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The New Zealand Valuer

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Editorial Comment

GST AND VALUERS

N.Z.I.V. Submissions

Government is promoting GST as part of a major tax restructuring exercise. There is little doubt that it will involve the business community in a substantial additional administration chore. At the present time, it is expected to be in operation from 1 October, 1986, and will apply to all suppliers of taxable goods and services in New Zealand at a rate of 10% of the sales value. It will also be payable at the same rate on the value of goods imported into New Zealand but export of goods and services are effectively relieved from the tax by applying a special "zero rate".

The New Zealand Institute of Valuers made submissions to the Select Committee, and these were presented by the General Secretary, Kevin Allan, in September.

The Institute's submissions were carefully researched, and they were reported in the National Business Review as having been well received. For the general information of members, they are reprinted in this issue of the Valuer at page No. 182. The Institute submissions were given careful consideration by the Select Committee as they illustrated some anomolies, not the least of which is that, if he so objects *a taxpayer may well have been required to fund both the valuation presented for him and against him.*

The Bill proposed the use of the District Valuation Roll with a formula based on the relationship of improvements to capital value. It further provided that special valuations were to be commissioned where the above approach "is materially inaccurate or not up to date". As the Institute's submissions stated "the valuation roll is inevitably out of date with regard to the existence of new buildings and their initial *assessment on the District Valuation Roll".*

The Institute's submissions have brought about major amendments to the Bill in this regard, as these provisions have since been deleted.

Insurance Valuations

Should GST be included when calculating the inflationary provision on reinstatement insurance forms?

There have been different points of view advanced over the past 12 months and a lack of unanimity in the profession. Some Valuers have included GST; others have excluded it; and probably others haven't thought about it.

Various members of the Institute have held in the past that as the matter is not clear, it is better to play safe and include an allowance during both the period of the policy and during the rebuilding programme.

Other members have adopted a contrary view because a "registered person" is able to recover GST in full. The difficulty is that not all persons are "registered persons", i.e. they may be exempt such as banks, life insurance companies or private land-lords.

The article at page 180 prepared by Tony Anderson of Arthur Young, Chartered Accountants, represents a point of view which bears careful scrutiny. It must be stressed that the GST legislation is still in its Bill form. The final legislation may indicate significant variations, and this matter is worthy of further consideration when the legislation is in place.

Valuers have to deal with this problem on a day to day basis now, and cannot wait for the passing of the legislation. The valuation prepared now could be affected by GST.

One thing is clear. A person who is "registered" can recover GST. An unregistered person cannot and bears the tax. The unregistered person could make a claim on his insurance company for the total amount including GST. For that reason, it would be prudent for valuers to refer to the matter in a letter accompanying the insurance certificate.

Valuation Practices

Valuers will become taxgatherers. How many of us envisaged that situation when we first set up practice?

Tony Anderson assumes that any established valuer will have a turnover in excess of $24,000 and will therefore become a "registered person." Importantly too, he suggests that an individual acting as a commission agent, who is not an employee, will also become a "registered person". Perhaps this is the time for some valuers, who are technically commission agents, to look at the way in which they are employed. Those who are paid a salary will not be required to collect GST as it will be collected by the firm for whom they work. Those who are not paid a salary and receive payment by way of commission may be required to register and also become taxgatherers.

President's Message

G. J. HORSLEY

One of my first actions as President was to invite myself to visit branches and the universities in the earnest belief that the "so called" hierarchy of our Institute could be seen, heard and answerable to students and members at large and from within their own districts. I did this not out of any desire to travel widely around the country, which is something I do enough of as a partner in my practice, nor did I necessarily have the time to spare for such an assignment. However I believe that members are generally more comfortable within their own branches the problems which they perceive as affecting them professionally are both more real and more likely to be aired from within their own districts. At the time of writing I have been to Taranaki, Hawke's Bay, Gisborne, North Auckland, the sub-branch of Wairarapa Bush, Rotorua-Bay of Plenty and to Massey. I am shortly to visit Southland, Otago and Nelson/ Marlborough. I have found that members appreciate the opportunity to debate and air issues with me. I have left every meeting better informed as to the feelings of members within the branches. I have been able to personally explain the thoughts behind the Institute embarking upon an advertising *programme to the benefit of the registered valuer. I have been able to explain as to where increases in subscriptions have gone. I have been able to carry back to the Statistical Bureau comment upon the shortfalls and benefits of the microfiche sales system and suggested improvements in the Valpack floppy disk. I have noted computer developments by individual members within the smallest of branches, overall I have been very impressed with the professionalism of members generally and my eyes have been opened as to the wide sphere of work that valuers find themselves involved in. I carried back to Council one word of warning, to tread carefully through any consideration as to increasing membership costs and I can say that that cautionary note was uppermost in the minds of Councillors when they considered the Institute budgets for 1986. 1 suggested to Council that they should look carefully at the question of advertising and I am happy to say that Council agreed to our agency undertaking some primary market research before commitment to advertising expenditure for 1986.*

One of my most pleasing duties to date was to attend a dinner function in Tauranga to present the Life Membership Certificate announced at this year's Annual General Meeting to Murray Mander. This was an excellent evening, well attended by members not only from within the Rotorua/Buy of Plenty Branch but also from outside of the branch. This was surely a true indication as to the merits of Murray's elevation to Life Membership.

I can now advise that our General Secretary has made many excellent submissions to Review Committees in the year to date and it was pleasing to see the Institute's work in this field recognised in being the first to present submissions to the Select Committee Hearings on GST. This is where the Council Office of your Institute is most effective and why it must be organised and structured in such a manner so as to allow for input in this type of work to continue. On two occasions this year I have asked parties to air their grievances before the Executive Committee and while such action may be time-consuming it has resolved the issues in a much better way than through an exchange of letters.

In summary, I firmly believe that we as valuers are in the field of communication, whether it is communicating by way of reports the result of our valuations, or as an Institute maintaining the lines of communication between Councillors, Executive and our members. That line of communication must also extend into the universities because that is where the valuers of the future are being nurtured. We are but guardians of their inheritance.

Report on Mid-year N.Z.I.V. Council Meeting

by the Editor

Council's mid-year meeting was conducted on the 6th and 7th October, 1985, under the Chairmanship of the President, Mr G. J. Horsley.

Mr Horsley noted an apology from Mr R. J. Chappell, and welcomed two new Councillors, Mr I. R. McKillop (Taranaki) and Mr E. T. Fitzgerald (South Canterbury).

Congratulations were extended to John Wall and Ian Lyall, appointed to the High Court.

At the outset, the President provided a report indicating changes in reporting and budgeting procedures. He then provided an outline on his work as President to date, including visits he has paid to the Taranaki, Hawke's Bay, Rotorua/ Bay of Plenty, Auckland and North Auckland districts. He indicated that he proposed shortly to visit Otago, Southland and North Otago.

The Minutes of the previous meeting as circulated to Councillors were signed by the President as a true and correct record.

MATTERS ARISING

The background notes on tariff were to be given priority and were soon to be available from the General Secretary's office, posted to Public Valuers and Valuation Department Offices.

There has been no recent progress on the Valuers' Bill.

The Task Force was asked to reconvene, to consider the mid-year Council Meeting topic discussed, and in particular to reconsider the paper on standards. Council agreed that this Task Force should report to the Annual General Meeting in April 1986.

The New Zealand Institute of Valuers and R.I.C.S. are proceeding with discussions on reciprocity. Discussions are at an early stage.

ASSET VALUATION STANDARDS

Council passed a motion not to proceed with the rule change known as Clause 16A, being an amendment to the Code of Ethics.

It would appear that the Act and The Rules do not empower Council or the Institute itself to introduce standards which are binding on members.

Council then passed a further motion that this matter be referred to Executive for report to the next Annual General Meeting and that the matter be treated as urgent.

Council adopted the standards on asset valuation as guidelines, and members will be advised accordingly.

ADVERTISING BY VALUER(S) PRACTICES

A detailed background paper on valuer practice advertising was circulated to Councillors, having been prepared at the direction of Council following the April 1985 Council Meeting.

Council approved the adoption of the recommendation of the Task Force on advertising which reads as follows:

> "After detailed consideration, the Task Force at its meeting on 5th August, 1985 unanimously recommended Option 3.2(ii) - controlled expansion/limited advertising as being the most viable alternative for Valuer Practice Advertising. It recognises that the current code is outmoded and no longer credible in the present business and professional environment. Controlled expansion is much in accord with the principles now to be adopted by other professions (e.g. N.Z. Society of Accountants and Law Society). The Task Force believes that standards should be written in terms which emphasise good taste, professionalism, promotion of the profession as a whole, the integrity (and particularly) independence and impartiality of valuation advice, as well as the standing of the profession. Controlled advertising would prevent self-laudatory forms of promotion with other valuers, false or misleading statements or promises of performance.
>
> The Task Force considers that the standard should be fixed for several years, but would be read in conjunction with Guidance Notes, which contain examples of the type of promotion allowed or acceptable. These Guidance Notes could be regularly updated, to reflect changing conditions and situations. The Task Force has prepared and attaches as an appendix a DRAFT ADVERTISING, PUBLICITY AND SOLICITATION STANDARD together with a set of DRAFT GUIDANCE NOTES."

Council approved the date of 28th February, 1986 as the date by which submissions on this subject were to be made to the Task Force for consideration.

