> <u>\$</u>	<u>Term</u>	<u>Fitout</u>	<u>Part/</u> <u>Full</u> <u>Floor</u>	<u>Position</u>	<u>Adj</u> <u>GOC</u>
Ground -								
South	7/88	BNZ	142	+3%	-6%	-	-25%	102
North	7/88	BNZ	134	+3%	-	-	-25%	105
Second	7/88	CJC	112	+3%	-6%	-5%	-	103
Third	2/89	BNZ	114	+3%	-6%	-5%	-	105

Mr Hanna then informed me that as a result, the average adjusted gross occupancy cost is therefore \$104 psm for bare upper floor space for a three year term.

Mr Hanna then dealt with the question of carparking and adopted a weekly rate of \$40 per park for the subject premises.

Mr Hanna concluded by informing me that he remained of the view that the internal reviews at No.222 Willis Street which were roughly contemporaneous with the subject, provide the most compelling evidence for the determination of the rental for the Whitcoulls tenancy and accordingly he had adopted a Gross Occupancy Cost rate of \$104 psm as appropriate.

He then stated his recommended rental structure at p.10 of his evidence as follows:

"Whitcoulls First Floor Tenancy 1512m ² @ \$104.00 psm	157,248
Less Building Operating Expenses as noted 1512m ² @ \$27.50 psm	41,580
	<hr/>
	\$115,668
Plus 8 carparks @ \$40 per vehicle per week	16,640
	<hr/>
	\$132,308

If Goods and Services Tax should be payable then it should be charged in addition to this amount."

Mr Hanna had also been given Schedule 1 by Mr Forbes for comment on which he did during the course of his evidence and again I shall refer to Mr Hanna's comments on Schedule 1 later in this Award.

The next witness called by Mr Forbes was Mr P J Mahoney a Property Investment Consultant and Registered Valuer of Auckland and a Fellow of the New Zealand Institute of Valuers.

Mr Mahoney is also a very experienced valuer.

Mr Mahoney was not retained to carry out a valuation of the subject property but his brief from Counsel for Whitcoulls was to provide an opinion as to the relevance of new market lettings vis-a-vis rental reviews and other market factors in the determination of a current market rental.

~~It was Mr Mahoney's opinion that in considering the factors to be considered in determining a current market rental of the premises subject to rental review, market rentals determined at arbitration would normally represent a consideration of all the known market factors which usually include: new lettings, details of sublettings, rental reviews where applicable, a consideration of alternative available accommodation, levels of demand and the vacancy factor existing in the market at the time of review.~~

He then went on to explain that traditionally, market rentals are ideally set by direct reference to open market rentals as evidenced by arms length transactions negotiated by a willing but not over anxious lessee with a willing but not over anxious lessor. That such rentals are normally obtained by a detailed analysis of the available evidence of rentals payable for comparative premises as close as possible to the rental review date, with any necessary adjustments.

That where free open market rentals are not readily available, or, for whatever reason they are considered not truly comparable, then other evidence is usually considered. Such additional evidence would normally include: sublettings, particularly of similar premises within the same building and any subletting of the subject premises. In considering sublettings, he believed that they can provide useful market evidence provided the terms and conditions are identical to, or very similar to, the terms of the lease under consideration but that also adjustments may have to be made.

Also that rental reviews of other leases recently negotiated can and are often used as market evidence, particularly where the valuers and parties have first hand knowledge and experience of such reviews. In considering such review evidence he believed that it is important that the valuer/parties be fully aware of all the circumstances pertaining to the review agreement and ascertain if special circumstances were in existence where any such agreement may have been reached.

Further, that the inclusion of ratchet clauses in many commercial leases can maintain an existing contract rental which under certain market conditions may be in excess of a true open market rental. In such a situation, he believed that that review evidence should be disregarded as the rental so fixed may not recognise or reflect the factual situation of the open market.

Again, some negotiated review rentals can include hidden incentives details of which are unknown to the valuer.

Mr Mahoney informed me that the application and adoption of the principal components as he had outlined represented the mechanism of the market to which the valuer or arbitrator must give consideration.

Those components represented the valuer's normal data source in deriving the actual dollars per annum rental rate, but in themselves were not the only factors to be taken into account. Other market related factors to be considered included the availability of alternative accommodation, the asking prices sought for such accommodation and the degree of response from the market together with the period for which any available space had been exposed to the market in an attempt to attract any prospective lessees. It was Mr Mahoney's opinion that failure to take up available space after a letting period of say six months would be indicative of either: extremely limited tenant demand, an excessive asking rental, accommodation not suitable to meet the markets needs, or terms and conditions which were not compatible with the present state of the market.

He went on to inform me that in a ~~static or declining market which is~~ currently being experienced in most of the major metropolitan centres and in his opinion as it particularly applies in Auckland and at least some sectors of Wellington City, the burning issue now confronted by most valuers and arbitrators is: what weight is to be placed on those individual factors forming part of the composite market. That issue becomes particularly critical where there is little or no evidence of comparable new lettings.

In such a situation he believed that the assessment of the "market rental" must then have very careful regard to:

- (i) The quantity of comparable space available on the market for lease and the level of asking rents being sought. Where supply far exceeds demand, then it is not unusual for lessors to offer substantial concessions/inducements to attract a new lessee. Such inducements will usually consist of:
 - Rent free holiday periods
 - Cash inducements
 - Contributions to the lessee towards fitout and relocation expenses.
 In some instances the lessor taking over the incoming lessee's contractual obligations for an existing lease

- (ii) The incentives/inducements as such, are normally converted to an equivalent cash sum and then discounted over the period of the lease commitment. Some valuers and other commentators even suggest that the conversion should be discounted only over the initial rental review term. This latter approach does not, he believed, necessarily reflect the true nature and raison d'etre of such incentives; which is to attract a lessee to enter into a substantial lease commitment. In other words, a long term lease commitment of twelve years would normally attract a larger incentive payment than a short term lease of three or six years.

The intention of discounting the incentives over the lease term, is an attempt to convert the stated contract rental to an equivalent market rental presuming that no such incentives/inducements were offered.

- (iii) If the premises the subject of the rental review, have been available for sublease on the market, then the questions to be considered will include: what has been the level of the asking rental, the terms being offered by the headlessee - are they similar to the terms of the headlease agreement and how long has the property been available for lease.

Whilst it is accepted that the lessee itself is recognised as a potential occupier, it is also recognised that such a lessee can only be expected to pay a rental sustainable on the market at that time.

Mr Mahoney then went on to explain what was happening in the Auckland market and referred to the two tier market. He believed that in theoretical terms a two tier market does exist - only as a temporary phenomenon and more so in a declining market. The only justification being where the lease contract itself incorporates time and conditions which provide for a rental which is not necessarily market related.

It was Mr Mahoney's opinion that premises subject to rental review as to a current market rent under market and economic conditions prevailing as at late 1988, must be at a rental level which truly

reflects the conditions of that particular market. Such a rental may therefore differ from some of the negotiated rentals which may have been reached between lessors and lessees, or in some cases, rentals fixed by valuers or arbitrators who because of the circumstances existing may not have had sufficient regard to all the market factors.

Further, that one of the features of many negotiated rental reviews, has been the reluctance of some lessees to proceed to arbitration either for reasons of the costs involved or even inadequate advice being given.

Mr Mahoney further observed that the state of the property market which existed in late 1988, some 12 months after the stock market crash of October 1987, created for the first time in many years at very best a static if not a declining market which had not been experienced by most valuers for many years. Features of the market included: the lack of new lettings, the growing volume of uncommitted space available for lease and a belated recognition by some lessors of the need to adopt a totally different attitude towards lessees when negotiating rental reviews.

The extent of the decline and impact of the market reversal, initially created a period of inertia, with many investors lessors and lessees effectively "treading water" in the hope that events may improve or certainly get no worse. That subsequent events had shown that that was not to be the case and particularly in Auckland City where the decline in the commercial and industrial property market has continued up to the present day.

During that particular period some 12 months after the stock market crash, with the paucity of new open market transactions, there was a tendency for some if not many valuers to rely almost exclusively upon rental review evidence which may or may not have truly reflected the market conditions pertaining at that time.

Finally, it was Mr Mahoney's opinion that a market rental to be determined under such market conditions must therefore have regard to:

- ① Principally any evidence of "arms and length" new lettings

- ② Evidence of any sublettings of comparable quality space on similar lease terms and conditions.
- ③ The state of the particular market including consideration of: available vacant accommodation, rental levels being sought for the available space, the vacancy factor in the market and the recognition of any incentives/inducements being offered to any incoming tenant.
- ④ The length of time any vacant space has been advertised on the market. A period of up to six months at a competitive asking rental, would normally suggest a very soft market with a low level of demand which would have its impact on actual rental levels.
- ⑤ Consideration of rentals achieved on review, but recognising the likelihood of the captive element in some such agreements and the possibility of hidden incentives being offered.
- ⑥ Finally, that the weight to be placed on such factors could only be determined by the valuer or arbitrator having regard to the totality and quality of all the evidence available.

The next witness called by Mr Forbes was Mr D C Taylor, Managing Director of Wellington Realty Brokers Limited, who has had five years' active selling and leasing in the Wellington Commercial and Industrial market. Mr Taylor gave evidence in the area of the company's marketing of the subject premises but his evidence was in response to a series of written questions submitted in letter form to his firm by Mr Forbes. I do not propose setting out the questions posed nor the answers given. It was however Mr Taylor's opinion that the premises did not lease because they were virtually functionally obsolete.

He could not give specific figures relating to the supply/demand situation of warehouse space of that type in Wellington during the period February 1988/July 1989 or as to the vacancy factor during that period but he was able to say that there was generally at that time and remains, a considerable oversupply of above ground office/warehouse accommodation.

That in 1988 there were very few prospective tenants and that a small number were able to locate to better options than Whitcoulls' premises.

Mr Taylor's recollection was that as at late 1988 as a result of the 1987 sharemarket collapse the effect was a vast amount of industrial space available for leasing and there was a trend away from interest in such space in the Te Aro area during the period under consideration.

Also, that there was comparable and superior accommodation in 1988 available in the Newtown and Miramar areas which competed strongly with Te Aro.

He confirmed that Whitcoulls were negotiable at all times.

In response to a question from Mr Forbes as to whether or not there was any correlation between movements in office rentals and warehouse rentals in Wellington that occurred in 1987-1989, Mr Taylor responded that the only correlation noted was that the quality of accommodation became a telling factor in both office and warehouse markets.

Finally, in response to a further question from Mr Forbes as to whether or not in 1988 there was any tendency for lessors to hold out for rentals which they in fact could not and ultimately did not achieve, Mr Taylor agreed that there were a number of lessors who refused to acknowledge the changed market conditions who held out for unrealistic rentals and that it took up to a year post-crash for many of the lessors to review their rates.

The next witness called by Mr Forbes was Mr G R Corlieson (under subpoena) a Registered Valuer and an associate of the New Zealand Institute of Valuers having some 22 years' experience in the real estate market commencing as a valuer in 1968 until 1980 and as a real estate salesman since then.

Similarly as with Mr Taylor, Mr Forbes had sent a similar questionnaire letter to Mr Corlieson. Again I do not intend repeating either the questions or the responses given by Mr Corlieson here.

However, in general terms Mr Corlieson so far as he was able, outlined the basis upon which a former firm in which he was associated, Harcourts, marketed the subject property.

Mr Corlieson viewed the subject premises as being somewhat unattractive with limited appeal due to large size, awkward first floor location and limited usefulness.

It was his view that with the market in a strongly emerging downward trend and prospective tenants being rather thin on the ground that the premises would likely prove difficult to lease although not necessarily impossible and that the market for warehouse style space from February 1988 to July 1989 was generally categorised by oversupply and limited demand - as indeed was the entire property market.

He further commented that a number of market observers have commented on vacancy factors with some generalised opinion that a warehouse vacancy of some 20% existed in the Te Aro basin but he was not aware of any definitive study of industrial vacancy factors, but that it was fair to say that there has always been a degree of industrial space vacant at any point in time and that generally the less desirable space has always been more difficult to lease.

He confirmed that a limited number of leaseings occurred throughout 1988 and up to the present.

He further commented that the demand for warehouse space subsided from early 1988 through to the present time and generally throughout the entire Wellington Region with industrial space in the Te Aro basin being less affected than some other areas.

Mr Corlieson was unable to accurately state the amount of warehouse space available for lease in the Wellington region during 1988 but stated that it was probably fair to say that supply has generally exceeded demand at any one point in time over recent years.

He confirmed that the subject building was somewhat unique in terms of age, style and configuration with only a very limited number of similar buildings in the Te Aro area and that it was his experience that multi-level warehouse space had proved more difficult to lease compared to single level warehouse space.

Further, that it was his experience that there is no quantifiable correlation between movement in office rentals and warehouse rentals

and that both are influenced by supply and demand at any point in time.

Finally, Mr Corlieson commented that he could now say, with hindsight, that in 1988 a number of lessors held out for rentals that in many cases were not achievable. That most property market participants at the time, including himself, did not recognise the true nature and impact the sharemarket collapse, combined with tax changes to super funds, was to have on the property sector.

The final witness called by Mr Forbes was Mr R J Edney a Senior Economist employed by Business and Economic Research Limited.

Mr Edney was employed by Whitcoulls to give evidence from an economist's perspective on two specific areas:

- i) The nature of the commercial property market in Wellington at the time preceding and around the rent review of 222 Willis Street on 8 November 1988

and

- ii) Specific assumptions made in the valuations by valuers (Mr Hanna & Mr Horsley).

