Neil Construction Ltd v Manukau City Council

Supreme Court Auckland
8-11 August, 19 September 1977
McMullin J and RJ MacLachlan

Compensation – Land ready for development into residential subdivision – Principles of valuation – Hypothetical subdivisional value

The plaintiff sought compensation for land acquired by the Council for a public reserve. The land formed part of a larger block the whole of the balance of which had been developed into residential and industrial sites. The land had been shown as proposed reserve on the undisclosed town planning scheme. The implied underlying zoning was Residential A.

It was common ground as to the date of the valuation and that compensation was to be paid on the basis set out in the Finance Act (No 3) 1944, that the value of the land was taken to be the amount which the land if sold on the open market by a willing seller on the specified date would be expected to realise. The existence of the designation did not affect the value of the land (s 29).

Held, 1 The best evidence of value is furnished by sales of comparable pieces of land close in time to the specified date.

A second method of valuation is the hypothetical subdivisional method. Several valuers gave evidence with some measure of agreement as to the notional subdivision and roading and engineering costs. Differences occurred in the gross realisation from the sale of sections, the allowance to be made for profit and risk, the estimate of the period required for development and the sale of the sections and finally the rate of interest to be used. The Court analysed the differences and calculated the value. The acreage rate was checked against the block sales evidence.

2 The economic climate was considered. It reflected an upward trend in property prices at the specified date but showed that there was a dramatic change in interest rates and availability of mortgage money shortly after that date.

3 The discounted cash flow method was no more than a sophisticated way of setting out the hypothetical subdivisional calculation. It relied on the same assumptions and was only as accurate as those assumptions it made.

Cases mentioned
Lewis v Christchurch Drainage Board [1972] NZLR 229
Mercantile Group Ltd v Manukau City Council 4 NZTPA 166

McMullin J and RJ MacLachlan: This is a claim under Part III of the Public Works Act 1928 by the appellant ("Neils") for compensation for land acquired at Pakuranga by the respondent ("Manukau City") for a public reserve.

The land comprises 47 acres 28 perches situated in the City of Manukau and is part of the land on Deposited Plan 199952, Parish of Pakuranga. It lies to the south of the Pakuranga/Howick Highway with frontages to Cascades Road and Bells Road and forms part of a larger block of some 189 acres, known as the Bell Block, purchased by Neils in 1968. Practically the whole of the balance of this 189 acres has now been developed into residential and industrial sites. The subject land had been shown as "proposed reserve" on the local body's undisclosed town planning scheme and, although there have been subsequent objections, this designation has remained effective. The implied underlying zoning is Residential A. In contour the land is flat to gently undulating with no real outlook or views and falling away steeply to the Pakuranga Creek on the eastern boundary. There is an electricity transmission easement over part of the land carrying lines of wooden poles and wires.

Source: New Zealand Institute of Valuers (1993). Land valuation cases 1965-1992. Hutcheson Bowman & Stewart Ltd, Wellington.

The Principles of Valuation

It is agreed that the date at which the value of the land is to be determined is 1 October 1973, that being the date upon which the parties reached an agreement in writing as to its acquisition by the Manakau City.

It is also common ground that the land is to be valued and compensation paid on the basis set out in s 29 (1) (b) of the Finance Act (No 3) 1944 which provides that the value of the land shall be taken to the amount which the land if sold in the open market by a willing seller on the specified date might be expected to realise. Reference should also be made to the effect of the designation of "proposed reserve" in the district scheme. It is clear from the provisions of s 29 (1) (a) of the Finance Act (No 3) 1944 that the existence of this designation, imposed by the Manakau City, should not affect the value of the land. Section 29 (1) (a) provides:–

> "Where the value of the land taken for any public work has on or before the specified date been increased or reduced by the work or the prospect of the work . . . the amount of that increase or reduction shall not be taken into account."

Accordingly, to the extent that the value of the land at 1 October 1973 was increased or reduced by the reserve designation, that decrease or increase in value must be ignored and the land must be valued having regard to its underlying zoning. We note that this view was taken in *Lewis v Christchurch Drainage Board* [1972] NZLR 229 where a designation of "drainage purposes" placed upon the land by the respondent Board was ignored in valuing land taken by it.

Methods of Valuation

Essentially, the question to be determined is what it he proper amount of compensation payable at 1 October 1973 for some 47.175 acres of land suitable for immediate development at that date into residential sites.