The draft Standards and draft Guidance Notes were to be distributed not later than the distribution of the September issue of the Valuer.

The draft Standards would then be substituted for Sections 23-25 of the Code of Ethics, subject to a legal opinion supporting the action proposed.

Council expressed its thanks to members of the Task Force for the very detailed work undertaken on this subject.

PUBLICITY AND PUBLIC RELATIONS COMMITTEE

Since authorisation by the Council of the Institute at its meeting in April at Palmerston North, the direct media advertising campaign has commenced, with initially, the residential format advertisement being inserted in the selected dailies on a pre-determined exposure basis, by the Institute's advertising agency, Charles Haines Lim-

ited. During June and July alternative advertisements to cover both rural and commercial areas of valuation activity have been completed and are now being inserted in the dailies, on a selective basis. In the final weeks of the campaign, the residential advertisement will return, possibly without any further change to the design.

Mr A. Griffiths and two executives of Charles Haines Limited presented a graphic display to Council, illustrating their aims and strategy.

Council later approved the sum of $12,000-$15,000 be expended on a research programme as outlined by Charles Haines Limited

Mr Kirkcaldie, on behalf of his Committee, then indicated that the Committee now intends to release the detailed regional reports with the national (overview) report for 1985, to obtain maximum media attention.

STATISTICAL BUREAU

Council approved subscriptions as follows:

Practising members	$180 p.a.
Non-practising members	$100 p.a.

The amounts recommended are exclusive of GST.

Council approved that the recommended charges be applicable from the 1st January, 1986 and that the remaining charges remain unchanged.

LIBRARY

The New Zealand Institute of Valuers has an extensive library including both reference works and overseas publications. This information is available through the General Secretary of the Institute.

STATISTICAL BUREAU

The reformating of the microfiche sales categories by the Valuation Department is now not likely to take place within the immediate future as the Government Pipitea computer time is fully committed.

The Statistical Bureau Chairman, Mr J. N. B. Wall, has requested permission of the Chairman of the Registration Board for the Institute of Valuers to carry out the necessary reprogramming of the current tape being supplied by the Board. If this permission is obtained, the Bureau will endeavour to have the microfiche category regrouped as soon as practicable.

Statistical data and general information is becoming more difficult to obtain from branch newsletters and other publications. The Statistical Bureau seeks greater support from branch members.

Mr Wall put forward a summary of proposed charges for microfiche supply and sales data in electronic form, to apply from the 1st January, 1986. This recommendation was approved by Council and the recommendations were approved exclusive of GST.

EDUCATION COMMITTEE

The Education Committee recommended, and Executive endorsed, support for a further seminar on forestry valuation, to be held in the North Island, with a possible difference in emphasis from the recently held Forestry Valuation Seminar in the South Island.

A decision has been made to publish Volume 2 of Urban Valuation in New Zealand by the end of 1986. The form of publication is yet to be decided and it is likely that two sections will be deleted and published at a later date. These relate to leasehold land and the mathematics of valuation.

NEW TECHNOLOGY

Twenty-seven subscribers are now taking the sales lists in an EDP form by way of disc or tape. NZIV Services Limited is still investigating the practicality of providing a sales advice service by way of video text.

Mr Cooper, on behalf of the New Technology Committee, presented a number of papers that describe some of the current developments taking place within a number of land related Government Departments for the integrated land system formerly known as LINZ, now known as LIS.

The integrated land system will be available to both the public and Government alike at some time in the future. The implications for the valuing and similar land related professions are quite dramatic and this could involve us in one of the greatest changes in our profession likely within the foreseeable future.

PROFESSIONAL PRACTICES COMMITTEE

Mr A. L. McAlister presented a report on behalf of the Committee which comprises Messrs McAlister, Horsley, Hallinan and Jefferies.

As in the past, queries or "complaints" have taken up a considerable amount of time at meetings and once dealt with, these are taken back with recommendations to the main Executive Committee for action.

NEW ZEALAND VALUER

The costs of publication have been rising steadily, but generally in line with inflation. The casual subscription rate is now $15 per annum, set in 1984. Although costs are up, the overall cost to members has not increased significantly because of greater advertising in the "Professional Directory" part of the publication.

L.P.M.S.I.

Membership has continued to increase during the year and current membership is 141 practices.

Although subscriptions have risen steeply, it must be appreciated that they are based primarily on the cost of insurance cover with an allowance for administration and for a surplus. The surplus enables the Society to carry part of the initial risk and in the long term, a larger part of the risk, which should make the insurance aspect cheaper; relative however to the market conditions pertaining at the time.

There is a general lack of interest in this form of insurance both in New Zealand and on the London market.

Brokers for the Land Professional Mutual Society advise that nearly all professional indemnity insurance underwriters have had disastrous underwriting results. This has affected the attitudes of insurers, and this situation has been compounded by the London market having put very severe restrictions on the amount of business which may be underwritten by an underwriter depending on his capital resources.

The above has resulted in premium rate increases over various sectors of the market ranging between 30% and 300%.

PAN PACIFIC CONGRESS, HAWAII

By October 1985, 30 people have registered to attend, and the final number may well be between 35 and 40 persons.
The Committee has allocated technical papers as follows:

Plenary session.
- "Social Responsibility for Housing" - Graeme Horsley.

Workshop sessions.
- "Managing and Operating the Appraisal Office" - Robert Fisher.
- "Affordable Housing" - John Gibson.
- "Housing the Elderly" - Evan Gamby.
- "Valuation of an Agricultural Operation" - Jim Coyle.
- "Agricultural Productivity and Land Value" - Ian Gribble.

Panel Discussion.
- "What's Hot and What's Not" - Rod Jefferies.

PAN PACIFIC - CHRISTCHURCH

The Christchurch Pan Pacific Congress is to be held on the 20th-25th March, 1988. Preliminary work is underway and promotional material for distribution in Hawaii is also in course of preparation.
The Congress in Christchurch will be promoted in Hawaii by way of

(a) Personal ambassadorship.

(b) Establishment of a promotional stand within the conference foyer with promotional literature, posters, videos, etc.

(c) Cocktail party at which New Zealand delegates will host a cross section of invited delegates and wives from other countries.

COUNCIL OF LAND RELATED PROFESSIONS

The Committee has been meeting monthly. A current proposal is to co-ordinate publications and publish a list of those articles incorporated in each journal, including papers indicative of the type of structure of each organisation.

The Council is also making a forward list of events for the mutual benefit of the member parties and to reduce conflicting dates.

N.Z.I.V. SERVICES LIMITED

N.Z.I.V. Services are considering main frame computer applications and have upgraded the ICL to a 16 bit version.

COUNCIL MEETINGS AND A.G.M.

The 1986 Council Meeting/A.G.M. and seminar will be held in Whangarei from the 12th to the 15th April, 1986, with the seminar commencing on Monday the 14th April.

The venue is the DB Whangarei Hotel and Forum North in the central city.

The Nelson/Marlborough branch will be hosting the Annual General Meeting and seminar in 1987. The dates will be fixed and circulated at a later time.

LETTER TO EDITOR

Sir,

Thank you to Guest Speakers.

I am a Valuation student at Massey University writing on behalf of the Massey University Real Estate Club. The Club is made up of valuation and property management students and lecturers.

Through your publication we wish to thank the following who spoke at our winter, lecture series:

Ian Maskell of Keys, Preston, Maskell & Co. Ltd.
Colin Cook of Colin Cook Real Estate Ltd.
Graeme Horsley of Darroch Simpson & Co.
Brent Slater of Slater, Wilmhurst Ltd.
Paul Keane of Challenge Properties Ltd.
Bryce Barnett of General Properties Corporation.
Kelly Garland of Kelly Garland Real Estate.
Graeme Lindsay of Axis Consultants.

Some of the speakers went to considerable effort and expense in providing notes and background material. Again we wish to thank all speakers and appreciate and acknowledge their part in our education. Also we wish to thank the New Zealand Institute of Valuers (Head Office and Palmerston North Branch), for their help and assistance.

In closing we ask the Real Estate Industry to keep students in mind and give consideration to possibly speaking to the students and/or providing background material.

Yours faithfully,
B. T. BROWN

Massey University Real Estate Club Lecture Series Co-ordinator.

"Land Compensation"- Book Launch

On the occasion of the launch of "Land' Compensation" book by Squire L. Speedy

by President N.Z.I.V. G. J. Horsley

I welcome the opportunity to say a few words on the occasion of the formal launching of Squire Speedy's latest work "Land Compensation".

I note those attending the function represent a wide spectrum of professional interests including not only valuation but also the law field, the judiciary, the accountancy and general business ifeld, the real estate, local authority and of course the academic side of business being represented by those attending and operating from the University of Auckland.

It would be fair to say that Squire Speedy has been involved in all of these fields (with the exception perhaps of the judiciary!) during his long and well known career in Auckland. I join with the Auckland members of the Institute of Valuers in welcoming those representatives from the fields mentioned and agree that it is a mark of respect to Squire that people from these areas were willing and happy to attend this small gathering.

The whole purpose of the function was to officially "launch" the new publication on display here tonight and to recognise the significant and generous contribution that Squire Speedy has given to the valuing profession and more particularly to the furtherance of valuer education in the wider field. It is also an opportunity for us to express our thanks and to acknowledge Squire's generosity in making available the publication rights of this book to the New Zealand Institute of Valuers.