Mr Edney's evidence in area (i) relied extensively on quotations from documentary evidence available on the new Zealand property market and the general economy available late 1988/early 1989.

His overall impression from such references was that land values and rental values were static, if not falling, over 1988 for industrial rentals such as the type involved in this arbitration.

It was his opinion after a review of his references that the weight of evidence was that there was quite a substantial downturn in the demand for property, both industrial and commercial in 1988.

It was his further opinion that while it was clear that property values do tend to be sticky, in that prices do not adjust fully and quickly to clear the market, it is clear that there would have been some pressure upon the rental values of properties over that period as

a result of the weak recovery which indicated that a fall in demand for property also occurred.

In the second area of his evidence, Mr Edney was asked to consider several assumptions which I shall now deal with each in turn.

Assumption 1

That a negotiation between a captive tenant and a lessor on review can be treated as identical to a new entrant or free to exit market player.

Mr Edney in response commenced by saying that from an economist's perspective there are notable differences between the equilibrium price that will be arrived at by the market when there are frictions to market clearing.

He then went on to explain those frictions.

He went on to explain that the existence of those frictions means that a lessor can effectively use the friction to maintain rents at a relatively higher level compared to those of a new tenant. In fact, it may be the case that a lessor will need to substantially discount his required rental to obtain a tenant as a form of "teaser" to the market. That means that in an efficient market the difference between rentals for a new tenant and an existing tenant will be explained to a large extent by the existence of the cost of breaking a lease and obtaining a new lease for the existing tenant. While it may be convenient in many cases to assume that these rentals are the same it does not seem the case that such an assumption is justified in all circumstances for the purposes of a valuation.

He supported that contention by reference to an article by Gunterman & Smith (1987) which found that real estate markets are inefficient in the sense that they do not fully reflect all the information that affects the price in the market place and that Gunterman & Smith's empirical study confirms that there is a significant difference that is likely to be observed when comparing the costs of renting for a captive tenant and a tenant that is free to exit and enter the market.

Assumption 2

That the lessor in an oversupplied market is making a "non-market" transaction assuming the lessor is not in a cash flow crisis.

Mr Edney commented that it was difficult to support the contention that an oversupplied market should mean that a transaction conducted in it is a non-market transaction and that in economics it is generally assumed that transactions are conducted at equilibrium. He then went on to explain that comment and cited the fundamental difference between, for example, property markets, labour markets and capital markets and after further explanation, commented that property markets would seem to be somewhere between the two extremes that he had explained.

When considering a prospective tenant and lease, be it an existing tenant under review or a new tenant, the lessor will implicitly take into account the rent that is being offered and whether the rent offsets the costs of searching for another tenant and obtaining a potentially higher rental. The large amounts of money involved in rental transactions of this nature means that a lessor will not be entirely flexible in his price setting behaviour but that does not imply that the transaction that arises from such a situation is a "non market" transaction AND further that frictions to price adjustment do not imply that a transaction will necessarily be "non-market". Both parties may be at equilibrium, but the equilibrium is not the same as that for perfectly flexible prices.

Assumption 3

That nine months or even two years is not a reasonable exposure to the market given that they are warehouse premises.

Mr Edney stated at p.6 of his evidence as follows:

"As an economist I do not have a great deal to say about the fact that the property concerned is a warehouse but I would like to point out that there are significant differences between a property market and other types of markets in terms of the cost of obtaining information, searching for a property and the transactions costs that are associated with property transactions."

He then discussed those differences and commented further at p.6 & 7 of his evidence as follows:

The industrial property market probably has even a longer search time than a labour market given a certain set of economic conditions. However it does seem likely that nine months would be plenty of time to expose a property to a market. Certainly, two years would seem a more than sufficient length of time for a property to be exposed to the market. In buoyant demand conditions, a property could be snapped up almost as soon as it went on the market and in the period up to the October 1987 share market crash this was often the case. After this period, there was a substantial change in the economic fortunes of New Zealand and as a result of this the demand for commercial property fell substantially. The reason that there can be such a significant time between a property becoming available and a lease eventually being signed on a property is due to the average search time involved in finding a property which will depend on the number of vacancies in the market at the time and the determination of the lessee amongst other factors such as the price. After this period it seems that a major impediment to signing a lease will be the price that is negotiated for the lease. If the asking price of the lessor is above the expected rental income that the lessee believes he can generate from his revenue over the period of the lease then this means that there is a disequilibrium in the market place. As long as the lessee and the lessor's expectations remain different and prices remain constant, it is likely that the property will remain vacant and consequently a period of nine months or two years might be experienced as a vacancy in the commercial property market.

Economists like to assume that information is imputed into prices fairly quickly and in some markets it is. I would expect the commercial property market to be slower than many markets but nine months would seem sufficient in most circumstances, particularly if marketed sufficiently."

Assumption 4

That rents set on a review basis or even new letting rentals can be taken to be a market price if there is a significant vacancy factor in the market.

In this area of his evidence Mr Edney commented at p.7 as follows:

"As already noted in this briefing the property market has a number of price frictions in it which means that, unlike capital markets, the price will not fully adjust to take into account all information in the market ... The existence of a significant vacancy factor would indicate that there is an oversupply of space but this does not mean that the trade which takes place with a high vacancy factor is not a market transaction. The transaction could still be an optimal transaction but the existence of substantial vacancies may reflect wider economic circumstances, business expectations and the existence of sticky prices ...

If market participants are aware that there is a high vacancy factor when conducting their negotiations and it is likely they are, there is no reason why this information should not impact on the final negotiated price. Specifically, a high vacancy factor is likely to reduce the lessor's expectations of the rental that he might be able to obtain for the property and a prospective tenant will consider that the rent he will have to pay for a property should also be reduced accordingly. Although there are costs in property markets of obtaining information it seems very likely that two commercial operations that are involved in the property market such as the two parties in this dispute will have reasonable information on vacancy factors in the property market at a given time."

In his conclusion Mr Edney stated:

"Two major conclusions that I think can be drawn from this analysis:

- i) New Zealand's property markets were showing significant signs of a downturn in 1988 and this was the expectation of many economists;
- ii) Property markets contain a number of frictions and cited search shows these to be accounted for by transaction costs which include:
 - search costs;
 - negotiation costs;
 - legal costs;
 - goodwill cost;
 - costs of physical relocation;
 - cost of breaking a lease

This does not imply that prices arrived at in this market are "non market".

Mr Edney then gave in evidence comments on a transcript of a discussion with Mr Hanna supplied to him by Ms Lennon junior counsel for Whitcoulls. These were in fact answers given by Mr Hanna in his evidence to the Schedule 1 questions that I have referred to earlier.

I shall deal with Mr Edney's response to Mr Hanna's comments in a later section of this Award.

SCHEDULE 1

Schedule 1 was introduced by consent into the evidence by Mr Forbes Counsel for Whitcoulls during his cross-examination of Mr Quinn the valuer for Fletchers and for ease of reference I have attached Schedule 1 as Schedule A to this Award.

Schedule 1 is headed "Whitcoulls assertions as to the relevant principles of rental valuation (which will be supported by legal submissions of Counsel)" which were then briefly summarised.

Mr Quinn's response to Schedule 1 and its assertions I have summarised as Schedule B to this Award.

Mr Horsley, a valuation witness of Mr Forbes, was asked by Mr Forbes for his comments on Schedule 1 and they formed pages 20 to 23 of Mr Horsley's evidence which I have summarised as Schedule C to this Award.

Mr Hanna, a valuation witness for Mr Forbes, was asked by Mr Forbes for his comments on Schedule 1 which Mr Hanna dealt with at p.10 of his evidence which I have summarised as Schedule D to this award.

Specific Questions put by Mr Forbes to Mr Hanna

Mr Forbes put a series of questions to his valuation witness Mr Hanna which Mr Hanna recorded as "other matters" in his written evidence. I have attached those questions and the answers given by Mr Hanna (p.11-18 Hanna Evidence) as Schedule E to this Award.

It was to those questions and the answers given by Mr Hanna that Mr Edney (Mr Forbes' economic witness) was asked to comment upon. I have attached those answers from Mr Edney as Schedule F to this Award.

Mr Quinn was cross-examined by Mr Forbes on Mr Hanna's questions and answers and I have attached as Schedule G to this Award a summary of my notes of Mr Quinn's comments on Mr Hanna's answers.

The Valuation conclusions of the respective valuers

Mr Quinn for Fletchers fixed a current market rental of \$158,568.32 pa
Plus GST

Mr Horsley for Whitcoulls fixed a current Market Rental of \$128,375 pa
Plus GST

Mr Hanna for Whitcoulls fixed a current market rental of \$132,308 pa
Plus GST

THE CASE FOR FLETCHERS

The case for the lessor was based upon the evidence of W Grounsell and the valuation evidence of Mr Quinn who adopted what he termed the accepted method of comparing the subject premises to other space of similar characteristics. Included in that approach, Mr Quinn also considered all the evidence be it new leaseings, rentals set by arbitrations, or agreements between lessee and lessor, being of the view that the more evidence on which to draw, the more accurate the final valuation, provided the appropriate analysis and adjustments were made.

With reference to the definition of current market rent it was Mr McIntyre's submission that there that there were a number of varying definitions of "market rent", "current market rent" and "open market rent".

That it was generally accepted that the assessment of the "current market rent" was an objective one and may be defined as the best price or the best rent which might reasonably be expected to be obtained for an interest in a property at the date of valuation, assuming:

- a) A willing lessor and lessee (neither party acted under duress).
- b) A reasonable period in which to negotiate the letting.
- c) That values remained static during the letting period.
- d) That the property would be freely exposed to the market.

- e) That no account would be taken of any higher price or rent that might be paid by a person with a special interest (e.g an adjacent occupier).

That was a guideline adopted by McNamara contained in a paper attaching to Mr Quinn's evidence and acknowledged by Mr Quinn under cross-examination as the guidelines adopted by him for the purposes of his valuation.

THE CASE FOR WHITCOULLS

Whitcoulls' case was based on two alternative broad grounds as follows:

- i) It was based on conventional valuation evidence (but taking into account (ii) below as well) and (Horsley and Hanna):
and
- ii) Further based on the other evidence called on Whitcoulls' behalf as to exposure of the premises to the market, the economic evidence as to the operation of the rental market and the legal and valuation principles properly thought to be applicable in this case (Mahoney, Edney, O'Brien, Taylor, Corleison).

And further that basically the valuers Horsley and Hanna adopted the same general valuation approach adopted by Quinn as I have outlined in this Award.

The second ground was the primary ground of Whitcoulls' case, with Mr Forbes acknowledging that under that ground there were some legal and valuation principles at variance with the opinions of Horsley and Hanna as well as Quinn.

Included as a consideration of both alternative grounds, it was Mr Forbes' submission, that on any assessment of the current market rent for this review the parties must have intended that it was to be construed as the open market rent with vacant possession. That the potential lessor and lessee must be regarded as hypothetical persons negotiating in an open market and that market rental value is usually

defined as the rent which might reasonably be expected assuming a willing lessor and willing lessee for the premises with vacant possession for the duration of the term.

It was Mr Forbes' strong submission that based upon the evidence he had called and on his legal submissions, that I should fix a rent below the fixations of his two valuers.

Terms of the Lease

I have already referred to the terms of the lease, but I return now to the terms of the rent review clause which places upon the Arbitrator the function of fixing the rent at an amount which in the opinion of the lessor represents the then "current market rent of the premises" and if the lessee considers the rent fixed by the lessor not to be the current market rent of the premises then such rent is to be determined by arbitration.

The current market rent as so determined, shall become the rent payable in lieu of the rent fixed by the lessor subject to the ratchet proviso.

I note that there are no restrictions in the lease placed upon the assessment of the current market rent.

The premises are the premises as defined in the Schedule to the sublease and as also referred to in Recital A of the Deed of Variation of sublease being all those premises comprising 16275 sq feet being part of the first floor of the building situate at 222 Willis Street Wellington.

There is a dispute between the parties as to whether or not the current market rent is that assuming a willing lessor and lessee for the premises with, or without, vacant possession.

Miss Suhr contended that it was without vacant possession in terms of a proper construction of the relevant clauses contained in the Deed of Variation of Lease, while Mr Forbes contended that it was with vacant possession.

Bernstein & Reynolds in their Handbook of Rent Reviews (1989 Revision at p.607 para 6-41) refer to the fact that where there is no clear

direction that the premises are being let with vacant possession at the review date, it is a question of construction and little general guidance could be given.

In Avon County Council v Alliance Property Co Ltd (1981) 258 EG 1181 Judge Davies QC held the view that an absence of the words "with vacant possession" from a clause is not fatal to a claim that a particular clause contemplates a vacant possession valuation. The words may be implied in the clause.

I tend to the view in this case that the current market rent should be construed as the open market rent with vacant possession. I believe my view to be reinforced in the consideration I intend making shortly of the words "current market rent" and the fact that there are not contained within the sublease or the Deed of Variation any restrictions placed on my assessment of the current market rent, nor to the factors to which my consideration should be given.

In any event, as Miss Suhr conceded in her closing submission, although she did not accept "vacant possession" as being an implied term of the lease, nothing turned on it in any event, as the evidence of Quinn and Hanna was to the effect that there would be no difference in their respective valuations whether vacant possession was assumed or not. That Mr Horsley refuted its implementation, but in essence nothing turned on the matter.