Ideally, the best evidence of value is furnished by sales of comparable parcels of land close in time to the specified date. Often evidence of directly comparable sales is not available but that is not to say that block sales, as they are called, can be disregarded or discarded because of the difficulties of comparison. For all these difficulties, they may be of considerable value in determining the profit and risk factor in subdivisional development and, used on an acreage basis, they do provide a check on valuations arrived at in other ways. In this instance there are some block sales, particularly those referred to as the Stevenson and Broadlands purchases, which are of assistance. They will be examined in greater detail later.

The second and most commonly used method of valuation in a case of this kind is what is called the hypothetical subdivisional method. It is a method accepted both by valuers and the Courts. In this instance it was used by all the seven registered valuers who gave evidence. These valuers and the respective values which they placed upon the land were:

R L Jefferies	$733,000
C T Barraclough	716,000
N K Darroch	650,000
S L Speedy	630,000
P J Mahony	467,000
R M McGough	450,000
D H Baker	425,000

The State of the Economy in 1973

Before examining the valuation evidence it is necessary to look briefly at the economic climate as it was in New Zealand in 1973, particularly as to its effect on the real estate market in the months preceding 1 October 1973 and for a short period thereafter. The 1972 Budget was an expansionist budget stimulating demand for consumer goods and housing. By the early months of 1973 the economy had become buoyant with a strong demand for housing. The property boom had started.

It was fed by the ready availability of mortgage money at reasonable interest rates. The passing of the Property Speculation Tax Act 1973 which came into force on 15 June 1973 was undoubtedly intended to curb the spectacular rise in real estate prices. In fact, one of its effects was to cause owners to withdraw their land from the market leaving eager buyers to compete for whatever land was offering. The upward trend in property prices continued at least until the end of 1973. It was still apparent in early 1974 although at about this time there was to be a dramatic change as mortgage money became less readily available and as interest rates commenced to rise sharply.

Various estimates were given to us of the increase in the prices of vacant sections during 1973. These ranged from about 4.5% per month for the whole of the South Auckland area to a figure of from 8% to 10% for Pakuranga. It was suggested that the rise was not uniform being greater in the more desirable parts of Pakuranga than in the low to medium cost area. In the area continuing the subject land an increase of about 100% for the year (8% per month) appears to have been the norm for vacant land sales.

Valuations by the hypothetical subdivisional method

It was of considerable assistance to find that all valuers had valued the land on the basis of its notional subdivision into 214 lots. They also adopted a figure for roading and engineering costs of $428,555 based on this plan. The measure of agreement reached reduced considerably the areas of differences between valuers could occur and left as the main items in dispute (a) the gross realisation from the sale of sections (b) the allowance to be made for profit and risk (c) the estimate of the period required for development and sale of the sections and (d) the rate of interest to be used.

(a) **Gross Realisation:**

In assessing the figure for gross realisation, the use of which the land is to be put will determine the average section price. As a general rule, the higher the standard of housing, the higher will be the section prices likely to be realised. The Cascades Road area provides the main access to the subject land and its standard of development would undoubtedly have a bearing on the quality of subdivision expected. Generally there is a better standard of development to the north of the Pakuranga Highway where the land is more elevated and provides northerly views than there is on the south side of the Highway where a lot of low cost (group) housing is interspersed with medium cost housing. The latter area is, however, not unattractive in house siting and section development.

The subject land is relatively flat with little in the way of views. Having viewed the Pakuranga area generally and this area in particular and having regard to the evidence give, we are of the opinion that as at October 1973 this block would have been developed with a mixture of medium and low cost housing similar to that in the lower part of Cascades Road and nearby streets. We agree with the view expressed by Mr D Beale, a real estate agent dealing extensively in Pakuranga, when he said:

> "It was at October 1973 obviously extremely suitable for low cost housing and would have been eagerly sought for this purpose. It was also extremely suitable for the spec. building for the lower middle income range which was then prolific."

Close to the specified date there was little sales evidence in the area south of the Pakuranga Highway. There was not a great deal more on the north side of the Highway. Such as there was related generally to sections better located than on the subject land. The closest sales to the subject land are in Walworth Avenue with sales at $5,100 to $6,000 in April and $7,000 to $7,700 in August. Time escalation would bring these sales to between $8,000 to $8,500 at 1 October. Two sales in December 1973 at $11,000 were of sections described as having landscape views. One of the valuers submitted a list of all the vacant section sales he could find. These were listed irrespective of where they were located and whether they were comparable or not. He listed 8 vacant section sales for September 1973. Six of these ranged from $7,000 to $9,500 with he two further sales at $11,000 and $22,000. For October 1973 only one sale was listed at $10,000 but the section was located a long distance away from the subject land.