In the preface to the book Squire himself relates how the work came to be n reality; how the commissioning of a single chapter in a new comprehensive valuation textbook grew so rapidly and assumed such importance that it warranted singular treatment with the publication of a separate work.

This of course tells us a lot about Squire Speedy and his dedication to a task which he took upon himself and which he has taken on earlier occasions as recently as three years ago - when he produced the title "Financial Appraisal" also published by the Institute to whom Squire had generously passed the publication rights.

And whilst Squire records in his preface acknowledgements to various people involved in the practice, teaching and judicial oversight of valuation, it is also fair to say that the vast majority of the work, the research behind it and the. inspiration to produce it has come from Squire himself.

I mentioned earlier that Squire has interests in a number of fields and you will be aware that he is a Fellow of the New Zealand Institute of Valuers, a Fellow of the New Zealand Society of Accountants, a Fellow of the Institute of Chartered Secretaries and Administrators, a Fellow of the Real Estate Institute of New Zealand, a Member of the Property Management Institute, a Member of the New Zealand Association of Economists and is additionally a Justice of the Peace. I said earlier that he had been active in all of these areas excluding the judiciary but I suspect that he has probably in fact been called upon to sit on the Bench in his role as a Justice of the Peace!

In all of these fields Squire is both a "thinker" and "doer" and of course an acknowledged teacher. He has been able to combine a quite unique career in the practical aspects of valuation and related property matters, to make this significant contribution to writings in those fields and also to lecture students and address gatherings of valuers at university and in continuing education seminars. Truly a unique contribution described earlier by some as the "merging of town and gown."

Without doubt this latest work is a welcome addition to the library shelves of lawyers' and valuers' offices incorporating as it does the vast majority of legal precedent relating to land compensation decisions in New Zealand. It does however draw widely on the significant cases from the law courts in other parts of the world but for my part, there is nothing like reading a work of this kind and in which one can relate to the cases decided here in New Zealand and with which New Zealand practitioners are familiar. I commend the book to you urging you to place your order for this limited first edition publication.

I might add also that in typical Squire fashion, the book is extremely well indexed with cross references and is both easy to follow as a textbook and a pleasure to read as an informational work on a very specialist subject.

I wish to mention now the agreement entered into between Squire Speedy and the New Zealand Institute of Valuers over the publication of "Land Compensation". Among the terms of that agreement concluded earlier this year was that a consideration in the sum of 1 cent be paid to the author for the assignment of the publishing rights to the New Zealand Institute of Valuers. I will be taking the opportunity shortly to present Squire with a shiny new 1 cent piece and you will all be witness to his generosity in that regard. I am sure that if there had been a smaller unit of denomination available then Squire would have insisted upon it. However, the agreement further provided that any profits made from publication of the book "shall be used for educational purposes including where the Institute deems appropriate the funding of other books to be published by the Institute or for the award of a prize or

prizes to encourage high professional standards or research".

That condition, sought by Squire and readily agreed to by the Institute, is a mark of the man whose labour and sweat in the preparation of the book (and that must be a considerable strain and effort in anyone's terms) is rewarded by his gratiifcation in seeing any surplus funds being devoted to further education, research and publications. I need hardly tell you that the Institute of Valuers is delighted by the gesture made by Squire and will be applying any profits to further the availability of learned works in a valuation related ifeld. As President of the Institute of Valuers I wish to now publicly acknowledge that gesture by Squire, to sincerely thank him on behalf of all members for his contribution and publicly acknowledge this philanthropic gesture.

The Institute of Valuers were keen to ensure a more immediate and public recognition of Squire's contribution in writing this latest work and in recognition of his earlier works. In discussions with Squire it was decided to institute a prize to be awarded by the University of Auckland each year for a student doing meritorious work in the subject of Financial Appraisal towards the degree of Bachelor of Property Administration. This award, to be known as the Squire Speedy prize in Property Administration, is to be awarded for the first time in 1985 and annually thereafter being a prize of not less than $300 in value. This is a small gesture in recognition and appreciation of the enormous contribution made by Squire L. Speedy to teaching and published works in his specialist fields. I am sure you will take the opportunity to join me in congratulating Squire on this latest work and wishing him a well earned rest in what he has described as his pre-retirement period.

Membership

ADMITTED TO INTERMEDIATE:

Beatson, M. A.	Canterbury/Westland.
Blackmore, R. F.	Auckland.
Dowse, G. M.	Central Districts.
Harold, M. W.	Auckland.
Lill, G. D.	Southland.
Loh Chin Hua	Overseas.
Mahoney, G. W.	Auckland.
Morris, K. G.	Waikato.
Pearce, J. G. L.	Rotorua/BOP.
Peebles, R. S.	Canterbury/Westland.
Shields, R. J.	Southland.
Stevenson, J. B.	Hawke's Bay.
Winter, S. G.	Southland.
Woodhouse, S. O.	Auckland.

REGISTRATIONS:

Anselmi, A. M.	Waikato.
Diack, A. G.	Gisborne.
King, S. W. J.	South Canterbury.
McKeown, K. G.	Auckland.
Pryde, (Ms) L. M.	Overseas.
Pyne, R. M.	South Canterbury.
Sherlock, M. T.	Central Districts.
Trolove, W. G. C.	Canterbury/Westland.
Van Velthooven, P. H.	Central Districts.

ADVANCE TO ASSOCIATE:

Bamford, M. D.	Central Districts.
Bennison, R.	Nelson/Marlborough.
Cowper, B. D.	Gisborne.
Gaskell, (Ms) S. G.	Northland.
Greville	Northland.
Hines, P. J.	Rotorua/BOP.
Jeffrey, R. E.	South Canterbury.
Kwang Heng Lee (Miss)	Overseas.
McNally, S. R.	Northland.

Paterson, G. J.	Otago.
Percy, J. S.	Hawke's Bay.
Percy, R. N.	Nelson/Marlborough.
Schrader, L. G.	South Canterbury.
Thomas, G. R.	Northland.

RETIRED:

De Lautour, B.	Central Districts.
Rolle, R. H.	Central Districts.
Thomason, G. T.	Rotorua/BOP.

DECEASED:

Barnett, T. C.	Canterbury/Westland.
Bradley, H. O.	Wellington.
Girdwood, S. P.	Taranaki.
McGowan, R.	Central Districts.
Newman, R. H.	Hawke's Bay.

REMOVED FROM ROLL OF MEMBERSHIP:

Abbott, M. H.	Otago.
Boundy, J. H.	Hawke's Bay.
Chetwin, R. K.	Nelson/Marlborough.
Corbett, T. J.	Central Districts.
Edge, M. W.	Central Districts.
Gordon, R. B. P.	Taranaki.
Higgins, T. G.	Auckland.
Hinton, M. A.	Rotorua/BOP.
Kerr, B. J.	Waikato.
Lim Thiam Hock	Overseas.
McGill, J. N.	Otago.
Miller, B. R.	Wellington.
Mursell, A. J.	Central Districts.
Raymond, D. A.	South Canterbury.
Stuart, G. J..........	Central Districts.
Tan Beng Sooi	Overseas.
Walsh, D. J.	Auckland.
Walshe, C. J.	South Canterbury.
Wellbrock, D. A.	Central Districts.
Young, L. J.	Waikato.

RESIGNED:

Brandon, N. T.	Auckland.
Futter, S. K.	Central Districts.
McIlraith, R. R.	South Canterbury.
McPhail, G. E.	Otago.
Parkes, D. C.	Hawke's Bay.
Smith, R.	Nelson/Marlborough.

ANNOUNCEMENT

The American Real Estate Society was recently formed as an international association to encourage applied and theoretical research and interaction between academics and practising professionals The Journal of Real Estate Research will be the first official publication of the new organization.

The first annual meeting of the American Real Estate Society will be held October 9-12, 1985 at the downtown Holiday Inn in Denver, Colorado, U.S.A. This is the same city and time as the Financial Management Association meetings.

For information on membership please contact:

Dr. William C. Weaver
George T. Barnett, Professor of Real Estate
University of Central Florida
College of Business Administ ration
Department of Finance
Orlando, Florida 32816
305/275-2525

REPORT ON THE LAND PROFESSIONALS MUTUAL SOCIETY INC.

To Half Yearly Council Meeting 6/7 October, 1985

The financial year for the Land Professional Mutual Society is 31 August, 1985 and interim accounts show a surplus for the year of approximately $49,000 with members' funds now totalling about $176,000. In its annual accounts a provision of $35,100 has been allowed for claims liability in respect of the Society's share of claims.

Membership has continued to increase during the year although there have also been some defections from the Society. These defections have been mainly due to the very high increase in membership dues for the current year. Current membership is 141 practices.

The President, Mr G. Horsley, has advised that the increase in subscriptions has been a talking point on his visits around New Zealand and it is noted that the Councillor for South Canterbury wishes to bring up this matter at this meeting.

The situation as far as the subscriptions to the Land Professional Mutual Society are concerned is that they are based primarily on the cost of insurance cover with an allowance for administration and for a surplus. The surplus enables the Society to carry part of the initial risk and hopefully in the long term a larger part of the risk, which should make the Insurance aspect cheaper relative however to the market conditions pertaining at the time.

It has been difficult this year to obtain quotations for the group insurance both in respect of the Valuers and the Surveyors due to a lack of interest and limited market for Professional Indemnity Insurance both in New Zealand and on the London market and in the case of the Valuers (but not this year the Surveyors) the cost of estimated claims.