With respect I would agree.

My function is therefore to determine the current market rent of the premises in accordance with Clause 39 of the sublease dated 10 February 1986 as inserted by Clause 3 of the Deed of Variation of the sublease dated 30 September 1986 at the review date, namely 8 November 1988.

Basic Rationale of a Rent Review

Broadly speaking I view the basic rationale of a rent review as being encompassed in the words of Sir Nicholas Browne-Wilkinson VC in

British Gas Corporation v Universities Superannuation Scheme Ltd [1986]

1 EGLR p.120 at p.121 as follows:

"There is really no dispute that the general purpose of a provision for rent review is to enable the landlord to obtain from time to time the market rental which the premises would command if let on the same terms on the open market at the review dates.

...

... in my judgment the lease should be construed so as to give effect to the basic purpose of the rent review clause and not so as to confer on the landlord a windfall benefit which he could never obtain on the market and he were actually letting the premises at the review date ..."

Valuation Approaches

I have already referred to the valuation approaches adopted by valuers Quinn, Horsley & Hanna and it is my view from a consideration of their evidence and cross-examination that they have failed to fully address all those matters which I believe should have been addressed for the purpose of this rental review. (I shall return to this matter later in this award.)

In saying that, I am heartened by the words of Mr Justice Isaac's in the High Court of Australia's decision of Spencer v The Commonwealth of Australia [1907] 5CLR p.418 at p.441 when he stated:

"To arrive at the value of the land at that date, we have, as I conceive, 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 cognizant 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 reason soever in the amount which one would otherwise be willing to fix as the value of the property."

That is of course a classic statement which then has to be applied to the practical situation pertaining to the factors one has to deal with in this arbitration. Although that was a case dealing with the resumption of land, I am of the view that the same or similar

considerations apply in determining the current market value of the subject premises for rental purposes., subject to the practical situation as I have stated above.

Such a view is confirmed by the Court of Appeal in Legal & General Life of Australia Limited v A Hudson Pty Ltd (1985) 1 NSWLR 314 at P.329 as stated by McHugh JA:

"The rent to be ascertained is that payable by a willing lessor and a willing lessee for a lease on the same terms and conditions as this lease. Underlying the notion of a willing lessor and willing lessee are the assumptions that neither is willing to disregard those business considerations which are in his favour and that they are each equipped with the knowledge of the relevant circumstances. The question then is what the lessee would offer, and the lessor would accept, as rent for the grant of the lease of those premises."

It has been said that there is nothing hypothetical about the lease which is the subject of the hypothetical bargaining. The principle is, that unless the lease otherwise provides, the rental valuation must take account of all the terms and conditions of the existing lease, except of course, the rental being reviewed. (T&G Mutual Life Society Limited v Dominion Breweries Limited - arbitration 13 June 1988 Hon E Pritchard Esq at p.12)

I would respectfully agree with those comments, but in the present circumstances of this case I do not feel bound by the fact that the rental being fixed is on review, rather than on, say, a new leasing on the open market.

For the purposes of this arbitration I am of the view that there can only be one market. The lease itself refers to "current market rent" and I am bound to determine that market.

Following the words of Mr Justice Donaldson in F R Evans (Leeds) Ltd v English Electric Co Ltd [1978] EG (Digest) p.67 (noting that this decision was upheld on appeal 11.11.77) at page 75 as follows:

"I accept that the negotiations are designed to arrive at the appropriate rent in all the circumstances which in fact affect the property and in theory affect the hypothetical lessor and lessee: I would not myself have used the expression "fair rent" which, like "meaningful," has in recent years been much bandied about in the political arena

and may have become distorted in the process. However, I do accept that the appropriateness of the rent is to be judged in the light of all the circumstances of the case - other than those relating to the landlord and tenant as actual juridical persons - and that one of those circumstances is the rental values prevailing in the area. There are, of course, many others. The rent for which each is negotiating is that which is high enough to be acceptable to a willing lessor and low enough to be acceptable to a willing lessee. In the hypothetical life of hypothetical higglers, there is always one rent any never more that one rent which meets these criteria. If the arbitrator is heard to murmur "Oh happy hypothetical higglers" this is only too understandable. He has my sympathy."

Evidence

Mr Forbes in his closing submission made a submission to the effect that in ascertaining the current market rent it is necessary to assess:

- i) whether particular evidence is relevant at all;
 - ii) whether it is relevant but should be given only limited weight
 - iii) whether it is relevant but only if it is adjusted (cf(ii)).
- This may be especially so in regard to evidence of other transactions in order to make them truly comparable.

I adopt that submission for the purposes of my considerations.

Further, Mr Forbes warned that in land valuation/rent assessment situations, the tendency to work backwards from a perception as to the appropriate assessment by adopting and applying only evidence that justifies that perception, must be guarded against and that it was important to bear in mind that the function of expert valuers is to ascertain the market, not make it. That the arbitrator's function is to determine the state of the market and what it was doing at the time, which may not necessarily have been what the valuers thought it was doing and that in this case that factor was particularly relevant.

I accept that submission.

It was his further submission that the analysis should not be as to what sort of evidence the parties are presumed to have intended should be relied upon, or admitted on review when they entered into the lease

(and adopted the formula of "the current market rent" for future rent reviews) but rather, what the parties intended should be measured. Also evidence relevant to that should be considered and processed in the appropriate manner.

I accept that submission

Mr Forbes cited the case of Broken Hill Pty Co Limited v Australian Mutual Provident Society (the Valuer - October 1986 p.340 Supreme Court of Victoria - Nicholson J) as being an example which demonstrated some confusion as to the distinction I have just noted from his submission where the emphasis was on what evidence the parties could be said to have contemplated would be relied on review, based on market considerations at the time they entered into the lease.

Mr Forbes further submitted that he accepted that comparable rent review evidence is not legally irrelevant or inadmissible but that does not mean that it was necessarily the best or the only relevant evidence, in the absence of comparable new lettings evidence. Nor did it mean that it should be relied upon other than with caution and appropriate adjustment to make it truly comparable.

I accept that submission

In that area Mr Forbes placed reliance upon the case of Edmund Barton Chambers (Level 44) Co-operative Ltd v Mutual Life & Citizens' Assurance Co Ltd (1985) 6 NSWLR 312 at both instances (Supreme Court NSW McInerney J, and NSW CA - Glass JA).

At first instance McInerney J had the following to say at p.321:

"I am of the opinion that as a matter of law a valuer is not bound in the circumstances of the case to disregard similar rent review clauses. The situation here is a far different situation from that in Harris' case. Valuers have such experience and expertise that they are particularly equipped to assess what use they will make, if any, of the material they obtain. As stated the ideal situation will be rarely found in practice and to totally disregard other rent review agreements would not be permitting access by the valuers to as much material as possible and would be not giving them that flexibility I believe that would be necessary to enable them to properly assess the current market rent. It may be in the words of Staunton J they may have to adjust up or down or not at all, but that is for the valuer."

On Appeal, Glass JA accepted the submissions of Counsel for the respondent lessor at p.324 & 325 as follows:

"He put the following submissions: (1) The appellant's argument confuses the test to be applied in determining value and the evidence which may be taken into account. The authorities show that in determining the sale price which would have been acceptable to the hypothetical vendor and purchaser as a pure register of market forces, it is permissible to have regard to sales in which one or other party is influenced by non-market considerations provided allowance is made for that fact. Examples are dispositions by a vendor under pressure from his mortgagee and by one member of a family to another or acquisitions by a purchaser whose business premises have been destroyed or a developer who needs a particular block to complete his development site."

...

(2) The test of the hypothetical sale or letting is not fully described as a process in which each party is free to withdraw from the negotiations. The hypothesis requires the assumption to be made that although each is free to withdraw a bargain nevertheless results. (3) The rentals struck between a lessor and an incoming tenant are said by the appellant to give full expression to market forces and to constitute the only material relevant to current market rent. However, a lessor seeking to fill a new building may be under a host of constraints which force the rentals it will take below current market levels. Nevertheless these constitute acceptable evidence to which adjustments will be made in applying the criterion of the rental which would be agreed in a hypothetical letting responsive to pure market forces. (4) In principle, therefore, rent review rentals constitute material relevant to the determination of current market rent. In the process of evaluating such material the distortions due to non-market forces will necessitate some adjustment. The relevance of such material subject to this qualification has been expressly decided by the Queen's Bench Division in England and the Supreme Court of Victoria: Segama NV v Penny Le Roy Ltd (1983) 269 EG 322; Broken Hill Pty Co Ltd v Australian Mutual Provident Society (1986) 5 Conv R54-187."

In this area I am also assisted by the Segama decision reported as Segama NV v Penny Le Roy Ltd [1984] EG (Digest) 74 QBD Staughton J at p.84 as follows:

"I suspect that the market rent, to be ascertained for the demised premises, must be a rent which would be paid in the market for those premises with vacant possession. But even if that is right, it does not follow that the arbitrator must exclude from consideration any rents agreed for similar

property between an existing landlord and an existing tenant. He may think it right, as one of the steps in his determination, to adjust any such rent to what it would have been for vacant possession; whether the adjustment would be up or down, or none at all, I do not know, and Mr Bagnall put nothing before me to suggest an answer. I can see that an adjustment may be required. But I do not consider that such evidence must as a matter of law be altogether excluded.

My reasons for reaching that conclusion are essentially the same as I have already set out in connection with the construction of clause 5(3) under the first issue. First, what the arbitrator must have regard to is the worth, in terms of rent, of similar property let with vacant possession at the relevant time. In ascertaining that worth, he can have regard to the rents agreed at a different time, for similar property not let with vacant possession. But he must consider how far evidence of rents so agreed helps him to determine the answer to the actual question which is before him."

In summary, under this head I am satisfied that it is the Arbitrator's function to determine the state of the warehouse rental market in this instance as at 8 November 1988 and what that market was doing at that time, by way of an examination of the totality of evidence as submitted including of course, review evidence, as to its relevance, and if relevant, as to the weight to be given to it, and if relevant, as to what adjustments (if any) should be made to it in order to enable it, or the valuation produced therefrom to be rendered comparable to the subject premises under rental review.

Current Market Rent

I turn now to a consideration of the term "current market rent."

I have already construed it as being an open market rent with vacant possession and that the potential lessor and lessee must be regarded as hypothetical persons negotiating in the open market. Support for such a view comes from the decision of Donaldson J in F R Evans (Supra) at p.71 as follows:

"The first, and perhaps the most important, conflict between the parties is whether, in the application of the clause, the willing lessor is to be identified with the landlords and the willing lessee with the tenants. In a sense the willing lessor must be the landlords because only they can dispose of the premises, but for the purposes of the clause the landlord is an abstraction - a hypothetical person with the right to

dispose of the premises on an 18 year lease. As such he is not afflicted by personal ills such as a cash flow crisis or importunate mortgagees. Nor is he in the happy position of someone to whom it is largely a matter of indifference whether he lets in October 1976 or whether he waits for the market to improve. He is, in a word, a willing lessor. He wants to let the premises at a rent which is appropriate to all the factors which affect marketability of those premises as industrial premises - for example, geographical location, the extent of the local labour market, the level of local rates, and the market rent of competitive premises, that is to say, premises which are directly comparable or which, if not directly comparable, would be considered as viable alternatives by a potential tenant.

Similarly, in my judgment, the willing lessee is an abstraction - a hypothetical person actively seeking premises to fulfil needs which these premises could fulfil. He will take account of similar factors, but he too will be unaffected by liquidity problems, governmental or other pressures to boost or maintain employment in the area and so on. In a word, his profile may or may not fit that of the English Electric Co Ltd, but he is not that company."

Further, in this area the Hon E Pritchard Esq in the T&G Mutual Life Society award (Supra) had the following to say at p.11:

"In the case of a market rental, the valuer must regard both potential lessor and lessee as hypothetical persons negotiating in an open market. As Donaldson, J. said in F.R Evans (Leeds) Ltd v English Electric Co Ltd (1977) 36 P & RC 185, 191 each "is a complete abstraction and, like the mule has neither pride of ancestry nor hope of posterity". Unlike the mule, however, each of the hypothetical negotiators must be deemed to be a prudent man of business and either a willing lessor or a willing lessee. A "willing lessor" is a hypothetical person who has the right to grant a lease of the premises for the term of the actual lease and who wants to obtain a rent which is appropriate to the premises and commensurate with the rents of comparable properties. A willing lessee is a hypothetical person who is actively seeking premises to fulfill needs which the subject premises could meet and who is prepared to pay a rent which takes account of the same relevant factors as does the hypothetical lessor. Thus both parties to the hypothetical bargaining are abstractions; neither is to be identified in any way with the actual lessor and lessee."

I accept Mr Forbes' submission to the effect that the current market rental is usually defined as the rent which might reasonably be expected assuming a willing lessor and lessee for the premises with vacant possession for the duration of the review period. I am of the view that the comments under this head reinforce my earlier views (refer p.40-41).

Furthermore I would accept:

- i) That the hypothetical, willing lessor, is not affected by personal ills such as a cash flow crisis or importunate mortgagees. Nor is he in the happy position of someone to whom it is largely a matter of indifference whether he lets at the review date or waits for the market to improve.
- ii) That the hypothetical, willing lessee, will be unaffected by liquidity problems or e.g governmental or other pressures to boost employment in the area. He is willing to take the subject premises at the right price, but he is not considering the proposition or negotiating in a vacuum.
- iii) The fact that he is likely to be the only potential lessee is relevant, but only indirectly. It does not matter if he or another lessee is the only potential lessee.
- iv) The concern is with the attitude of the hypothetical willing lessee, who is not in occupation and (the clause in the lease) assumes there is such a person.
- v) The willing lessee has to agree the rent with the hypothetical, willing lessor. The negotiations would be conducted in the light of all the bargaining advantages and disadvantages which affect the property and the lessee and which exist at the review date.
- vi) The rent is to be judged in all the circumstances one of which, are the rental values previously in the area. There are of course many others.