The range of values assessed for the 214 sections by the valuers was as follows:–

Mr Jefferies	$4,000 to $11,000
Mr Barraclough	5,500 to 10,000
Mr Darroch	6,000 to 10,000
Mr Speedy	Not given – standard section $9,500
Mr Mahoney	7,000 to 8,500
Mr McGough	6,000 to 8,500
Mr Baker	6,500 to 9,000

All valuers assessed a number of sections at a lower figure because of the contour down to the creek or the detrimental effect of the power line easement. The number varied from valuer to valuer ranging from 29 to 41. We have adopted a figure of 35 which we assess at an average price of $6,500. The remaining 179 lots we have assessed at an average of $8,250 representing a range of prices between $7,500 and $9,000. This we believe would be the range of section prices at 1 October 1973 for the medium to low cost housing we envisage and having regard to the general tenor of the sales evidence.

(b) **Profit and risk:**
In a hypothetical subdivisional calculation, an allowance is usually made for profit and risk. It would perhaps be more correct to say that an allowance is made for profit, the allowance varying according to the risk involved. The greater is the risk, the greater the profit to be sought. The profit allowance which is in addition to an interest return on the investment is expressed as a percentage of the capital cost involved d and should be based on what actual market situations disclose that prudent buyers and sellers are willing to accept.

Mr Darroch analysed four sales to reach the conclusion that for two small blocks of five and seven acres the profit and risk factor was zero and 20% respectively. In the Stevenson purchase it was 25%, and for the Broadlands 24½ acre block it was 45%. Mr Baker had also analysed these last two sales. In the Stevenson purchase he had allowed a time escalation of 25% on the block price and a 50% escalation on the section prices to equate the sale to 1 October 1973 and had demonstrated a profit margin of 55% to 60%. In our view he ought to have analysed the sale without a time escalation which appears to have artificially inflated the profit and risk figure. In the Broadlands case he had assessed a profit margin of 60%.

Mr McGough also analysed both these sales but his approach was a little different. In each case he adopted a 25% profit and risk factor and a four year development and disposal period and the found what average lot value was required to bring the escalation to the actual purchase price. He arrived at an average lot value of $7,250 in the Stevenson purchase and $9,000 for the 24½ acre Broadlands block. Both lot values are extremely low, particularly in the Broadlands purchase where Mr Darroch had assessed the lot value at $11,750 and Mr Baker at $14,000. Mr McGough saw the significance of his analysis of these sales as being that he had to adopt conservative section values to equate to a 25% profit and risk factor. If he had adopted what he called "full site values, then an allowance for profit and risk higher than the norm would have been required. A similar conclusion can be reached by examining the results of the analysis by Mr Darroch and Mr Baker especially in relation to the Broadlands purchase.

Mr Mahony also analysed these sales and his findings confirm Mr McGough's thesis. In the Stevenson case a section level of $8,000 gave a profit and risk factor of 30.3% with the factor increasing to 40% if a section level of $9,000 was used. For the Broadlands purchase he had a 24.3% profit and risk factor on conservative section values of $9,000 rising to 41.7% on a section value of $11,000.

In the valuations the profit and risk factor used varied from 20% used by Mr Jefferies to 35% used by Mr Baker. Mr McGough and Mr Mahony had each made three calculations using low section values coupled with a low percentage of profit, then increasing the section value and the risk factor

in each of two subsequent calculations to arrive at practically the same answer as in the first calculation. Messrs Barraclough, Darroch and Speedy had all adopted 25% for profit and risk. We have adopted 25% as this is in line with the approach we have used in the assessment of gross realisation.

(c) **Period for development and disposal:**
Another integral part of the calculation is the period allowed for the physical development of the land and the disposal of the sections. The higher the prices asked for sections the longer they may take to sell. Mr McGough and Mr Mahony in their approach varied the disposal period according to whether they had used conservative or full section values in the calculation. In this case we have adopted a period of three years which was the period used in most of the valuations.

(d) **Reserves:**
It was submitted that provision for reserves in the subdivisional calculation should be wholly or partly in land in accordance with what was said by the Number One Town and Country Planning Appeal Board in *Mercantile Group Ltd v Manakau City* 4 NZTPA 166. All the valuers, however, made provision for reserves by means of a cash contribution based on 10% of the gross realisation and no evidence was given as to what land should have been set aside to provide for the reserve. The subdivisional plan already referred to made no such provision. There is no other course open to us but to follow the method used by the valuers.