Brokers for the Land Professional Mutual Society advise that nearly all Professional Indemnity Insurance underwriters have had disastrous underwriting results with one underwriter having reported an underwriting loss of $1.2 billion, the biggest loss in a single insurance year ever recorded. Another large American Professional Insurance underwriter has suffered a 250% loss ratio. This has affected the attitudes of insurers, the situation having been compounded by the London market having put very severe restrictions on the amount of business which may be underwritten by an underwriter depending on his capital resources. The regulations have been tightened considerably as a result of some scandal which hit the Lloyds market during the past two years. Reinsurers have been very badly hit with the result that it has meant that reinsurers have dropped out of the market and as a result premium rate increases over various sectors of the market range from 30% to 300%.

The result as far as the Land Professional Mutual Society has been concerned is that the market has been more limited for quotation with a corresponding increase in fees due to the projected loss ratio for the previous year.

The Society continually hears of members who say they can get insurance much cheaper and to that extent it has no axe to grind as to who the insurance is placed with and would be pleased to hear who these cheaper insurers are, so that quotations may be obtained from them.

The Society had during the year 20 notifications of claims for what were considered possible claims from Valuer members. Of those - 6 files have been closed with no liability, 2 claims have been settled and the remainder are still open. It was interesting to note that a number of claims have been generated when Valuers get to a stage of suing for their fees.

The Society when it advised members of their new subscriptions endeavoured to do a reasonable "P.R." job but it is obvious from the correspondence received by the Society and the general feeling of members that it was not successful. One of the problems as far as the Society is concerned is that it is often not possible to get the new reinsurer until virtually the date of the commencement of the new policy. Nevertheless it is agreed by the Society that their P.R. on this matter has not been successful and they propose advising members individually to more fully inform them of the situation.

A. L. McAlister
N.Z.I.V. Representative on the
Professional Mutual Society Inc.

G.S.T. Insurance A Point of View

A POINT OF VIEW

"Tony Anderson is a tax consultant with Arthur Young, Chartered Accountants, in Auckland. Until recently, he was with Arthur Young in London, specialising in U.K. Value Added Tax.

While agreeing that GST will be far simpler to operate than its U.K. counterpart, Tony cautions that there are still likely to be a number of areas of practical difficulty. One such case, where valuers will need to tread carefully, is considered in the following article."

EDITOR'S NOTE: It must be appreciated that at the time of writing the GST legislation is still in its draft form. The final legislation may indicate significant varations both as it affects valuers' businesses and insurance on property.

INTRODUCTION

After 1st October, 1986 any business with a turnover in excess of $24,000 p.a. will be required to register for, and therefore deal with, GST. A registered business is effectively a collector of GST and does not, with few exceptions, bear the tax.

The collection process is achieved by requiring the registered person to follow a simple procedure for all taxable sales and purchasers as follows:

- When you sell goods or services, you charge GST to your customers (output tax).
- When you buy goods or services for your business your supplier will charge you GST (input tax).
- If your output tax exceeds your input tax, you periodically pay the excess to the Department.
- If your input tax exceeds your output tax, you receive a refund from the Department.

At the end of the transaction chain the final consumer, who is not registered, bears the tax as an expense.

Any established Valuer or Estate Agency business will have a turnover in excess of $24,000 and will therefore become a registered person. (This would include any individual commission agent who is not an employee for income tax purposes.) As a general rule, all supplies of services by Valuers will be taxable at 10% (or 0%, "zero rating" if exported). There are few exemptions; only financial services, such as banking activities, and the letting of private accommodation are exempt in the draft legislation.

Remember:-

- If you make taxable supplies (10% or zero rated) charge GST on sales to customers and deduct GST on purchases from suppliers.
- If you make exempt supplies you must not charge GST on sales and cannot deduct GST on related purchases.

Although valuers are most unlikely to make exempt supplies the distinction is important if your client (perhaps a bank or a private landlord) does so, and also if your client's property is simply their own home.

INSURANCE

The application of GST to payments by insurance companies to cover claims (other than under life insurance policies) is covered in the Bill by S.5(14) which states:

"Where a registered person receives an indemnity payment pursuant to a contract of insurance, that payment shall, to the extent that it relates to a loss incurred in the course of making a taxable supply, be deemed to be consideration received for a supply of services by that registered person in the course or furthermore of that taxable activity."

The working of this section is probably best demonstrated by an example.

1. Basic Situation: insured able to recover GST in full

M Ltd. (Insured Manufacturer) factory replacement value $1 million — Building — B Ltd. (Builder)

Claim

I Ltd. (General Insurance)

If M Ltd's factory is destroyed by fire, the following steps would be taken:

(a) M Ltd. (presumably) would contract with B Ltd. for a new building. On completion B Ltd, will charge M Ltd. $1 million plus $100,000 GST, and pay the tax to the Revenue. As this is tax charged on goods (the building) acquired for the principal purpose of making taxable supplies (the products from the factory) M Ltd. will claim credit for it as input tax in their next return.

(b) M Ltd. claims on I Ltd. under their insurance. Under the section quoted above, the payment received by M Ltd. is deemed to be consideration for a supply of services, and they must therefore account for GST on it, and pay it to the Revenue in their next return. In order for them not to be out of pocket, therefore, they will have to receive their $1 million actual cost, plus the $100,000 which they will pay to the Revenue.

(c) I Ltd. will therefore have to pay the full $1.1 million required by M Ltd. but would be expected to be able to recoup the GST element from the Revenue as input tax in their next return.

We should also consider the situation that would arise if, for example the insured was a bank, life insurance company, or private landlord, all of which are exempt GST and can therefore not recover all of their input tax.

2. Insured unable to recover GST

Let us assume that the insured is E Ltd. and the building destroyed was used wholly for making exempt supplies. In that case:

(a) B Ltd. would supply E Ltd. with the new building and charge $1 million plus GST, as before.

(b) E Ltd. cannot reclaim the input tax charged as it is not incurred for the principal purpose of making taxable supplies.

(c) E Ltd. will claim on I Ltd. for $1.1 million. As this does not relate to a loss incurred in the course of making a taxable supply, (see S 14 extract above) it is not deemed to be consideration for a supply of services by E Ltd. to I Ltd.

E Ltd. should not regard part of the $1.1 million received as GST, and I Ltd. cannot claim input tax credit for any of it.

If half of the building had been used for making taxable supplies and half for making exempt supplies, it appears that half of the insurance payment to E Ltd. by I Ltd. would be regarded as on account of a supply of services by E Ltd. and GST would be accounted for and deducted accordingly.

As a consequence, we can conclude that whether a building should be insured for a GST inclusive or exclusive replacement value, will depend on the use to which it is put in a particular instance.

Clearly it will be impractical for a valuer to ascertain this in each case, and the use of the building may change from time to time in any case. It will therefore be necessary to ensure that your clients are aware that:

(a) If they are able to recover input tax in full, they can insure for a GST exclusive value but the contract of insurance must enable them to claim a GST inclusive amount. This should not affect premium levels as the insurance company will recover GST and thus only suffer the net cost.

(b) If they are unable to recover some or all of their input tax, they must insure for a value inclusive of the appropriate proportion of GST. They must also bear in mind the need to amend the insured value should the use of the building change.

It may be that some of your clients in this. latter position may choose to insure for a 100% GST inclusive value to avoid administrative complexity, or losses from failing to amend an insurance value on a change to using a building for making exempt supplies.

Submissions of New Zealand Institute of Valuers

Goods and Services Tax Bill

The following are the submissions of the Institute filed with the Finance and Expenditure Select Committee in September, 1985.

The New Zealand Institute of Valuers was the first body to be called before the Select Committee and our submissions, prepared and presented by the General Secretary, Mr Kevin Allan, were reported to have been well received.

1. The New Zealand Institute of Valuers comprises some 1,900 members engaged in all facets of the economy dealing with land; members are employed in state, municipal, corporate business, the financial service sector as well as being in practice as public valuers making valuations for a wide range of sale, purchase, mortgage, insurance, compensation, leasing and other purposes. All registered valuers are members of this Institute and there are some 1,300 individuals registered throughout New Zealand.

2. Submissions were made to the Advisory Panel on the Goods and Services Tax and those views were founded on the White Paper and the subsequent draft legislation comprised in discussion papers released by the Inland Revenue Department around May, 1985.

   The essence of some of those submissions were taken aboard by the Advisory Panel in their report published 24th July, 1985. We have had the further opportunity to examine the subsequent Treasury officials' report to the Minister of Finance dated 5th August 1985 dealing with GST on land and residential rents.

3. It would be fair to say that a number of matters of concern to the Institute which were not entirely clear in the first departmental draft have since been clarified and concepts resolved with the publication of the Bill proper.

4. As Members of the Committee would expect the concern and interest of the Institute and its members are essentially in those areas relating to the effects of GST on land transactions and more particularly the administration of and compliance with the new tax.

   It goes without saying that the introduction of GST is a complex and far reaching measure; like many, the Institute believes that the measures should contain a high degree of certainty as to the method of determination, certainly as to the procedures for settlement of disputes and a streamlined process for filing and collection of the tax. The Institute argues for a system which is simple to understand and capable of application without recourse to professionals in the first instance. The measures proposed in the Bill do not meet the tests of simplicity, certainty and speed.