There is only one rent and never more than one rent that meets the criteria.

All those contentions were discussed and adopted by Mr Justice Donaldson in *F R Evans* (Supra).

There are other matters that would also have to be considered by the Arbitrator e.g monopoly positions, inducements, fitout concessions and others.

In summary, it is my view that the willing lessee is not going to pay more than the market requires him to pay. As stated by Fox LJ in Dennis & Robinson Ltd v Kiossos Establishment [1987] 1 EGLR 133 (CA) p.133 at p.134:

"It is essentially a matter for the valuer to inquire into and determine the strength of the market. He is, for example, entitled, if such is his expert opinion on the facts, to say that, having regard to the state of the market and the condition of the property, a tenant, though a willing tenant, could not be expected to take the stipulated lease save at a low or nominal rent and that the full yearly market rent must be determined accordingly."

In that general area of the evidence before me Mr Forbes submitted that the absence of new lettings evidence does not mean that the market must be assumed to be evidenced by the review evidence. I would agree. Further, I would accept that it is not merely a matter of the weight to be given to the review evidence, if such evidence has to be adjusted to be truly comparable, then, to give any weight at all to it without that adjustment, would in my view, be wrong.

That is a factor for consideration by the arbitrator.

I do not however necessarily accept a further submission of Mr Forbes, that sitting tenants in a building do not compete with each other or with other prospective tenants when undergoing a rent review and nor can they compete with space actually available on the market. To my mind that is too much of a sweeping statement and an assertion that is too wide. It overlooks in my view the passage I have just quoted from Dennis' case (Supra). What was stated by Mr Forbes may be a factor for consideration by the Arbitrator but that is a matter for the Arbitrator based on the evidence presented.

Mr Forbes was very critical of the review process in his submission referring to the fact that it was just as open to "manipulation" as new lettings area. Also that a head lessee may settle the head lease rental and use that as a "comparable" for his sublease reviews and in doing so create a domino like effect - with compliant subtenants. He also cited other factors.

I accept that many criticisms can be levelled at the review process, but in the end, it must come back to Glass JA's acceptance of Counsel

for the respondent's lessor fourth submission in the Edmund Barton Chambers case (Supra) at p.325:

"In principle, therefore, rent review rentals constitute material relevant to the determination of market rent. In the process of evaluating such material the distortions due to non-market forces will necessitate some adjustment."

The Market

The question at issue under this head is what is the warehouse current rental market as at 8 November 1988.

I have already traversed the evidence in this area and shall now briefly repeat it here.

(i) The Valuation Witnesses

Mr Quinn's view was that as at 8 November 1988 the market had not fallen to any large extent but that from early 1989 the situation began to deteriorate so that rental levels had fallen by the end of that year. He illustrated that view from the analysis he had made of rental settlements within the same building at various intervals either side of the review date on some or very similar lease terms and conditions.

He then made a further analysis of rentals in 1987, 1989 & 1990 to highlight the decline in the market that had occurred since 1989 and produced a graph pinpointing from his evidence when the market began to fall, namely early-mid 1989.

Further, that the Head Lease rental level had been accepted between the lessor (AMP Society) and the Head lessee (Fletchers) both experienced property owner, developers and managers and had been further confirmed by the subtenants either directly themselves or through their valuers in respect of their subleases in March 1988.

Under cross-examination Mr Quinn did not shift from his position. He agreed that the perception of the market in 1988 was important, confirmed there was no decline in 1988

- that it was essentially a stable one, but that its perception was uncertain and that his comparables indicated rents reasonably stable and that his perception of the market was borne out in 1989 when rents began to fall.

His comment on Mr Edney's evidence where Mr Edney had made reference to the bleak outlook for commercial property sales in 1988 and early 1989 was that was the perception, but that all were projections, no actual evidence was produced, and it was all opinion but in hindsight probably accurate.

He concurred with Mr Hanna's response to vacancies in the Wellington warehouse market in 1987 & 1988 in that there may have been some but as with Mr Hanna he had no specific figures.

He also concurred with Mr Hanna that the absence of new lettings of warehouse space was not necessarily an indication that warehouse market rents were falling.

Mr Quinn also agreed with Mr Hanna as to the market conditions existing in November 1988 with particular reference to the inertia characteristic of the real estate market which in mid-late 1988 did not reveal an undue concern as to the way the market was heading.

Mr Horsley's view was as at 8 November 1988 a two tier rental had become evident with rental levels for occupied space being settled on review at levels in excess of some recent leasings or indeed asking rentals. That was true of the office rental accommodation market and that there was subsequent evidence to suggest that it was also true in general terms of the warehouse rental market although there was a lack of new leasings as at November 1988 but he had no direct evidence.

Further, that in the market as the one which existed in November 1988, there were a number of anxious lessors keen to lease vacant space and maintain cash flows resulting in a discounted rental in various forms. It was his view that a

lessor who found himself in such an oversupplied market and was obliged to grant concessions in order to achieve a letting was not a "willing-lessor".

Apart from the references I have made to Mr Quinn's view of the market to those of Mr Hanna's views, Mr Hanna under cross-examination was of the view that in terms of general perception, the market had not been seen to be falling away rapidly before early 1989.

(ii) Other Witnesses

Mr Grounsell employed in property management for 8 years including one year as a commercial real estate agent was of the opinion that as at 8 November 1988 properties in the central business district and on the fringe were still able to be tenanted without great difficulties and further that the impact of the 1989 stock market crash did not significantly affect the property market in his view until in or about the middle of 1989.

Mr O'Brien's evidence was contrary to that of Mr Grounsell's (refer my summary of O'Brien's evidence p.19-21 Supra). Under cross-examination Mr O'Brien could not quantify the amount of warehouse space available or the area as at November 1988 nor could he quantify the total availability of warehouse space in Te Aro in 1988 nor could he quantify a specific percentage of vacant warehouse space in Te Aro.

Mr Taylor's evidence was also contrary to that of Mr Grounsell's (refer my summary of Taylor's evidence p.29-30 Supra).

Mr Corlieson's evidence was also contrary to that of Mr Grounsell's (refer my summary of Corlieson's evidence p.30-31 Supra).

Mr Edney an Economist whose evidence I have traversed at p.32 of this Award had the overall impression that land values and rental values were static, if not falling over 1988 for industrial rentals such as the type involved in this arbitration.

Despite Miss Suhr's submission that I should place little weight on Taylor and O'Brien's evidence; that Edney had difficulty in calculating any percentages as to warehouse space vacancies or availability and that although Corlieson had referred to a vacancy factor of 20% in warehouse space in the Te Aro area he was unable to substantiate it, I prefer the evidence of O'Brien, Taylor, Corlieson and Edney to that of Grounsell and the valuers Quinn, Horsley and Hanna even after treating the economic evidence of Mr Edney with some caution.

I am of the view from the totality of the evidence I have favoured that it sufficiently established a static if not a downward trend in the property market, including the warehouse market, which would include rentals from at least March 1988 through to 8 November 1988 and thereafter, even after allowing for the fact that some of Mr Edney's references upon which he was relying, post dated 8 November 1988. From the evidence, I believe that there were market forces existing in 1988 sufficient to cause such a trend.

I am further of the view that the three valuers' perceptions as to the market were restricted by what I consider to be the restricted nature of their investigations in their handling of their respective valuation approaches to the subject property. Perhaps it could be said that they were somewhat "blinkered" in their approach, although that was denied by Mr Quinn. I shall return to this matter later in this Award.

The Two Tier Market

A great deal of play was made of a two tier market by some of the witnesses and Counsel during the course of the Arbitration.

The two tier market has been referred to by some authors, Whipple and McNamara included, while mention was made of such a market in the BHP Case (Supra).

In this area I would agree with Mr Hanna where he stated his views to question (b) as posed by Mr Forbes (refer Schedule E to this Award) as follows:

"A: *I do not believe that there is any theoretical justification for the alleged phenomenon of a "two-tier" market. In my view the market is the market. However where it is perceived that review rentals are being set above (or below) open market rents the illusion of two tiers is created for observers who are not conversant with the principles stated in the most important legal decisions such as F R Evans (Leeds Ltd v English Electric Co Ltd (1977) 36 P & CR 184 (1977) 245 EG 657, and summarised in the schedule referred to above.*

Having said that I acknowledge that the illusion is compounded by the inertia which is a characteristic of the property market, and that response to changes in economic conditions is accordingly slower there than is the case in other information-responsive markets such as shares or commodities."

However, (unlike Mr Hanna) in assessing the review rental of a property in a market which appeared to be exhibiting a two tier structure I am of the view that valuers should be able to adjust review rentals either upwards or downwards depending upon the factors under consideration even if the quantum of adjustment necessary to account for the legal principles might be difficult to establish without first hand knowledge.

The position might well be the same even without a so called two tier market.

The Evidence of Mr Mahoney

I have traversed the evidence of Mr Mahoney at some length earlier in this Award (refer p.24-29).

Mr Mahoney was not called by Mr Forbes to carry out a valuation of the subject property but he was called to provide an opinion as to the relevance of new market lettings vis-a-vis rental reviews and other market factors in the determination of a current market rental.

In the main I accept Mr Mahoney's evidence as a guide to valuers, the guide representing the mosaic of the market, comprising those components representing the valuer's normal data sources in deriving the actual dollars per annum rental rate and I would agree with him that they are not the only factors to be taken into account. Other market related factors to be considered include the availability of alternative accommodation, the asking prices sought for such accommodation and the degree of response from the market, together with the period for which any available space had been exposed to the market in an attempt to attract any prospective lessees.

This mosaic of the market with its other factors were referred to by several witnesses in this arbitration as the "basket" of evidence to be considered.

I recall from p.29 Supra that it was Mr Mahoney's opinion that premises subject to rental review as to a current market rent under market and economic conditions prevailing as at late 1988, must be at a rental level which truly reflects the conditions of that particular market. Such a rental may therefore differ from some of the negotiated rentals which may have been reached between lessors and lessees, or in some cases, rentals fixed by valuers or arbitrators who, because of the circumstances existing, may not have had sufficient regard to all the market factors.

Post Review Evidence

I have referred to the role of post review evidence in at least two of my fairly recent Arbitration Awards (Wellington City Council v Equity Portfolio Investment Company Limited Award 1 February 1990 at pages 51-52 AND

Tower Corporation v Wellington Area Health Board pages 13 and 37) where I cited Segama's Decision and Bernstein & Reynolds (Supra) paras 7-86) where the learned authors state that the position at present is

that the balance of authorities indicate that evidence of post review date transactions is admissible but it cannot have any secondary effect on the market sentiment at review date.

I also note that at para 7.85 in the same text evidence of events such as economic catastrophe which occurred after the review date is inadmissible (Ponsford v H.M.S. Aerosols Ltd [1979] AC 63).

I have no reason to change my view in this arbitration that post review evidence is admissible to help establish a valuation as at the review date but that the weight of evidence will depend on all the factors of the case.

Rental Assessment by reference to the Valuations

I have earlier referenced the valuation assessments of the three valuers and commented upon their use of comparables to arrive at their rental figures. I have no difficulty from the evidence presented to me in acknowledging that the lower valuations of Horsley and Hanna are preferable in my view to that of Quinn's. However, I have difficulty from the evidence, in accepting the lower, namely Horsley's. My problem stems from the three valuers' virtual reliance upon comparables and more particularly those comparables within the subject building. Admittedly there were no comparable new leaseings after putting aside "Sages Lane" and "Quality Transfer" and therefore, as the valuers have informed me, they have relied on comparables.

In an earlier award of mine, namely WCC v Equity Portfolio Investment Company Limited (Supra) which was an award relating to the fixing of a ground rent, I referred to the comments of Sir Clifford Richmond in the Britannic House Award dated 12 April 1984 (which I believe are just as apposite for this Arbitration) where at p.16 I quoted Sir Clifford Richmond as follows:

✓ *"With respect, I regard Mr Holmes' remarks as most helpful. The only qualification which I would personally make is that I would hesitate to regard the most compelling influence, from the point of view of the prudent lessee, as being a consideration of what other lessees have agreed to pay as indicated by negotiated settlements or*

✓ formal arbitrations. I say that only because, while I accept that a prudent lessee would attach very great weight to such considerations, I would not wish a state of affairs to develop where the answer in these cases might in practice depend too much on past precedent. Lessees, having watched what Mr Holmes called the "slow marginal increase from time to time" in ground rentals, should be quite untrammelled in their right to query the justification for any further increase, however slow. And in like manner a lessor should not be precluded by precedent from seeking a fresh enquiry into the fairness of the rental levels achieved by historical methods. I make these comments because in the present case I have had the advantage of opinions expressed by several witnesses as to the underlying principles which should govern the selection of a particular percentage rental rate as being the fair one in all the circumstances."

With respect, I would agree with Sir Clifford Richmond and I too, with particular reference to this arbitration, would hesitate to regard the most compelling influence from the point of view of a willing lessee as being a consideration of what other lessees have agreed to pay as indicated by negotiated settlements or formal arbitrations and I would adopt the other comments of Sir Clifford Richmonds as I have quoted.