Our calculation of the value therefore is:

Gross realisation			
179 lots @ $8,250	=	$1,476,750	
35 lots @ $6,500	=	227,500	
			$1,704,250
Less			
Commission:			
5% of $214,000	=	10,700	
$2^1/_2$ of $1,490,250	=	37,256	
		47,956	
Legal costs:		12,840	
			60,796
25			$1,643,454
Profit and Risk 25% (125)			328,691
Outlay			$1,314,763
Less Development Costs:			
Roading & Engineering			428,555
Advertising		5,350	
Reserves at 10%		170,425	
Rates			6,616
Interest (at $8^1/_2$% for $1^1/_2$ years on 41,314,763		167,632	
Contingencies (1%)		5,250	
			783,828
			$530,935
Less Stamp Duty and other costs of purchase:			5,935
			$525,000

Discounted cash flow method
Mr Jefferies used a discounted cash flow method as a check on his valuation made by the traditional

hypothetical subdivisional method. Future income and cash outlays on development costs were plotted on a monthly basis to give a projection of monthly cash flow with the income and costs discounted (in this case at 8%).

In our opinion this is no more than a more sophisticated way of setting out the hypothetical subdivisional calculation. It relies on the same assumptions and can only be as accurate as those which it makes. It is not surprising that the answer was not very much different from what Mr Jefferies arrived at in the traditional way.

Block sales

A number of block sales were quoted in evidence but only four appear to have relevance to this case.

The first two were purchases by Universal Builders in December 1973 of 5 acres at $8,000 per acre and 7.72 acres at $8,460 per acre. Both blocks, situated in Bucklands Beach Road, adjoined land already owned by Universal Builders. The sales were some ten months prior to the specified date and are of interest in indicating the probable level of values at that time although some allowance may possibly be necessary for the sale being to an adjoining owner.

The third sale was the Stevenson purchase of 43.07 acres for $420,000 in April 1973, a rate of $9,750 per acre. For the purpose of registration and the convenience of the parties the transaction was split into two but we were told that it was negotiated as one deal. The land comprises two blocks in Gills Road and adjoined land owned by the purchaser. It was a privately negotiated sale and was said by some witnesses to be "cheap". It appears to us that it is a comparable sale and although the development costs would be higher than for the subject land, it was considered superior as a block by all the witnesses, Mr Baker assessing an average section value of $12,000 at 1 October 1973. Its acreage value at t October 1973 was assessed by Mr Baker at 25% above purchase price (ie $12,188) and by Mr McGough at between $11,000 and $11,500.

The fourth sale was the Broadlands purchase from the Roberts Estate. The estate called for tenders for the land from a small group of selected tenderers in August 1973 and tenders closed in October with he successful tender being accepted in November. The specified date of 1 October was therefore right in the middle of the tender period. There were three parcels of land totalling 35.554 acres and the Broadlands tender was $542,203 which is $1,525 per acre. We were told that a well known unsuccessful tenderer was "about $25,000 less". This purchase was criticised as having been restricted but it is not without significance that it was by tender and that more than one tender was received. Many sales which are at full market value are privately negotiated and the fact that a property is not widely advertised does not necessarily mean that a sale is not at market rates. In this case the vendors appeared to be well informed and businesslike and the purchasers were widely experienced in land dealing. We therefore accept the sale as being relevant.

We were told that Broadlands tendered for the land on the following basis:

24.58 acres for $423,501 or $17,224 per acre
4.28 acres for 56,640 or 13,249 per acre
6.69 acres for 62,062 or 9,274 per acre

The 6.69 acres was sold immediately to Prestige Homes for $63,620 or $9,509 per acre. Compared with the subject land the 24 acre block was said to be much superior, the 4 acre block fairly comparable and the 6 acre block definitely poorer. A 4 acre block is not a good comparison for a 47 acre block and an acreage rate for a small area would normally be expected to be greater than the acreage rate for land ten times larger. In this instance the sale does no more than indicate that the acreage rate expected on the subject land would be something less than $13,249 and something more than $9,274.

The figure of $525,000 at which we have arrived by the hypothetical subdivisional method equals $11,129 per acre. This acreage rate can now be to check the valuation against the block sales evidence. Taking the Stevenson purchase first of all, this figure is about $1,000 per acre less than the estimate of that sale time adjusted and on the comparisons of the two blocks given by witnesses, the value

assessed to the subject land appears to be quite generous. With the Broadlands purchase, the figure lies almost midway between the acreage rates for the two smaller parcels. This is where it would be expected to lie and indicates that the assessment of $525,000 is fair.

We therefore determine the value of the land at 1 October 1973 to be the sum of $525,000.

We understand that part of the sum awarded has already been paid by the Manukau City. We allow interest on any unpaid sum from 1 October 1973 to the 21 October 1974 at 5% per annum from that date on to the date of payment at $7^1/_2$% per centum. We reserve the question of costs.