5. VALUE OF SUPPLY OF LAND (Section 11 of Bill). It was the view of the Institute in submissions to the Advisory Panel that the value of the interest to attract GST should be determined by a simple application of the sale price and the Panel recommended that 70% of the price be taken as a figure to represent the value of the improvements included in each sale (NZIV submitted 60%). Instead, the Bill proposes use of the district valuation roll with a formula based on the relationship of improvements to capital value. The Bill further provides that special valuations are to be commissioned where the above approach "is materially inaccurate or not up to date".

   The Institute of Valuers has grave reservations about the administrative aspects and the adequancy of the valuation rolls to be used for this purpose, given the demands likely to be placed upon the resources of the Valuation Department and the inherent time delays that could be occasioned by this approach.

   For the reasons stated above and later noted in this submission, it is the view of the Institute that the simplistic approach recommended by the Advisory Panel be adopted preserving however the rights of the parties to call for valuations where needed. In the event that the Committee does not accept this view, the further submissions on aspects of administration of GST relating to land supply are advanced.

6. PARTIES TO TRANSACTIONS (Section 11.3 of Bill). In the event that the formula does not arrive at an accurate value of the supply to be taxed, the Bill provides for the registered person to negotiate with the Commissioner or, in default of agreement, to have the value so determined by a special valuation made by the Valuer General.

   While it might be true to say that quantum of GST will not be of significant concern to a registered person who has a set-off by deduction of input taxes, GST is of very real concern to the non-registered person who must find the tax in addition to the purchase price either by his own equity or from borrowings. In the vast majority of cases the non-registered party in a transaction will be the purchaser and it would appear simple justice that they also be given a right to either agree

on or dispute the amount of GST. We note the Treasury report recommended that both parties to the sale should have a right of appeal but the Bill would appear to be deficient in recognising only the registered person.

7. VALUATION FEES - RECOVERY THEREOF (Section 11.4 of Bill). The Bill goes on to provide that where a valuation is commissioned from the Valuer General to determine the correct value for the taxable supply, a valuation fee is payable by the Commissioner and recoverable from the registered person.

   This provision does not currently parallel other taxing measures most notably the payment of stamp duty or estate duty where valuations made at the request of the Commissioner (having been unable to agree with the taxpayer on the correct assessment), no valuation fee has been demanded from the taxpayer nor paid by the Commissioner to the Valuer General. Any costs thereof have been viewed as an administrative or compliance cost. It is the view of the Institute that the same situation should prevail and that the Commissioner should be responsible for any valuation advice secured from the Valuer General and the costs of that service.

   Where the Commissioner and the party or parties are unable to agree on the value, an option should exist for the taxpayer to submit his or its own valuation of the improvements as determined by a registered valuer. In that event, the taxpayer would clearly be responsible for the fee and such valuation should have the same standing as that produced by the Valuer General. It should be remembered that in many cases where a transaction is proceeding a valuation may have been called for by either of the parties in any event; registered public valuers are available throughout the country to undertake this service and this would relieve what will be undoubted pressure placed on the Valuer General.

8. OBJECTIONS TO SPECIAL VALUATIONS - (Section 12 of Bill). This Section provides that a right of objection and appeal to the Land Valuation Tribunal will exist against any valuation made by the Valuer General within terms of the Act; the procedures to be followed shall be those now set forward in the Valuation of Land Act, 19451. Whilst the Institute agrees that such appeal rights are both desirable and logical to resolve disputes, the question of valuation fees arises again and in this event the objector will possibly also retain independent valuation advice. We might then have a situation where he could have been required to have funded valuation advice to support two opposing views.

   Should the Committee not agree to the Commissioner being responsible for the Valuer General's fee, and the value of the improvements is later amended either by agreement with the Valuer General or by a decision of the Land Valuation Tribunal then, at the very least, a refund of any fees should be automatic.

   Not all sales of an interest in land are capable of being determined by reference to the district valuation roll. Where a company has been formed for the purpose of developing and selling shares in an own-your-own unit, either residential or commercial, the valuation roll simply represents the fee simple of the total company asset. No single valuation of an individual shareholding is shown on the roll but that shareholding does represent the capital value of the property - including an interest in the land. To place these transactions on the same foundation as freehold title, it would be necessary to have a valuation made of the "improvements" thereby excluding the land component from GST payment. If the transaction were treated simply as a transfer of shares and attracted GST on the total consideration, this would over-recover the amount of tax liable on the transaction and make this class of real estate somewhat more expensive. The Bill should be extended accordingly.

9. DETERMINATION OF VALUE OF SUPPLY - (Section 11.2 of Bill). The Institute is extremly concerned that significant delays could be occasioned by the need for special valuations to be made in the event that the formula provided in the Bill at Section 11 (2) does not disclose the appropriate value of the improvements in the transaction. The proposed legislation does not meet the test of being simple to administer nor give certainty at the time a transaction is entered into. This results from the fact that the valuation roll is inevitably out of date in regard to the existence of new buildings and their initial assessment on the district valuation roll.

   In the normal course of events a new building is not required to be assessed and shown on the roll for some time after its completion, sale and occupation. However, in the vast majority of cases where new buildings are sold, either from developers in a commercial scene or from builders to home owners in the residential sector, special valuations will therefore be required. The Institute estimates that something between 15,000 and 20,000 special valuations per year might be required to meet the provisions of the Act by reason of the fact that no values exist on the roll at the time of sale or because the roll is "materially inaccurate". (This compares to 13,300 and 13,400 special valuations performed by the Valuer General over the past two years).

   The Valuation Department is already under considerable current resource pressure and may find it difficult to accommodate this sudden and urgent demand for assessments. In that event, excessive delays could be occasioned by this new work which, in the eyes of the parties to the transaction, will almost inevitably be of extreme urgency.

The Institute's submission in this regard could be met by an amendment to the Bill at Section 11 (3) which permits either party in the transaction to submit their valuation of the improvements assessed by a registered valuer. (See para. 6 above). If this concept is accepted then it would be logical against any valuation so tendered by either the registered person or a non registered person.

10. WHY VALUATIONS BY THE VALUER GENERAL. In the foregoing paragraphs the Institute has discussed what it sees as potential problems in the determination of valuations and administration of the tax collecting mechanism. It has submitted that valuations made by independent and registered valuers under the same statutory approach as required under the Valuation of Land Act, 1951 should also be accepted, subject to objections and appeal, as valid valuations for the purposes of the value of the "supply".

    The above leads the Institute to further examine the approach being suggested in Section 11 of the Bill i.e. the use to be made of the district valuation roll for the determination of the value of improvements. Over many years there have been valid arguments advanced and questions raised as to why the Valuation Department should value the buildings in situations where local authority rating is determined on the land value. Land value rating exists in about two thirds of the local authorities in New Zealand but considerable resources of the Department are devoted to the inspection, documentation and valuation of buildings (valuation of improvements).

    The Institute wishes to make the point that adoption of the formula approach suggested in the Bill will probably be the first valid justification for the continuance of the practice adopted by the Valuation Department in valuing the improvements irrespective of the rating system.

    Once the taxation measure is put in place and the district valuation roll becomes the starting point for the determination of values for GST purposes, Government would be committing itself to a continuation of that Department and its functions and indeed a broadening of its role.

    Compounded by the probable demand for prompt and priority service being given to GST assessments, other services provided by the Valuer General may suffer unless a balancing imput of manpower and other resources is provided. The point being made by the Institute is that the GST provisions set forward in the Bill may mean an irreversible decision is made cementing in the present practice of valuing improvements in all parts of the country. The proposal advanced by a registered valuer will considerably ease a potential resource problem.

11. LEASING OF LAND. The definition of land within the Interpretations clause of the Bill includes "a tenancy of land for a term certain of or in excess of 21 years". There appears no valid reason why an occupation of land for this specific period should be viewed differently to a shorter term lease although the argument advanced for it is apparently founded on the premise that such a term (of 21 years plus) is tantamount to the fee simple or gives rise to a calculable interest in land. In fact, leases for very short periods and even at so-called market rents can give rise to an "interest" in land which valuers might describe as a lessee's interest or perhaps simply what is sometimes known as goodwill or key money. The Institute would argue therefore that the interpretation of "land" be amended by removal of the reference to a tenancy of or in excess of 21 years thereby treating occupations of land, whether freehold, permetually renewable, long term but terminating leases or short term leases all on the same basis. Some inevitable problems might exist in defining the "land" component in a transaction involving the sale or assignment of a leasehold interest but the problem is essentially a valuation one.

    The Institute has also examined the transitional provisions contained in Section 86 of the Bill which broadly provides for leases and other contracts to come within the orbit of GST and be reviewed after 1st October, 1986. There is however one area which does not appear to be catered for and that is the position dealing with tenancies where part or perhaps even all of the rental payment is determined on the basis of turnover. Typically, a small retailer in a mall may pay a minimum rental but the full rental is actually determined on the basis of gross sales. When these lease contracts may have been entered into, say in 1981, to run for a period of perhaps 10 years with reviews of the rental to occur at say 2 year frequencies, neither the landlord/owner nor trader/tenant envisaged the "turnover" to be other than the gross business receipts of the trader since at that time GST had not appeared on the horizon. Where no provision exists in the lease to amend the definition of "turnover" the result could be a windfall gain to the landlord. (See example).