These comments only serve to confirm my earlier comments in this Award (refer p.45 to 47 Supra).

I have already traversed in this Award the market factors that I believe should have been examined by the valuers in this arbitration being the mosaic of the market plus the other market factors I have referred to leading to a "Basket" of evidence.

There is evidence from all the valuers as to the various adjustments they made when arriving at their respective market valuations of the subject premises, but in making those adjustments I believe they misread the market, that I believe from the evidence, existed at 8 November 1988.

I do not accept that any of the valuers really researched and sourced the market in order to establish what it was doing at the time. They all had a perception but that is as far as they could go.

None of them appear to have gone to the O'Briens, Taylors, Corliesons and Edneys of this "world" in any endeavour to establish how the market,

and in particular the warehouse market, was behaving as at 8 November 1988 in order to ascertain its strength or weakness.

They all appeared to be hidebound by their traditional valuation approaches.

I do not accept that the mosaic of the market plus other market factors leading to a "basket" of evidence is looking at this very difficult matter by way of hindsight. Although Mr Mahoney conceded that from his point of view his views might now be one of hindsight I do not accept that it is necessarily the case. It is my view that it is exactly the valuation approach that valuers should have been making over a long period of years, and the fact that they have not done so in my view goes back to my early comments of valuers being hidebound in their traditional valuation approaches and possibly "blinkered" also. There is no doubt they considered amongst other matters:

- (i) the attempts by Whitcoulls to sublease or assign the subject premises from February 1988 up to the date of the rent review and beyond and the rental being asked.

(There is no doubt in my mind that the spectre of a rent review on 8 November 1988 would have put a blot on any assignment of that sublease - it is another factor to be taken into account in the totality of matters.)

- (ii) The review of the Head Lease rentals for the subject building.

Mr Horsley in particular seriously questioning that settlement, being as he thought on the basis where Fletchers settled in the belief that it could pass the same directly on to the sublessees.

That was a matter of opinion and there was no hard evidence before me from any of the valuers as to how that particular settlement was arrived at.

- (iii) The review of rentals for some of the sublessees in the same building in March 1988.

Again there was no hard evidence before me as to how those particular settlements were arrived at.

- iv) The possible or actual appearance of a two tier market as at 8 November 1988 and thereafter.

- v) The vacancy and availability factors relating to other warehouse space.

To my mind and from the evidence, only on a desultory basis.

- vi) The absence of new leasings.

- vii) The supply and demand factors.

Again on a desultory basis.

- viii) Mr Hanna looked at commentary in valuation reports prepared by his firm, perused newspaper advertisements at the time and referred to his firm's newspaper clipping book. It is not apparent from his evidence that he looked elsewhere.

Having said all that, I do not accept that the three valuers in their assessments of the current market rental for the subject premises gave the time, care and attention to all those factors making up the mosaic of the market and the basket of evidence, which I believe they should as valuers have given very careful consideration to.

The valuers went a certain distance but in my view not far enough when arriving at their respective assessment of the current market rental.

As a result, I am of the view that the lower of the valuers, Mr Horsley, is too high at the figure he fixed as the "contract rental" at \$128,375 p.a plus GST.

On the other hand, I do not accept that there should be no increase in the present rental as at its review date.

From the evidence before me and the general impression made upon my mind of all the various relative factors that I have cited in this

Award, which I believe have been well and truly canvassed by me, together with my perception of the market from the evidence I have favoured (Supra p.54).

I assess the current market rental of the subject premises as follows:

1512 sq metres @ \$89-25 psm	134,946
plus 8 carparks @ \$37-50 per week each	15,600

Total occupancy cost	\$150,546
Less outgoings	- 41,442

CURRENT MARKET RENTAL: \$109,104

Plus GST

In reaching that figure I have reduced Mr Horsley's square metre figure of \$102 by 12½% to \$89-25 psm in arriving at my figure of \$134,946.

I have accepted Mr Horsley's carpark figure of \$37-50 per car park.

I have accepted Mr Horsley's figure in respect of outgoings at \$41,442 as being the nearest figure to the date of the review 8 November 1988 consistent with the agreed outgoings for the CJC tenancy, as being the best estimate and within the bounds of Segama's decision (Supra).

I therefore do hereby award and determine that the current market rental in relation to the rental review period of the sublease for the subject premises, that is for the new three year period commencing 8 November 1988, be fixed at \$109,104 plus Goods and Services Tax should it be payable.

I do further award by way of consent between the parties that the lessee pay to the lessor interest at the rate of 15% p.a on the difference between the current market rental presently being paid by the lessee and the new current market rental of \$109,104.00 from 20 August 1990 until 11 September 1990.

Questions of Law

Mr Forbes in his final submissions raised with me the question of stating a case to the High Court on certain questions of law which he presented to me in draft form.

With the consent of Counsel that matter was reserved by me until after I had fully considered the evidence and Counsels' submissions.

I advised Counsel on 23 October 1990 that I was then in a position to publish my award indicating my views in general terms on the questions of law as posed by Forbes.

After several communications between Counsel and myself, Mr Forbes on 26 November 1990 agreed that subject to my confirmation that I would treat all the matters referred to in his draft questions of law as being relevant, along with the specific answers I had provided to some of the questions, then that essentially met the issue of whether it would be necessary to state a case to the High Court.

Mr Forbes also requested that I specifically deal with the relevance and weight of each of those questions as part of my Award.

I confirmed Mr Forbes' request on 18 December 1990.

I attach Mr Forbes' draft questions of law to this Award as Schedule H.

I am of the view that I have dealt with all the questions posed during the course of this Award during my review and consideration of all the evidence to which I have referred, with particular reference to its relevance and weight to be given to it, or whether it is relevant but only if it is adjusted.

I would make the observation that the weight to be given to the evidence is very much based on a subjective view which can only be formed after seeing and hearing the witnesses concerned and considering Counsels' submissions on the matter.

With specific reference to the draft questions of law I would answer each question as follows:

1. Question 1 The current market rent should be construed as the open market rent with vacant possession.
2. Question 2 Relevant
3. Question 3 Relevant
4. Question 4 Relevant
5. Question 5 Relevant
6. Question 6 Relevant
7. Question 7.1 No
8. Question 7.2 The factors in 3-6 are relevant as market factors
9. Question 8 Irrelevant
10. Question 9 Yes - if the evidence warrants it
11. Question 10 No
12. Question 11 No
13. Question 12.1 Relevant - if the evidence warrants it
12.2 Relevant - if the evidence warrants it
14. Question 13 Yes - My reasoned determination on this question follows.

I turn now to the final issues raised with me which are best expressed in terms of Mr Forbes' final draft question of law namely:

Question 13 - *"On the arbitration of a disputed rental assessment on review, can an arbitrator award interest on the differential between the previous rent (assuming it has continued to be paid) and the rent as assessed? If so, is this restricted to the rate provided for by the Judicature Act 1908 s.87?"*

Similar questions have been raised before me in two earlier ground rental arbitrations where I found in both instances that as the arbitrator I did have jurisdiction to award interest on the differential between the previous ground rent (assuming it has continued to be paid) and the new ground rent that I assessed.

I also found that the rate of interest was restricted to the rate provided for by the Judicature Act 1908.

In this arbitration both Miss Suhr and Miss Lennon made submissions to be in this area.

Miss Lennon's submissions were based on the premise that no interest is payable on the Award. Miss Lennon accepted that an arbitrator had power to award interest on an order for debt or damages by analogy to Section 87 of the Judicature Act 1908 but argued that the award in this arbitration would not be an order for debt or damages. Rather it is a declaration of the rental payable and she referred to Clause 1 of the Submission to Arbitration.

She also relied upon the Award of J G McGrath in NZ Railways Corporation v Roadmaster Services Limited (9 March 1989) p.19.

She further submitted that if the lessor wished to recover the amount declared to be the rental it would have to bring an action.

Miss Lennon submitted that it was clear on the authorities that there is no power to award interest on a declaration and she cited several of the Judgments of their Lordships in Swift & Co v Board of Trade (1925) AC 520 (House of Lords).

She also cited Newport BC v Monmouthshire CC (1947) 1 All ER 900 (House of Lords) and referred to the fact that those decisions were referred to in Knibb v National Coal Board (1987) 1 QB 906 (Court of Appeal) and applied by Nourse LJ at p.918 and distinguished by Sir John Donaldson MR at p.916 on the grounds that in the earlier two cases the arbitration mandate was to fix compensation not make an order for its payment.

In any event Knibb's case was distinguishable from the present case because in Knibb's case the obligation to pay compensation did not depend on the determination of the arbitrator - the cause of action was complete as soon as damage was caused. The Arbitrator was to resolve disputes about liability and make appropriate orders.

Further, if the sole question for determination had been the amount of the payment, a declaratory award might well have been appropriate and no interest would have been payable and 'a priori' that applied in the present arbitration since "Knibb" was a claim for compensation by way of damages.

Miss Lennon then submitted that in this arbitration what is being assessed is neither a debt nor damages. The contract price for the

lease is that which is being determined.

Miss Lennon then submitted that the rationale for the payment of interest on an award of debt or damages is stated in Day v Mead [1987] 2 NZLR by Cooke P at p.463 line 13 to be to compensate a plaintiff for loss of the use of money to which he was entitled and that in this case there is no entitlement to increased rental until an arbitrator declares what, if any, increase is justified.

Further, that interest cannot be awarded on a debt until that debt is overdue. That Section 87 provides for the payment of interest on a debt from the date on which "the cause of action" arose and there can be no analogy with that provision where the arbitrator makes a declaration of the rental payable. There is no "cause of action" in the sense of a wrongful failure to pay a debt or the infliction of harm for which damages are payable. The sum payable in accordance with the award does not fall due before the award is made and that the sum payable falls due on the next day next following the award. South Tottenham Land Securities Ltd v R & A Millett (Shops) Ltd (1984) 1 All ER 614 (Court of Appeal)

Miss Lennon further submitted that if it is not accepted that no interest is payable then interest should be paid at the Judicature Act rate.

Miss Lennon finally submitted that if interest was payable then it should not be payable for the full two years and argued that the lessor should not be paid interest for the period before 18 December 1989 since that was the date on which, at the earliest, this dispute could have been heard.

Miss Suhr in reply noted that the South Tottenham Land Securities Case was not considered by Mr Tipping (now Mr Justice Tipping) in the Matheson 1985 Award, nor by myself in the NZ Guardian Trust (NZI) 1989 Award, where Section 87 was held by Tipping and myself to apply on the basis that the Arbitration award is akin to an order for recovery of a debt, and as the lessee was liable to pay the arrears of rent as from the review date, then there was power to award interest.

Miss Suhr further submitted that the reasoning of Mr Tipping and myself was to be preferred.

Although the English decision in the South Tottenham Land case may be suggested as being of persuasive authority Miss Suhr preferred to rely on the decision of Henry J in Angus Group Ltd v Lincoln Industries Ltd High Court Auckland CL 46/88 June 1988 where Henry J confirmed the decisions in K Sika Plastics Ltd v Earthquake and War Damage Commission [1980] 2 NZLR 590 at 595 and Kenneth Williams and Co Ltd v Martelli [1980] 2 NZLR 596 at 612 which followed earlier English and Australian authorities, where he concluded that those judgments correctly set forth present New Zealand law on this issue, namely:

"The power here arising by virtue of the implied authority of the Umpire to follow the ordinary rules of law" (p.4)

Miss Suhr then sought interest upon the amount of the shortfall in rental paid as opposed to the rental fixed by myself from the review date namely, 8th November 1988 to the date of my Award.

Such were Counsel's submissions.

In essence the question posed by Mr Forbes is no different from the broad question stated by Tipping J in the Matheson Award and as adopted by me in the NZI Award, namely:

- i) Whether I have jurisdiction in the circumstances to award interest.
- ii) Whether, if I have jurisdiction, Fletchers are entitled to interest as of right or only as a matter of discretion.
- iii) If an award of interest is within my discretion whether that discretion should, in this case, be exercised in Fletchers' favour.
- iv) At what rate should any interest which I award be fixed.

I will first consider the question of jurisdiction.

It is my view, following that of Mr Justice Tipping in the Matheson Award that it is settled law in New Zealand that an Umpire has in general terms the same power as a Court to award interest and that the question as to whether the interest should be awarded as of right or

by way of discretion should also be approached on the same basis as if the matter had arisen before a Court of competent jurisdiction.

I would refer to the decision of His Honour Mr Justice Quilliam in K Sika Plastics Limited v Earthquake and Ward Damage Commission (Supra) with particular reference to p.595 lines 13 to 31 as follows:

" The Court of Appeal in the Chandris case applied the long standing decision in Edwards v Great Western Railway Co (1851) 11 CB 588; 138 ER 603, and held that an arbitrator had the power to award interest because it was an implied term of the submission that he should decide the dispute according to the existing law of contract. That law included a statutory provision giving a Court power to award interest on debt or damages. If that decision is correct then the arbitrator in the present case should have power to award interest upon a similar implied term. Section 87 of the Judicature Act 1908 is, for all practical purposes, the same as the statutory provision applied in Chandris. The full Court of Victoria in the Robert Salzer Constructions case examined closely the decisions in the Edwards case, Podar Trading Co v Tagher [1949] 2 KB 277; [1949] 2 All ER 62 (which was overruled by Chandris) and also the Chandris case itself. The Court concluded that the Edwards case was not authority for the proposition attributed to it in Chandris and concluded also that Chandris was wrongly decided. Now the High Court has overruled the Robert Salzer case and, in effect, restored the authority of Chandris. The result is that the principle now seems to be firmly established both in England and Australia that an arbitrator has power to award interest subject, of course, to any statutory provision which may affect a particular case. I consider I ought to follow that principle."

That decision was followed by Mr Justice Thorp in the Kenneth Williams case (Supra).

Both those cases, followed the principles of Chandris, namely, that the power to award interest arose by the necessary implication of the powers of the Court and did not depend directly on the statutory provision.

As with Mr Justice Tipping in the Matheson Award I am of the view that as the Arbitrator in this case I have power to award interest if the

Courts of New Zealand would have had the power to do so if this matter had come within their jurisdiction.

As in the Matheson Award it is clear beyond doubt that the subject lease does not address the question of interest. Similarly, there is no direct power given to me in my appointment.

It follows that there is no contractual right vested in Fletchers to recover interest in the present circumstances, but, it is my view that that does not conclude the matter.

The general power to award interest as vested in the High Court in New Zealand may be found in Section 87 of the Judicature Act 1908. The relevant terms of that section being:

"In any proceedings in the High Court ... for the recovery of any debt or damages, the Court may, if it thinks fit, order that there shall be included in the sum for which judgment is given interest at such rate, not exceeding the prescribed rate, as it thinks fit on the whole or any part of the debt or damages for the whole or any part of the period between the date when the cause of action arose and the date of the judgment."

There are then several provisos which do not apply here. I note that this statutory provision is in terms which are not materially different from the relevant provisions in England.

The question becomes whether a rental arbitration of this type can be properly regarded as akin to proceedings for the recovery of any debt or damages and not of a declaratory nature as submitted by Miss Lennon. As no question of damages arises here the question remains as to whether or not the proceedings before me can be regarded as the equivalent of proceedings for the recovery of any debt.

With respect I would adopt Mr Justice Tipping's approach and reasoning in the Matheson Award which I now heavily draw upon in this Award.

The first case which needs to be mentioned, in the present context, is the decision of the House of Lords in B.P. Exploration Co (Libya) Ltd v Hunt (No.2) [1982] 1 All ER 925. The leading speech was delivered by Lord Brandon. That case involved payments which had been awarded

from one party to the other under the Frustrated Contracts Act 1943 of England. The problem arose through the expropriation by the Libyan Government of B.P.'s interest in an oil concession. Robert Goff J had awarded a sum of money under the Act and had also awarded interest. The argument was whether or not the interest was properly awarded, it being contended that a payment under the Frustrated Contracts Act could not be regarded as having been awarded in proceedings for the recovery of a debt. At page 991 J Lord Brandon said:

"On the first question, whether Robert Goff J had power to order payment of interest on the principal sums awarded by him at all, it was submitted by counsel for Mr Hunt that sums recoverable under the 1943 Act were of a very special character indeed, and because of that did not come within the expression 'any debt or damages' as used in Section 3(1) of the 1934 Act set out above. [The equivalent of our Section 87]

I do not accept that submission. In my opinion the words 'any debt or damages', in the context in which they occur, are very wide, so that they cover any sum of money which is recoverable by one party from another, either at common law or in equity or under a statute of the kind here concerned. In this connection I adhere to the view with regard to the scope of Section 3(1) [our section 87] which I expressed in The Aldora ... [1975] 2 All ER 69 at 72. I hold therefore that Robert Goff J had power to order the payment of interest on the principal sums awarded by him."

It is useful also to consider what Lord Brandon, then Mr Justice Brandon, said on the point in The Aldora (Supra). That case was an action for salvage and His Lordship was considering whether or not, having made an award of salvage, interest could be awarded on the amount of the judgment. At page 72 h His Lordship said:

"I do not think that a claim for salvage is a proceeding for the recovery of damages, and the question is accordingly reduced to this: Whether it is a proceeding for the recovery of a debt. As to this it is to be observed that the words used are 'any debt' indicating that the net is being spread as widely as possible. Those words are, as it seems to me, apt to cover sums, whether liquidated or unliquidated, which a person is obliged to pay either under a contract, express or implied, or under a statute. They would, therefore, cover a common law claim on a 'quantum

meruit', or a statutory claim for a sum recoverable as a debt, for instance ..."

He went on to hold that a claim in salvage was analogous in nature to a common law claim on a quantum meruit. It is implicit from the foregoing authorities that there is no bar to the award of interest on the basis that the precise amount of the debt, or damages, in question is not ascertained until the primary judgment has been given. That is really a self-evident proposition when it comes to damages and the position has been held, rightly in my respectful view, to be the same in respect of the question of debt. It does not matter therefore that in this case the precise amount of the rental was not ascertained during the period for which interest on the short fall is now claimed. The position is, in my opinion, fortified by the decision of the House of Lords in President of India Case (Supra). Again the leading speech was delivered by Lord Brandon who carried out a very extensive review of the law in relation to awards of interest generally. He traversed the position at common law in admiralty, in equity and under statute. He stated at page 781 his conclusion in this way:

"The true position in law is, in my opinion, not in doubt. It is this. Where parties refer a dispute between them to arbitration in England, they impliedly agree that the arbitration is to be conducted in accordance in all respect with the law of England, unless, which seldom occurs, the agreement of reference provides otherwise. It is on this basis that it was held by the Court of Appeal in Chandris ... that, although Section 3(1) of the 1934 Act, by its terms, empowered only courts of record to include interest in sums for which judgment was given for damages or debt, arbitrators were nevertheless empowered, by the agreement of reference, to apply English law, including so much of that law as is to be found in Section 3(1) of the 1934 Act."

His Lordship made reference to a passage from the judgment of Mr Justice Mason in Codelfa Construction v State Rail Authority of New South Wales [1982] 56 ALJR 459 at page 472 where His Honour said:

"The arbitrator's power to award interest in the present case, as Atkinson Leighton decided, is referable to Section 94. As such it is circumscribed by section 94 (1) (a) and it does not extend to the making of an award for compound interest."

In other words while an arbitrator derives power to award interest by the implied incorporation of Section 87, as it is in New Zealand, that power is circumscribed by the provisions of Section 87 and the power can only be exercised if the case fits Section 87 and subject to the restrictions set out in Section 87.

Against the foregoing background I have already referred to Counsel's submissions which are diametrically opposed.

Miss Lennon has relied on the Line of decisions resulting from Swifts Case (Supra) and basically that there is no power to award interest on a declaration, which any Award made by me, is.

On the other hand Miss Suhr prefers to follow the line of decisions resulting from the Matheson Award as confirmed by myself in the NZI Award and the decision of Henry J in the Angus Group (Supra).

I for my part prefer the Matheson Award approach. I do not believe that the South Tottenham Land case furthers the matter. It was a case dealing with an application for relief against forfeiture and in my view it is well settled law that different considerations apply in such a case and it is distinguishable from the present case.

Further the Award cited by Miss Lennon in further support, namely Roadmaster, did not discuss this matter apart from holding that the Award was a declaration of the rental payable.

As I have already stated neither the submission to Arbitration (Clause 1) nor the Lease and its Variation referred to an Award including interest, but that in my view is not the end to the matter as I have already commented upon.

Further it is my view, as it was Mr Tipping's approach in the Matheson Award (refer pages 49 to 55) that:

- a) The words "any debt" should be taken in the widest possible meaning. Reference was made to Lord Brandon's speeches in the BP Exploration Co (Libya) Ltd v Hunt (No.2) [1982] 1 All ER 925 at 991 and The Aldora Tyne Tugs Ltd and Another v The Owners of the Motor Vessel Aldora [1975] 2 All ER 69 at 72.

- b) "any debt" covers any sum of money that one person is obliged to pay to another.
- c) The effect of the award is to create an obligation to pay a sum of money.
- d) A debt arises because the award relates back to the date upon which the obligation arose.
- e) There is no bar to the award of interest on the basis that the precise amount of the debt in question is not ascertained until award is given.

In furtherance of the widest possible meaning approach being given to the words "any debt" I would also refer to the explanation contained in Chapter 19 of Equity Doctrines and Remedies by Meagher Gummow & Lehane, 2nd Edn, at page 453 and the quote of Lord Sterndale, "... the power of a Court to make a declaration where it is a question of defining the rights of two parties, is almost unlimited; I might say only limited by its own discretion." That in other words a declaratory power being equitable in nature gives the Court a wider power, rather than a narrower power. The Court and therefore the arbitrator may decide all issues raised before them on grounds of equity and fairness. That is if I am wrong in holding that my Award is not one of a declaratory nature.

I have already stated that I do not agree with the submissions of Miss Lennon. Mr Justice Tipping, as I do, believed that the matter could be decided without direct reference to the particular terms of the arbitration when he stated at page 54 of his Award:

"I have so far discussed the matter without direct reference to the particular terms of the present submission to Arbitration. I would have come to the conclusion that I had jurisdiction to award interest in this case without reference thereto but such reference re-inforces the view to which I have come."

Having said that, I believe, like Mr Justice Tipping, I must turn to the matter against the background that an Umpire does have power in New Zealand to award interest subject to the matters discussed above.

The essence of Miss Lennon's submissions by way of argument I have discussed and in essence her argument is that these proceedings can not be equated with proceedings to recover a debt or damages and that my award is only declaratory in nature. I do not accept that any award I might make is merely a declaration of the rental payable under the lease. The lease provides in Clause 3 of the Deed of Variation of Lease that Fletchers may take certain steps not earlier than thirty days prior to the expiration of each succeeding period of three years by notice in writing to Whitcoulls "fix the rent" at an amount which in the opinion of Fletchers represents the then current market rent of the premises and the amount so fixed shall be the rent payable by Whitcoulls from the date specified in such notice and then follows a subclause referring to arbitration.

Those words, again, leave me in no doubt that the requirement on the Arbitrator is to fix with certainty the new rent payable for the next three years of the lease. I agree with Mr Justice Tipping that it does not matter that until an award is determined the tenant does not know how much it has to pay. That point is answered by the BP and the Aldora cases. It is not necessary for quantum to be established throughout the period for which interest is sought. The establishment of quantum by the award or judgment in effect relates back to the date upon which the obligation to pay the principal sum arose. So it is with a quantum meruit case and so in my view it must be with a case of this kind.

It is my conclusion that my powers in this case derive from and are limited in terms of Section 87.

Having held that I have jurisdiction to award interest, the next question is whether Fletchers are entitled to interest as of right or only as a matter of discretion. I adopt Mr Justice Tipping's reasoning that it is self evident and that in this case it must be the latter. There is no contractual right to interest in the present circumstances and Fletchers must rely on my power to proceed by way of analogy with the provisions of Section 87. Interest under that section is arguably a matter of discretion only.

The third point is whether I should exercise my discretion to award interest. I have already referred to submissions of Counsel in this

area. It is my view that no good reasons have been submitted to me as to why I should not exercise my discretion in Fletchers' favour. The Kenneth Williams case (Supra) represents clear authority in my opinion in New Zealand for making a discretionary award of interest. In the present circumstances, I consider that I should do so in this case and accordingly exercise my discretion in Fletchers' favour.

Miss Lennon submitted to me that in the event that I should award interest then at least Fletchers should not be paid interest for the period before 18 December 1989.

Miss Suhr on the other hand submitted that interest should flow from 8 November 1988.

It is my view that interest should commence from the date of Fletchers' rejection of Whitcoulls' counter proposal on 28 April 1989.

The final matter with which I must deal is the rate at which interest should be awarded.

In the circumstances I hold that I am bound by the prescribed rate as fixed in terms of Section 87 which is 11% p.a.

I therefore award interest to Fletchers at the rate of 11% p.a on the differential between the previous rent of \$71,864 p.a and the new rent as awarded, namely \$109,104 with an appropriate adjustment to be made in the light of my consent award and interest for the period earlier referred to in this Award (Supra p.60).

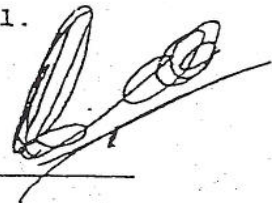
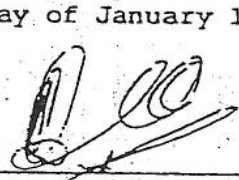
Finally I come to the question of costs.

Although submissions were made to me by Counsel in this area I am of the view that each party should:

- i) bear their own costs
- and
- ii) each pay one half of the administration costs borne by Phillips Nicholson in the use of their Boardroom together with the other facilities provided
- and
- iii) each pay one half of the Umpire's costs and disbursements

Having regard to the time spent and the relative importance of this award, the interlocutory proceedings prior to the commencement of the Arbitration and the communications with Counsel after the hearing, I fix my own fee at \$22,800-00 plus GST \$2,850-00 together with disbursements of \$780-86 making a total of \$26,430-86 which sum is payable as to one half by Fletchers and as to one half by Whitcoulls.

As witness my hand at Wellington this 18th day of January 1991.