    Whilst the Select Committeee has apparently no authority to consider changes to Clause 86 of the Bill, the Institute submits that this particular question warrants further investigation by offïcals with the object of clearly establishing the GST effects in this area. The Treasury paper already alludes to this point in disagreeing with the Advisory Panel recommendation.

12. EXEMPTING LAND FROM GST. Most of the potential problem areas outlined above arise as a result of the decision to exempt land from GST. Whilst the concept of excluding land on the grounds that it is not "consumed" is a purist one, land is nonetheless a commodity which is traded, developed and redeveloped and when built upon is inseparable from the improvement (buildings) which ,give rise to rentals and other trading activities generating consumer spending and GST rev-

enues. Given firstly, that the family home traded between non-registered persons is exempt from GST and secondly, that the "land" component of the vast majority of goods and services supplied is extremely small (minor marginal effects on GST payable) a good argument could be advanced to disallow the proposed exemption on land. This question should perhaps then be the first to be resolved in considering the above submission.

13. CONCLUSION AND RECOMMENDATIONS. The New Zealand Institute of Valuers submits the following matters be resolved by the Select Committee and taken in the indicated order:

(a) Ratification or otherwise of the decision to exempt land from GST (para. 12).

(b) Reconsideration of the need for a formula approach to the determination of the value of the supply i.e. the assessment of improvements by reference to the district valuation roll (para. 5).

(c) Acknowledgement of the possible impact on the Valuation Department and the commitment to a new and permanent use for valuation rolls (para. 10).

(d) Acceptance by the Commissioner of Inland Revenue in the first instance of valuation assessments by a registered valuer (para. 9).

(e) Extending to either party in transactions the right to dispute a formula-derived assessment (para. 6).

(f) Providing for the Commissioner to not accept the assessment made by a registered valuer and thence to secure a special valuation from the Valuer General.

(g) Adopting the principle that all parties are liable for their own valuation advice and charges and that the Commissioner not recover any valuation fee from the public (para. 7).

(h) That the Bill provide for company share title holdings in real estate to be treated on the same footing as other interests in land (para. 8).

(i) Consideration be given to a new and widened definition of "land" to recognise any tenancy or occupation of land for whatever term (para. 11).

(j) A re-examination of the transitional provisions as they might relate to a tenancy where all or part of the rental is founded on a definition of turnover (para. 11).

Example of effect of GST on Percentage or Turnover Rental

	(a) Current Situation	(b) Allowing GST included in Turnover	(c) Where GST excluded from Turnover
Turnover	$100,000	$100,000	$100,000
GST at 10%	-	10,000	-
Turnover including GST		110,000	
Percentage Rental @ say 8%	8,000	8,800	8,000
Plus GST @ 10%	-	880	800
Total Rent Paid	8,000	9,680	8,800
GST paid by owner	-	880	800
Net rent Retained by owner	8,000	8,800	8,000

The Land Act Reflection and Development

Report by J. Dunckley, Assistant Editor

CROWN LEASEHOLD LAND

Following representations by Federated Farmers, the Minister of Lands set up a committee comprising members from the Department of Lands and Survey, Land Settlement Board, Federated Farmers, N.Z. Meat and Wool Boards, Economic Service and the Valuation Department. This group included three registered valuers and reported back in August 1984. They raised the following subject points which if perused are of vital interest to any Valuer in the assessment of a Crown rental under the Land Act.

The Land Act 1970 - Section 131

Requires the assessment not earlier than two years and not later than one year before the expiry of a renewable lease of:

(a) Value of improvements unexhausted and included in the lease.

(b) Value at commencement of all improvements included in the rental value at commencement. (Crown Improvements).

(c) The land included in the lease exclusive of improvements referred to in paragraph (a).

Provides that:

(i) Equal emphasis on values (a) and (c).

(ii) The values shall be ascertained on an equitable basis, having regard to the relationship between lessor and lessee.

(iii) Sum of (a) and (c) shall be equal to the "Capital Value".

The committee outlined the currently accepted method of assessment.

1. Assess Capital Value - A straightforward valuation.
2. Assess L.E.I. - a difficult task in the absence of comparative evidence.
3. Improvements - The difference between 1 and 2 (added value principle).

The L.E.I. is held as being the land value less the lessee's development (cultivation, grassing, draining consolidation, top dressing, over-sowing etc.) by case law re in The Valuer General vs. Sullivan 1962.

The Principal calls for the Capital Value assessment.

less	Improvements (Structural)
	Land Value
less	Development

Land exclusive of improvements.

The Court

"Such as apportionment is no more than an expression of opinion but in the Absence of better evidence is usually accepted to one based on unsupported evidence".

In M. A. and J. A. Redpath to The Bruce Woollen Manufacturing Company Ltd. (1947) 23 N.Z.L.J. 183; N.Z.V. Vol. 5, No. 1, Mar. 1947, p. 8; Judge Archer giving his judgement in the Land Sales Court had this to say:

> In the absence of a well defined "market" for real property the market value in any particular case must of necessity be arrived at by valuation, which in turn may be based upon one or more of several recognised and accepted methods of valuing. Of these methods none can be claimed to be conclusive and it is conceived that where two or more methods of valuation can properly be applied to a particular property, the true value is most likely to be found by a critical comparison of the results obtained by the application of all such methods as appear appropriate.

In J. R. and C. P. Tilby and Others v. Valuer-General, L.V.C.B. 410; N.Z.V. Vol. 11, No. 1, Mar. 1953, p. 27, the Judge, in the Land Valuation Court, gave similar advice, this time in relation to farming land having subdivisional potential.

> The Court has frequently pointed out that it is unusual for any one method of valuation to be conclusive and beyond question, it is the duty of the valuer to check his valuation, when made by what he deems to be the most reliable method, by any other method of valuation which is appropriate to the case.

The Crown in offering a perpetually renewable lease gave up a bundle of rights for all time further to the right to obtain a rental, and the Land Act states in, S 131.

Subsection (ii) "equitable basis having regard to the relationship between lessor and lessee".

The committee thus isolated two areas of uncertainty within the act -

(i) what is the L.E.I. method of assessment.

(ii) Equitable relationship.

(i) L.E.I. Assessment

In its review the committee related the original carrying capacity of the land to its present. An Invermay Scientist has designed a method of establishing the original carrying capacity of. the land based on dry matter production of the original herbage and from this the degree of lessee's improvements could be apportioned on a quantative basis. (Supportable evidence?)

"The practical application of this method is that it may assist valuers to apportion more equitably the sale price or capital value as between land exclusive of improvements and the added value of the owner's improvements, if the difference between the present carrying capacity and the original carrying capacity is treated as a fair reflection of the lessee's improvements then the apportionment or ratio of such capacity can

47th ANNUAL GENERAL MEETING & SEMINAR

Forum North, Whangarei

14th - 15th April 1986

PROGRAMME & REGISTRATION

Day 1 -- Monday, 14 April 1986

9.00am	10.00am	Registration & Morning Tea.
10.00am	10.30am	Opening Address - John Banks M.P. Whangarei.
10.30am	12.30pm	Ground Rentals - The lessor and lessee viewpoint in establishing Market Rentals. A mock arbitration. For the Lessor - P.J. Mahoney For the Lessee - R. L. Jefferies Umpire - R. P. Young Critical Summary - J. N. B. Wall from the Society of Arbitrators. (A mid session break will be called at an appropriate time).
12.30pm	4.00pm	Lunch. "Think Big" - N. Milne, Public Relations Officer for N.Z. Refining Co. Ltd. Problems encountered in establishing and disposing of residential and village accommodation for the Refinery Expansion. A bus tour of the residential accommodation areas and the Refinery at Marsden Point.
4.00pm	6.00pm	Annual General Meeting.
7.00pm	8.00pm	Cocktail Hour.
8.00pm	Lai3	Social Function.

Day 2 - Tuesday, 15 April 1986

8.00am	9.15am	Breakfast Session - Professor G. Shouksmith - Head of Dept. of Psychology Massey University. "The Value of Stress".
9.45am - 10.45am		"G.S.T." - An overview from the public and private sector. Mr D. W. Green, Chief Examiner of G.S.T. Inland Revenue, Whangarei. Mr D. W. Hewitt, Senior Partner Coopers & Lybrand, Whangarei.
10.45am	11.15am	Morning Tea.
11.15am	12.15pm	Dr A. D. Meister Forestry in Northland.
12.30pm	12.45pm	Closing.
12.45pm	1.45pm	Lunch.
2.00pm	Late	Golf Tournament. The first NZIV National Tournament to be hosted by the Whangarei Golf Club at Mount Denby.

TEAM. OFF HERE

NAME..........._....._.................. _.............. CHRISTIAN NAME .... WIFE's CHRISTIAN NAME

ADDRESS .... _ .. _._ .. _.................................. ._ ...._... PHONE NO...

PREFERRED NAME (For Name Tag): MEMBER ...._..... WIFE _.......

TRAVEL ARRANGEMENTS

I/We will be arriving by (a) Car on /4/86
(b) Air on /4/86

We wish to be met at Whangarei Airport YES/NO Flight No........._.._.............................