B Bornholdt - Umpire

SCHEDULE 1

re: Whitcoulls Limited/rental arbitration/222 Willis Street

Whitcoulls assertions as to the relevant principles of rental valuation (which will be supported by legal submissions of counsel) can be briefly summarised as follows:

- obj. notes* 1. *open market rent with vacant possession*
- relevant* (i) ✓ the rationale for rent reviews is to enable the lessor to achieve the open market rental of the premises as at the review date.
- relevant* (ii) the terms of the lease are to be taken into account, but not the fact that the lessee is and must remain in possession, nor the fact that the rental is being assessed as for a review rather than a new letting.
- relevant* (iii) it is an implied term of the rent review clause that the market rental to be calculated is as for vacant possession.
- relevant* (iv) all lettings of similar properties at a similar period can be used as comparables but may need adjustment.
- relevant* (v) where a comparable is a new letting, any inducement paid should be decapitalised over the term of the lease to give the rental value (as opposed to the rental stated in the lease).
- relevant* (vi) the rental value thus calculated should be regarded as the market rent.
- depends* (vii) new letting comparables should be adjusted where any non-market factors were present in the negotiations.
- market value is an objective test* (viii) a non-market factor may be defined as any consideration which affected the decision of the lessor or the lessee, but which would not have affected the decision of other lessors or lessees in the market.
- hypothetical lessee/lessor* (ix) a factor such as market over-supply is a market factor and should not be adjusted for. A factor such as a cash flow crisis on the part of the lessor should be adjusted for.
- Evans (Leeds) and General Electric - cash flow ignored.* (x) it should be assumed that there is a buyer in the market willing to take the subject lease, but it should not be assumed
- yes*

that it is willing to pay any more than the market forces it to. If there is little or no demand for similar space in the market, that may indicate that it should be assumed that there is only one willing lessee. That lessee may be willing to pay only a peppercorn rental.

Dennis & Robinson Ltd v Kioskos Establishment
Through hypothetical lessee is willing to pay more than the market requires, say only have to pay
 (xi) that rental should be treated as market rental, as it is the *to pay* outcome of a market bargain. Lessors who accept a rental *low on* which does little more than cover outgoings (in preference to *normal rent* leaving the premises vacant) are not necessarily ignoring ordinary business considerations and are not "unwilling lessors" if on an objective assessment of the situation it would be financially advantageous to any lessor of the subject premises to let at such a rental.

- Segona & Edmund Barker Chambers* ✓
- (xii) review evidence can be used as comparables but the valuation should expressly state whether the review evidence has been adjusted or not.
 - (xiii) the fact that a tenant is in possession and has no choice but to continue in possession is a non-market factor. If the fact that the tenant is in possession has (or probably has) affected the rent set on review, an adjustment should be made to account for that. The extent of the adjustment has to be a matter for the valuer.
 - (xiv) the existence of an ascertainable two-tier market (with rent reviews being in the higher tier) should be taken into account and adjusted for. Specifically, the existence of a two-tier market indicates that rents set on review are influenced by the fact that the tenant is locked in.
 - (xv) it may also be relevant whether the tenant, on review, had had adequate valuation advice before agreeing to the rental.
 - (xvi) whether or not the lease under which the rental on review was fixed or agreed had a ratchet clause and whether this influenced the rental would also be relevant.

(xvii) any comparable which appears to be affected by a secret or similar arrangement - for example a secret inducement to the tenant in exchange for a higher rental on paper - should not be used unless the details of the secret arrangement are known and can somehow be properly adjusted for.

(xviii) evidence of recent awards of umpires or valuers should only be used if they can be assessed for accuracy. If it is a non-speaking valuation or award, the evidence presented or used to arrive at the valuation or award cannot be assessed and may have been inadequate.

*Britannia House
award 1984*

2. In the present case, rents set on review in the same building appear to have been used as prime evidence by Mr Quinn (for the lessor) (although his valuation does not list comparables) and by Mr Horsley (for the lessee) (his revised valuation refers to those comparables). If there is anything to suggest that these rentals may have been affected by any sort of secret bargain, they should not be used, at least without adjustment. Likewise, if it is considered they are at a level above the open market rental.

3. Valuation opinion is also sought as to:

- (i) whether a comparable can be used without adjustment where it appears that a special tenant (as "buyer") was in the market for the leased premises.
- (ii) the effect on rentals of ratchet clauses (see above para 1(xiv)).
- (iii) how could the economic concept of "market" be defined in such a way as to be consistent with the possibility that there are two tiers within one market (Whitcoulls would say that this must in fact constitute two markets, which both cannot be "the market rental").
- (iv) how much higher review rentals are or appear to be, in percentage terms, than new letting rentals in the relevant Wellington areas.

SCHEDULE B

Mr Quinn's response to Schedule 1

Mr Quinn made the following responses to Schedule 1 that I noted during his cross-examination and the numbering I have adopted is as per Schedule 1.

1. (i) Basically agree
- (ii) Basically agree
- (iii) Basically agree as being between a willing lessee and a willing lessor
- (iv) Basically agree
- (v) Basically agree
- (vi) Basically agree
- (vii)) Basically agree
- (viii)) But Mr Quinn did not believe a cash flow crisis could be
- (ix)) adjusted by a valuer easily
- (x) Mr Quinn agreed with the first sentence but not as to the second sentence.

"If there is little or no demand for similar space in the market, that may indicate that it should be assumed there is only one willing lessee. That lessee may be willing to pay only a peppercorn rental."

Mr Quinn commented that that was only half the question and that the lessor was coming from the other half of the bargaining table.

- (xi) Fundamentally agreed - that he did not necessarily agree that a lessor who accepted a rental which did little more than cover outgoings (in preference to having the premises vacant) necessarily means that that lessor is a willing lessor.
- (xii) Basically agree
- (xiii) Did not agree

(xiv) Basically agree - but in response to a question from myself (the existence of an ascertainable two tier market) Mr Quinn admitted that it was a very difficult one.

(xv) It might be relevant - not necessarily so.

(xvi))

(xvii)) Basically agree

(xviii))

SCHEDULE C

Mr Horsley's response to Schedule 1

Mr Horsley agreed in broad terms with the principles asserted with the exception of 1(iii) which stated:

"1(iii) It is an implied term of the rent review clause that the market rental to be calculated is as for vacant possession."

Mr Horsley pointed out that the rent review clause in the lease of the subject premises directs that the rental be "an amount which represents the then current market rent of the premises", with no reference to the calculation being made as for vacant possession. It was his opinion that the rationale for rent reviews was to enable the lessor to achieve the open market rental of the premises as at the review date given a willing lessor and a willing lessee situation. The lease contained no direction that the lessee must remain in possession and that had been reinforced by the lessee's ability to sub-lease the premises. He did not believe that at the review date the rental assessed as for vacant possession would be any different from the rental which would be assessed if it were assumed that the tenant was already in possession.

Mr Horsley did however believe it important to keep in mind the state of the market as at November 1988 as he considered a two tier rental market had become evident by November 1988 with rental levels for occupied space being settled on review at levels in excess of some recent leaseings or indeed asking rentals. That was true of the office rental accommodation market and there was subsequent evidence to suggest that it was also true in general terms of the warehouse rental market although there was a lack of new leaseings as at November 1988.

He stated there were a number of anxious lessors keen to lease vacant space and maintain cash flows. They therefore acceded to lessee demands for a discounted rental in the form of a rent free period over and above normal rent free periods, free naming rights, a rebate of outgoings for a period or a contribution to subdivisional costs or a combination of these. A lessor who found himself in such an over

supplied market and was obliged to grant these concessions in order to achieve a letting would not in his view be a "willing lessor".

Mr Horsley was aware that there was a certain school of thought suggesting that the only valid comparisons were those relating to premises where vacant possession is available and where tenants in what is perceived to be a tenants' market are able to demand and receive concessions such as the ones he had outlined. He did not accept that proposition to be valid in those terms, and it had not to his knowledge found favour in a number of Wellington arbitrations conducted over the past 12-18 months. To his mind the most critical element in any leasing or agreement in order for it to form part of the relevant evidence was that it conformed with the well documented criteria defining market as being that state existing between a willing lessor and a willing lessee. That it must be assumed until the contrary is shown that a lessee in a review situation is a willing lessee.

It was Mr Horsley's view that the fact that Whitcoulls' tenancy was available for assignment or sub-lease for a period of two years from February 1988 showed that there was a very willing sub-lessor but no sub-lessee. That factor must be given some cognisance although he did not think that a vacancy factor within a given class of accommodation in itself means that asking rentals set the market rental nor may some new letting rentals. The market rental may well still be above the new letting rental level.

He further informed me that the subject premises appeared to have been the only upper floor warehouse premises available within the Te Aro area with a floor area in excess of 1,500 square metres on a single floor with the exception of the buildings about the produce markets. As at November 1988 there was a vacancy factor for upper floor warehouse accommodation. Because of that he would also expect that a prudent lessee would have sought a reduced rental to reflect the size factor when compared with smaller premises of less than (say) 900 square metres.

The fact that there do not appear to have been any willing tenants for the premises at an asking occupancy cost of \$69-94 per square metre for a period of 9 months before the review date and 15 months after

the review date did not necessarily indicate that the asking rental of his assessment was not appropriate.

That it was always very difficult to say with any certainty what a reasonable period of exposure on the market for this type of space should be. The premises were offered on the market for 9 months before the review date and for a total of two years but it could not be assumed that the absence of any willing tenant in that period had any significance. That was especially so since the lack of interest in the premises may have had little to do with the asking rental. The asking rental was \$71,864 inclusive of carparks and he believed it would have been perceived on the market as negotiable. The fact that it was offered at that rental with no interest being shown for two years does not necessarily mean that the premises were not worth \$128,375 (his assessment). The lack of response from the market may have been the result of other factors, for instance there may have been no prospective tenants looking for warehousing of that kind and size in that area at that time.

Mr Horsley's view on whether two years' exposure to the market was sufficient is not changed by the fact that the lease had less than six years to run from November 1988.

Mr Horsley considered new letting evidence as the prime evidence of market rental (if the lessors in the market are willing lessors). If there is no new letting evidence, he believed it must be assumed that review evidence is the best evidence of the market level. If there had been new letting evidence which showed a decrease in rentals, that would have been significant and it would have altered his assessment.

Mr Horsley had already expressed the view that the rental set on the head lease in March 1988 had an influence on the rents set on review. Also, once three or four similar reviews had been made in the subject premises it was difficult in the absence of new lettings for a valuer to demonstrate that they are not the market rental for the premises. That by comparison with rents set on review in premises in other buildings, it appeared to him that the rents set on review in the subject premises were high. It was for that reason that his assessment was lower than the rents set on review in the subject building.

Finally, he stated that it was clear that during the year to 18 months following the crash, businesses were generally not making decisions to enter into new occupancy arrangements and hence there was a lack of activity in the new letting market.

SCHEDULE D

Mr Hanna's response to Schedule 1

Mr Hanna agreed in general terms with all the principles expressed in Schedule 1 with some qualification regarding principle (v) on the basis that an inducement should not be decapitalised if it did not represent a real benefit for the tenant.

SCHEDULE E

Specific Questions put by Mr Forbes to Mr Hanna
p.11 to 18 of Mr Hanna's Evidence

(b) Q: What are your views on the so-called two tier market?

A: I do not believe that there is any theoretical justification for the alleged phenomenon of a "two-tier" market. In my view the market is the market is the market. However where it is perceived that review rentals are being set above (or below) open market rents the illusion of two tiers is created for observers who are not conversant with the principles stated in the most important legal decisions such as F.R. Evans (Leeds) Ltd v. English Electric Co Ltd (1977) 36 P & CR 184 (1977) 245 EG 657., and summarised in the schedule referred to above.

Having said that I acknowledge that the illusion is compounded by the inertia which is a characteristic of the property market, and that response to changes in economic conditions is accordingly slower there in the property market than is the case in other information-responsive markets such as shares or commodities - currency.

(c) Q: If you were assessing the rental of a property in a market which appeared to be exhibiting a two tier structure, how would you treat review rentals? Would you adjust them, or simply give them less weight?

A: That would depend on my knowledge of the circumstances, however in general I would tend to give them less weight on the grounds that the quantum of adjustment necessary to account for the legal principles would be difficult to establish without first hand knowledge.

(d) Q: Was there in fact a two tier market structure developing in the Wellington office rental market as at November 1988?

A: Office rental settlements (both new and review) which would later be interpreted as indicating a two-tier market may

have started to appear by November 1988 but a review of reports originating in my office up to that time do not suggest that the two tier phenomenon was then considered significant.

(e) Q: In 1988, were new tenants of office accommodation in Wellington being offered any inducements (whether secret or otherwise) to take premises? If so, would such inducements be decapitalised to produce new letting rentals which were lower than those being set on review during the same period?

A: It is possible that inducements were being offered at that time but I am not aware that this was a common practice although it certainly became so in later 1989 and 1990. When that occurred the answer to the second questions would probably be "yes".

(f) Q: Was there a vacancy factor in the Wellington office space rental market in October 1987?

A: There was little or no vacant space in that market in October 1987, certainly no more than the range of 3% - 5% which is regarded by researchers as a component of equilibrium.

(g) Q: Was there a vacancy factor in Wellington rental office market in October 1988?

A: In the RYT Research Report for October 1988 the figures for the CBD Core and Fringe area stated at 8.2% and 18.2% respectively and the overall total for the two zones of 12.15% - The research exercise we do 6 monthly. It only takes account of space available/vacant or available is confined to the CBD core and fringe. No notice is taken of buildings under construction.

(h) Q: Does a vacancy factor of 12% in any given market tend to make rentals in that market lower than they would be if there were a low or nil vacancy factor?

A: Technically yes, but allowance must be made for the characteristic of inertia to which I referred earlier. In

fact the Wellington office market remained generally at 1987 levels throughout most of 1988.