Please send Air New Zealand Voucher

ACCOMMODATION

I/We require accommodation for the following nights:

Friday 11 April ❑ Sunday 13 April ❑

Saturday 12 April ❑ Monday 14 April ❑ Tuesday 15 April ❑

Accommodation at: Settlers Motor Inn $50 per night Single; $63 per night Double; $63 per night Twin.
Casa Blanca $50 per night Double Motel 6 $52 Double Plus 2 new motels not priced.

GOLF TOURNAMENT

I/We will/will not play in the First NZIV Golf Tournament on Tuesday at 2 p.m.

PAYMENT REQUIRED

(a) Seminar Registration Fee $100 (includes Seminar kit, papers, morning/afternoon teas, bus trip and luncheon Monday and Tuesday and Cocktails Monday. One day registration fee $70. $..........._ .._..._._ ...

(b) Dine & Dance (includes a range of alcohol and buffet meal: Single $40, Double $70) $

(c) Spouses Programme

Monday - Morning Tea then bus trip to Paihia including 3 hour cruise around the Bay of Islands - $25.00.

Tuesday - Breakfast session Forum North, free morning, golf afternoon. $...._...._

(d) Accommodation Deposit $50 $

REMITTANCE ENCLOSED $

Notes:
1. Accommodation charges correct as at 1/12/85.
2. Organizers reserve the right to amend the programme as they see fit.

SEND TO: NZIV Seminar Secretary
PO Box 1093
wSr A 1Jr-A T?,r..T

Table I

SHEEP FARM INCOMES, FARM LAND SALE PRICES AND

90 FARMGATE TERMS OF EXCHANGE 1970/71 - 1983/84

1200

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.50,r

$00

70 71 72 73 73 7S TO 77 7S 7t so t1 a? as

711 72 73 74 m 70 77 70 73 0$ 81 az ai 64

YEAR

SOURCE: N.Z. Meat & Wool Boards Eccnomic Service, Sheep & Beef Survey and Valuation Department (Grazing & Fattening Farm Land Sale Index).

For expianation of terms used see attached notes.

fairly be applied to the sale price (less buildings) to determine the apportionment between L.E.I. and Productive Improvements."

For example

Capital Value	$490,000
Structural Improvements (buildings)	$100,000
Paddock Value	$390,000
Original carrying capacity	$800
Present carrying capacity	$3,200
ratio 1:4 or 25%	

390,000 X 25% = $97,500 (L.E.I.)

(ii) Equitable Relationship

Associated taverns case 1983.

"In our opinion therefore the first proviso requires the valuer to be sure that his division of values, when they are made with little or no direct sales evidence, shall be very carefully weighed to provide a fair balancing of values between lessor and lessee".

Further committee looked at a floating rental for all lessees indexed to the New Zealand Meat and Wool Board's economic service farm gate terms of exchange index.

The table 1 above shows how farm values (rentals) have increased disproportionately due to unprecendented inflation and some lessees stand to be seriously disadvantaged.

The proposed "terms at exchange index" would be set annually within a maximum and minimum range (2.5%-5.5% of L.E.I. is suggested) and would apply to all Crown renewable lease holders. The lessees would still have their L.E.I's established in accordance with the Land Act and the Economic Service would provide the appropriate rental rate.

The advantage to the lessor is that trial runs show very little difference in gross rental received over a 10 year period. The lessee is able to pay a higher rental when he can afford it again a little relief in hard times.

This report was necessary due to the very high inflation of the late 1970's early 1980's which exposed the short-comings of L.E.I. assessment following the method set out in the Sullivan case. No legislator or tribunal could anticipate the variables apparent now as we would not expect them to in 20-30 years hence the search for a simple all encompassing formula is futile and I feel the associated taverns case highlighted an often ignored feature the equitable relationship between lessor/lessee. We as valuers must maintain our independence in doing so the profession will progress only if we are prepared to critically analyse and formulate, discuss and pursue necessary advances.

This Committee has produced this paper which I have briefly sketched and copies should be available from Mr K. Allen, N.Z.I.V., Wellington. Further discussion would be welcomed on this very complex and sensitive area.

Athletic Park Case-Won But Lost

by Graham A. Halstead, F.N.Z.I.V.

Graham Halstead is a Fellow of the New Zealand Institute of Valuers, and holds both rural and urban qualifications.

Graham established his own valuation practice in Wellington in 1972 after 11 years employed with the Government Valuation Department. He has had a long involvement in Education matters and is the convener of a project arranging for the writing and publication of a second volume of Urban Valuation in New Zealand.

Why did the Maori owners win their case but end up having to subsidise the Wellington Rugby Union's rental of Athletic Park? The answer is all to do with designations.

The Court's decision is reported in "The New Zealand Valuer," December, 1984, pages 708-712: The Wellington Rugby Football Union Inc. v. The Valuer-General and The Maori Trustee (Wellington Registry Administrative Division of the High Court M No. 128/83 - 25 May, 1984).

The Court decided that as the Residential `C' land had been given two designations in the Wellington City Council's 1967 proposed District Scheme - private recreation area (stadium) and public reserve - the unimproved value should be reduced to $230,500. This figure represents a discount of six percent from the Residential C zoned value of $245,000 agreed to between the valuers.

The Maori Reserved Land Act 1955 specifies that for 21 year perpetually renewable leases, the rent for urban land shall be fixed on the basis of four percent of a special government valuation of the unimproved value. As a result of the Court's decision, the Maori owners will suffer a total loss of rental of $12,180 over the 21 year term.

Anyone familiar with the Athletic Park decision and the earlier High Court of Appeal decisions, would no doubt be appalled by:

* The fourteen year delay in deciding the unimproved value for assessing rent (revaluation comes up again in 1991);

  The Maori owners suffering a loss in rent simply through designations of their land, something that Parliament would not have intended or envisaged when the Maori Reserved Land Act 1955 was introduced;

  The enormous cost borne by the three parties over three Court hearings and five different valuers, to say nothing of the taxpayer footing the bill for the judicial system.

In respect of the latest decision, there are several matters that give rise to some concern:

* Vague evidence on the crucial town planning situation as at the relevant date of 1 August,. 1970.
* The decision is devoid of any discussion on the Town and Country Planning Act 1953 as at 1970, whereas there is mention in several places of the quite irrelevant Town and Country Planning Act 1977.

  The Court's acceptance of the Public Reserve designation.

  The decision concedes that both the private and public designations would have had no practical effect but nevertheless decided that there would have been only a 90 percent chance of the designations being lifted.

  The five valuers involved had unimproved values ranging from $114,500 to $237,750.
* No comparable sales evidence of designated lands.
* Slavish adoption of Addington Raceway approach.

TOWN PLANNING LEGISLATION IN 1970

Before examining the various issues in more detail, it is appropriate to set out the legislation as at 1 August, 1970 relating to designations.

Section 21 of the Town and Country Planning Act 1953 sets out the contents to be provided in District Schemes, including matters referred to in the Second Schedule:

`3. Designation of reserves and proposed reserves for national, civic, cultural and community purposes, for afforestation and water catchment purposes, for recreation grounds, ornamental gardens, parks and children's playgrounds and for open spaces.

`3A. The designation of land for public works or for proposed public works differentiating between government and local works.

`4. The designation of land or buildings used for purposes of value to the community but not intended to be owned by the Crown, Council, or any local authority.'

Under the 1960 Town and Country Planning Regulations, the Second Schedule, page 41, it is made clear that proposed reserves should have the abbreviation `Prop' added after a reserve notation on the planning map.

DESIGNATED LANDS MUST BE ZONED

Section 33A (introduced by 1966 Amendment) sets out the effect of designating land. This section made it mandatory for designated lands to be zoned. The zoning was not to have any effect in respect of construction, execution or operation of the public work designated.

It should be noted that although zoning was not to affect public works, zoning would have been applicable to private designations of land not intended to be publicly owned.

The 1966 Amendment requiring designated lands to be zoned gave rise to the term "underlying zoning'. In one respect this term was misleading because it gave the impression that the zoning would be activated only when the designation had been removed. Section 33A did not specify or intend such a procedure.

Zoning, in fact, gave certainty as to what uses the land could be put. The effect of zoning land was that designations for existing or proposed uses became additional to the uses permitted under the zoning. A council could, for example, therefor use its own land for both the designated use and any of the zoned uses without restriction. However, designated land (for a public work) in private ownership required that a land-owner had to secure the Council's (or Minister or local authority having financial responsibility for the public work) consent before carrying out a zoned use such as building or subdivision.

RESTRICTIONS ON USE OF DESIGNATED LAND

As the Wellington City Council's District Scheme was a Proposed District Scheme, Section 38 provided for restrictions on uses likely to affect public works. Section 38 allowed a Council to delay for up to two years or approve subject to conditions the erection of buildings, subdivisions, etc., if it was a `detrimental work'.

A `detrimental work' was defined (among others) in Section 38 (d) as `any subdivision of land, structure, excavation or other work, whether public or private, that would or might adversely affect any existing or proposed public work, or the construction, execution, establishment, constitution or undertaking thereof.'

It now becomes clear that any land with a private designation was not affected because Section 38(d) applied only to public works. In other words, private designations as they applied in 1970 did not restrict using the land for any of the zoned uses. If anything, private designations in many cases sanctioned uses not otherwise permitted in a particular zone (e.g. churches), thus giving them the same status as predominant uses.

In the case of a designated existing or proposed public work, Section 38 did not apply where the Council (or other local authority or the Crown) already owned the land for its own public work. In other words, the Council could have used its land for any of the zoned uses even though it was designated for a public work.