(i) Q: Can any parallels be drawn between the office rental market in Wellington and the warehouse rental market in Wellington as at November 1988?

A: I have no evidence to suggest that such a comparison can be made.

(j) Q: Were there any vacancies in the Wellington warehouse rental market in October 1987.

A: I presume so but I have no evidence to show that vacancy rates were seen as being beyond normal market tolerances.

(k) Q: Were there any vacancies in that market in November 1988?

A: I have no research data available from that date but commentary in valuation reports prepared by my firm in late 1988 seems to suggest a perception of limited demand and some prospect of oversupply. However having perused newspaper advertisements at the time and our own newspaper clipping books, it does not seem that an unduly large amount of warehouse space was on offer.

(l) Q: Were there any new lettings of upper floor warehouse space during the nine months before and after the review date?

A: I know of only one new letting of upper floor warehouse space in the nine months before the review date and I do not know of any new lettings in the nine months after the review date.

(m) Q: What is the significance of the answer to the previous question?

a: There can be no positive answer to your question. It would depend entirely upon supply and demand neither of which is well documented.

(n) Q: Does the answer to the previous question suggest that the market for warehouse accommodation was falling as at November 1988?

A: Not necessarily. I believe it must be assumed for the sake of the valuation exercise that there is at least one willing lessee. A willing lessee for whom the premises were suited cannot be assumed to be unwilling to pay the same rental as a tenant on review has agreed to pay. I believe it must be assumed that the hypothetical willing lessee is a reasonable lessee, willing to pay a reasonable price for the premises.

(o) Q: Were asking rentals for warehouse accommodation as at November 1988 high in the sense that lessors might have been holding out for higher rentals than they could obtain?

A: That is possible. However, asking rentals are notoriously unreliable and they are not necessarily an indication as to what premises are actually worth. It is not possible to say that the market rent for the premises would necessarily be equal to or higher or lower than asking rentals advertised.

(p) Q: Is evidence of rentals achieved on review in the same building good evidence of market rental for the premises?

A: Yes. I consider that it is difficult for any theoretical considerations or legal principles to overcome the cumulative effect of the review evidence available in this case.

(q) Q: Is a rental review a market transaction?

A: If the legal principles are applied it must be the equivalent of a market transaction and that appears to be the direction in which the Courts are pointing us. Some of the factors affecting a lessee on review may be different to the factors affecting a lessee on a new letting, however it cannot be assumed that a lessee on review has acted imprudently unless it is proved to the contrary. I do not think one can exclude the presumption that a lessee on review receives correct valuation advice and is aware of the bargaining advantages which a notional new tenant would have had in the market. Nor that the sitting tenant would

have been unaware that these advantages are also theoretically available to him on review. If a sitting tenant is unhappy with the review rental, he can take the matter to arbitration, and on an arbitration, he would achieve an award which reflected the new letting level of the market. Having said that however, it is often difficult to prove the point one way or the other and in the absence of certainty the weight given to review evidence should be less than that given to new lettings if they are available.

(r) Q: If you had been advising a lessor or sublessor in Whitcoulls' position who wished to sublet or assign the lease of the subject premises as at the review date, what rental would you have advised them to ask in the realistic expectation that a tenant would take the premises within a reasonable time?

A: I would have told such a lessor to expect a total net rental of \$115,668 exclusive of carparks, which is the rental I determined on this review based upon a GOC of \$104.00 psm less BOE of \$27.50 psm. I would probably advise that the asking rent be pitched slightly higher in order to allow room for negotiation.

(s) Q: Was this in your view an open market rental with vacant possession at the time?

A: Yes.

(t) Q: Is a hypothetical willing lessor entitled to wait for the market to strengthen or otherwise change?

A: That depends upon his expectations for strengthening or change.

(u) Q: Are there any factors present in a review negotiation which are not present in a new letting negotiation and which might affect the outcome of the bargain?

A: The review process does involve different bargaining strengths and weaknesses for tenants on review as opposed

to new letting tenants depending upon market conditions of the time, but I do not believe that the outcome of a review bargain is necessarily any different from a new letting bargain.

(v) Q: If you were asked to assume that a two tier market in office space accommodation did actually exist as at November 1988, would that assumption influence your view on whether the warehouse market was exhibiting a downward trend?

A: No, I would not be prepared to assume that a downward trend in the office letting market indicated a similar trend in the warehouse market.

(w) Q: How did the market in November 1988 for rental space in general and warehouse space in particular compare to the market as at October 1987?

A: This question may be answered by quoting an extract from the valuation report concerning the Whitcoull tenancy which was prepared for you on 12 August 1990:

"MARKET CONDITIONS - NOVEMBER 1988

It is difficult now to revert to the attitudes of the marketplace in late 1988, and to see that time "snapshot" in the context of the totality of events in Wellington since 1985. Overall there can be no argument that the realignment initiated by the events of 19 October 1987 has very markedly affected the demand:supply balance for all types of real estate in the City, and no less so for warehousing premises such as the subject tenancy. Having said that however I must also record that the general fall in demand/prices/rentals was slow to take effect and that its momentum was not really apparent until the beginning of 1989. This inertia is, of course, a well-documented characteristic of the real estate market, and a review of files relating to other Te Aro properties valued by RYT in mid/late 1988 does not reveal an undue concern as to the way the market was heading, notwithstanding that within

15-18 months all of the symptoms of a weak and over-supplied market would be apparent."

(x) Q: One of the tenants on review achieved a rental of \$103 psm (adjusted). Could it be assumed that a new letting tenant who knew of that rental would be able to achieve the same rental? if not, why not?

A: No. A new tenant might not be able to extract the same concession from the lessor as was available to this sitting tenant.

SCHEDULE F

Comments of Transcript of Discussion with Mr Hanna

Prepared by Ross Edney BERL

GENERAL

This note comprises a series of comments on a transcript of a discussion with Mr Hanna supplied to me by Shuna Lennon.

- Point a) The main question I would have about the comment made by Mr Hanna in point a) is whether it really matters if the tenant does not want the inducement. This would amount to putting a relatively arbitrary value on a settlement. I would agree with Mr Hanna's last comment that inducements would normally be decapitalised over the full term of the lease to obtain comparable rentals. As an economist I find this idea of a two-tier market to be a relatively strange one and in this regard I would agree with Mr Hanna. There certainly is inertia in the property market but it does not represent a two-tier market. What it reflects is the non-homogeneous nature of the products in the property market and frictions such as contractual and other non-rental costs.
- Point b) I don't have any real comments on this point except to note that the two-tier structure idea is a rather odd one which I think has little justification.
- Point c) My comments on point b) are relevant to point c).
- Point h) In economic theory a high vacancy factor would in general circumstances indicate that there was downward pressure on the prices in the market and there appears to be inertia which might tend to counter downward pressure in the short term. Price flexibility (in terms of rentals) in the property market is partly reduced by the contractual obligations associated with the market and relatively slowly adjusting expectations within the market.

Point i) I think there is evidence to suggest that there was a general downturn in the property market for both warehouses and offices in Wellington. It is not clear to me that given the general economic downturn that the fall in demand for property should be merely confined to office rentals. There is this notion that it is possible that due to the share market crash there was lower demand for office space relative to warehouse space but it is quite clear that the nature of the economic downturn in 1988 was more general in nature.

Point l) This piece of evidence suggests that the valuers had very little data to go on in making their valuation. I consider that historical data is an indicator of appropriate rentals but it is not the full story. I consider there is a need for a broader economic context on which to base valuation decisions. It would appear that valuations seem to be reached by rules of thumb with only a small amount of reference to general economic circumstances. I wonder if the valuer has seen all the leases for the properties that he is comparing 222 Willis Street with.

Point n) Volume changes in a market are often associated with changes in demand and supply. In a case of few new lettings in a situation of over capacity this would indicate a fall in demand for a property, product or service. In the property market what tends to occur is that there is little price adjustment at the outset of a change in the market, but as time progresses prices do slowly come around to economic fundamentals. Another important question is what is a reasonable price when you don't have any up to date data to use for the basis of valuation. I would like to know what references were actually made to broader factors rather than just historical information. I am not convinced the valuation took on board all the available information at the time it was undertaken. In particular, there seems to be little reference to what was a reasonable expectation for economic activity and the property market at the time.

Point o) If there is a significant vacancy factor in the context of a normal demand situation then unambiguously there must be

price inflexibility. It is this price inflexibility which generates the difference between demand and supply in the market. If demand is low and there is a significant vacancy factor then this may indicate, in the absence of other factors, that prices are being held high due to holding out for higher rentals. As an economist I would hold that in the long run prices will adjust to a new equilibrium, but the short run path to this end state will be marked by changes in the quantities (number of lettings) that are settled in the market.

Point p) Yes, I agree it is good evidence but I would suggest that the evidence should be tempered by the heterogeneous nature of the reviews and premises in the property market and it maybe the case that all the negotiated reviews for one building are biased due to the nature of the parties involved.

Point q) As an economist I find it very odd to suggest that there is anything other than a market transaction. So my response to point q) is yes it is a market transaction.

Point r) I think that Mr Hanna has made a conservative and probably biased assessment of the general economic situation at the time. In my earlier briefing I gave some evidence which indicated that there was clear evidence of a downturn at the time the valuation was made. I therefore have doubts that the premises would have been let at the quoted rate in reasonable time given the economic situation. I think that on balance the asking rental, given the lengthy exposure to the market, was too high.

Point t) I wonder whether this is a legal question rather than an economic question. I would say yes barring any legal or contractual frictions operating in the market.

- Point u) My contention is that yes there are significant factors in place that enable a lessor to effectively drive a differential between rents for review and new rents.
- Point v) There is no need for an assumption in my opinion. There is evidence to indicate that not just office but also industrial and warehouse space was subject to falling demand at this time.
- Point w) There seems to be a very fine line between late 1988 and early 1989. The evidence surrounding the property market I have already prepared in my briefing suggests that the market was contracting in late 1988 if not earlier.
- Point x) Yes, I agree rentals are negotiated on a case by case basis. This is not inconsistent with economic theory. A similar product can trade at different prices in similar but slightly altered circumstances. It does not mean there is not one market but a market with multiple equilibria.

SCHEDULE G

Mr Quinn's comments on Mr Hanna's answers to Mr Forbes
under cross-examination by Mr Forbes

The same lettering system has been followed from Mr Hanna's evidence in the order as answered by Mr Quinn.

- Question B Concurs with Hanna
- Question C Concurs - that less weight should be given
- Question J In 1987 there may have been some vacancies in the
Wellington warehouse rental market.
In 1988 - probably more - no specific figures
- Question L As per his evidence
- Question M Concurs with Hanna
- Question O Basically agreed with Hanna
- Question Q Agreed with Hanna with particular comment by way of
agreement as to the relevance of the last sentence
namely *"That in the absence of certainty the weight
given to review evidence should be less than that given
to new leasings if they are available."*
- Question T Agreed with Hanna
- Question W Basically agreed with Hanna that rentals had not fallen.
- Question X Agreed with Hanna

SCHEDULE H

Questions of Law

1. What is the proper construction of "the current market rent" at the review date in Clause 39 of the lease?
2. Is it to be construed as the open market rent with vacant possession negotiated openly by a hypothetical, willing lessor and lessee and on the assumption that the subject premises have been freely exposed in the market for a reasonable period and that values remain static during this period.
3. Are such negotiations to be taken as having been conducted in the light of all business considerations, bargaining advantages and disadvantages and market factors which affect the property and the parties at the review date?
4. Is evidence that the subject premises were exposed to the market for subletting or assignment for a reasonable period both before and after the review date without success at an asking rental the same as the pre-review rent and well below the proposed review rent relevant to the assessment of the current market rent?
5. Is evidence that there were few prospective tenants in the market at the review date and very few interested in the subject premises in particular at or around the review date relevant?
6. Is evidence that there was a greater supply of than demand for leased space of a similar type to the subject premises at the review date relevant?
- 7.1 As a matter of law is evidence of (i) review rentals of (ii) new lettings of comparable premises of any greater relevance or to be given any greater weight than the factors referred to in paragraphs 3-6 above?

- 7.2 Are the factors in paragraphs 3-6 relevant as market factors in themselves or only to the extent that they are reflected in comparable evidence.
8. Are the facts that the rental is being fixed on review and that the lessee is in possession and is contractually bound by the lease relevant? if so, how?
9. May comparable review evidence require to be adjusted in the process of determining the current market rent defined in accordance with paragraph 2 above, in particular because:
- (i) it is not the result of open market transactions, or
 - (ii) of the factors referred to in paragraph 8?
10. Are the facts that any such adjustment may be difficult to assess in terms of amount or be subjective reasons for the arbitrator not to do so?
11. Can the hypothetical, willing lessee be required, on review, to pay a rent greater than a letting on the open market with vacant possession would require him to pay, in particular because he is to be assumed to be a reasonable lessee prepared to pay a reasonable rent?
- 12.1 In the process of determining the current market rent, should any factors which affect or may affect the contract rent in any comparable review evidence to adjusted for, such as the value of any inducement paid or given to the lessee or a rent rebate given? If so, how?
- 12.2 Is a lessor who gives or is required to give inducements in order to achieve a letting at all or a letting at a given contract rent an "unwilling lessor".
13. On the arbitration of a disputed rental assessment on review, can an arbitrator award interest on the differential between the previous rent (assuming it has continued to be paid) and the rent as assessed? If so, is this restricted to the rate provided for by the Judicature Act 1908 s.87?