However, there were problems for a private landowner intending to, say, build on or subdivide land designated for a public work.

The situation in 1970 was that a Council could allow building or subdivision providing that it (or other local authority or the Minister) agreed (see Section 38 (13)). Failing consent the owner could have appealed under Section 38(8) to the Town and Country Planning Appeal Board.

APPEAL TO TOWN AND COUNTRY PLANNING APPEAL BOARD

If the Board allowed the consent to building or subdivision, that would have been the end of the matter. On the other hand, if the Board confirmed the Council's refusal to allow building or subdivision, it could have required (if the owner wished) the Council to acquire (Section 47, subsection 3 (a) and subsection 4) the land within three months under the then Public Works Act 1928. As is common knowledge, compensation is based on full value disregarding the designation or proposed public work.

An interesting point is that the Act (and also the 1981 Act) does not instruct valuers to disregard designations, but of course it would be inequitable to make any discount for designations.

ALTERNATIVE APPLICATION REQUIRING LAND TO BE TAKEN

In addition to the provisions of Section 38 and Section 47 (3)(a) the alternative could have been to make application to the Board requiring the land to be taken if (Section 47 (3)(b)) 'The scheme will prevent future use of the land or building for every purpose . . . for which the owner or occupier, but for the scheme, could lawfully have used it without detracting from the amenities of the neighbourhood:'

An almost exact parallel to the Athletic Park land was decided in Nola v. Masterton Borough (1969) 3 NZTCPA 187. In this case the Board ordered the land to be taken despite there being no imminent change of use. The land was designated for proposed public recreation, with an underlying zoning of Residential. It could not be turned to residential use without substantial

ifllling. The designation removed any incentive for the applicant to do that, with the consequence that the land would remain virtually useless until required and developed by the local authority.

SELLING DESIGNATED LAND

What about the landowner with a vacant block of land designated for a public work who simply wanted to sell it in 1970? The land could have been practically unsaleable on the open market, particularly if a public work was imminent. On the other hand, the owner could have merely submitted or applied for a new building or subdivision, and therefore activated Section 38, with the ultimate objective of forcing the Council (or the acquiring authority) to acquire the land at full market value under the Public Works Act 1928.

In practice, however, negotiations for purchase at full market value by the Council, local authority or the Minister would in many cases have commenced. It would be fair to say that some landowners have done very well financially through having their land designated and taken for a public work, while some landowners have experienced frustration and uncertainty.

WELLINGTON CITY COUNCIL PROPOSED DISTRICT SCHEME

Returning to the town planning situation relating to Athletic Park, there is no doubt that the land in 1970 was designated in the Wellington City Council's proposed District Scheme as private recreation area, and apparently having a notation `stadium'. There is doubt, however, whether the land also had a public reserve designation.

If the Council had decided by resolution to make Athletic Park a public reserve, it had to accept financial responsibility for such as public work before it could require provision to be made in the Proposed District Scheme. The next step was for the Council to publicly notify a variation to its proposed district scheme in terms of Section 22A. It would appear that the Council did not carry out such a formal variation in respect of any proposed public reserve designation.

OBJECTION BY COUNCIL TO ITS DISTRICT SCHEME

The town planning evidence conveyed in the Court's decision has it that the Council objected to its own proposed District Scheme by requiring that the land containing Athletic Park be zoned Residential C (to correct the zoning omission as required by Section 33A) and also an underlying public reserve designation. The Act, of course, had no provision authorising such underlying designations. Having two designations was ambiguous or, at best, `five bob each way'.

The point was made in a recent Planning Tribunal decision, Miramar Golf Club v. Wellhngton City Council, that `it is, however, legally impossible to have an airport designation superimposed upon an identification pursuant to the provisions of Section 73 of the Act (1977)) with both again superimposed upon an "underlying zoning".' Section 73 replaced the provision for private designations under the 1953 Act.

The Rugby Union's town planning witness stated that the Council formally adopted the objection to its own scheme on 9 October, 1968. However, the Maori Trustee called a Wellington City Council town planning officer, who could not produce any documentary evidence confirming the Council's specific decision imposing the public reserve designation, nor could he produce the actual objection that requested the Council to impose a public reserve designation.

It is quite incomprehensible that a Council could not locate copies of specific Council resolutions and decisions relating to town planning objections. As is common knowledge, a Council is required to have a public hearing of objections to a District Scheme, giving due notice to objectors and cross-objects. It would appear that the Court could not ascertain whether or not the Council actually had a hearing of the objections relating to Athletic Park.

OBJECTION BY MAORI TRUSTEE

The Maori Trustee had also objected to the District Scheme and required that the land making up Athletic Park be zoned Residential C. Had there been a hearing, surely the Maori Trustee would have been notified of it, the Council decision, and given the right to appeal.

The Wellington City Council town planning officer also failed, it seems, to locate any Council decision confirming the Residential C zoning. The Court's decision commented that:

> `pribably the decision of an underlying zoning would have been available in August, 1970.'

Irrespective of whether or not the Council had resolved by August, 1970 to zone the land to Residential C, it would have been an unchallenged assumption that-the zoning would have been Residential C.

VALIDITY OF PUBLIC RESERVE DESIGNATION

Returning again to the matter of public reserve designation, it is doubtful whether the Council followed the correct procedure for a proposed public reserve. Instead, the Council apparently announced the public reserve by means of the objection process.

Irrespective of whether or not the public reserve designation was validly notified or had been the subject of a hearing, there are two important matters that the Council overlooked. One is that it was required to accept financial responsibility for the acquisition of the land for public reserve. Yet the Wellington City Council town planning officer stated on oath that there was `no intention of Council or other public ownership.'

The second matter is the notation `Public Reserve'. The Reserves and Domains Act 1953 sets out the meaning of public reserves. The land could not be a public reserve because it was privately owned. If the notation had read `Proposed Public Reserve' then it would have made some sense.

The private designation `Private Recreation Area' was of no practical effect, because it was not a public work. The Court confirmed this in its decision.

In respect of the public reserve designation, I believe it was totally invalid for the following reasons.

No satisfactory evidence as at August, 1970 that the Council had resolved to make Athletic Park a public reserve.

No satisfactory evidence that it was notified in the proper *way* and had been considered by the town planning committee.

5^ f It could not have been a public reserve in terms of the Reserves and Domains Act 1953 because it was privately owned.

Any designation should have been "Proposed Public Reserve.'

Council did not intend Council or other public ownership.

There was no provision in the Act for any underlying designation.

The Court observed (without deciding on the validity of the public reserve designation) that `a Council, even in 1970, could not simply impose a designation of public reserve on private land without readying itself for consequences which means it must have been prepared some time to acquire the land and pay full compensation with an underlying zoning of Residential C.'

Further on, the Court stated:

> `We are satisfied that if the Council had been asked in 1970 to lift the underlying designation the request would have been accompanied by a full investigation revealing the foregoing and in all probability it would have lifted the public designation there and then.'

At this point in the decision, a reader would probably have come to the conclusion that the Court was about to disregard the public designation and so fix the unimproved value on the basis of its full Residential C value. To understand why the Court back-tracked, we must now examine the evidence of the valuers.

EVIDENCE OF VALUERS

The two Rugby Union valuers and the Valuer-General approached the valuation by establishing both a full Residential C value and a value of the land as designated, and then estimating the chance of the designations being removed, to be expressed as a percentage of the difference in the base figures.

The approach appears to be arbitrary, without regard to market sales of designated land, and slavishly follows the approach adopted in the outdated Addington Raceway case (The N.Z. Valuer", March, 1969). The Addington case was concerned with private designated land, not zoned, and there being at that time (1965) no requirement that the land had to be zoned. In the case of Athletic Park, it was undisputed that the land was already zoned Residential C.

The Maori Trustee's two joint valuers (from the same valuation practice) appeared to take a realistic market-related approach by first of all deciding that there would have been a one hundred percent chance of removing the designations, but then effectively discounting (by adopting an equivalent eighty percent change) the full valuation to allow for the cost of uplifting the designations.

As the five valuers had agreed on the base valuations of $245,000 (Residential C) and 5100,000 (designations only), the only issue before the Court was really to decide the percentage of the difference in value, i.e. $145,000, to be added to the base figure of $100,000. More specifically, the Court had to decide the percentage change of having the designations removed from the land. (The Court described this as `the reasonably narrow point the Court is to decide.')

The five valuers had each determined a percentage chance, ranging from 10 percent to 95 percent. On the basis of the evidence from valuers, the Court was obviously constrained to ifx a percentage no higher than 95 percent, and no lower than 10 percent. Further, the Court appeared to be further constrained by the Maori Trustee's valuers' estimated chance of 80 percent, as against the Valuer-General's estimate of 95 percent.

ASSUMPTIONS FOR DETERMINING UNIMPROVED VALUE

A better understanding of the ultimate valuation to be fixed can be gained by looking at what had to be valued. For determining the unimproved value, the 3.7306 hectares of land had to be assumed to be in its original state, as unfilled, scrubby gully. The lease to the Rugby Union and occupation as a rugby ground had to be put completely out of mind. The zoning was Residential C, with two designations - one as private recreation area `Stadium', and the other public reserve.

That is the sum, now we have to answer the question, what percentage chance would there have been of lifting the designations?

First of all, the designations are ridiculous because the land in its unimproved state was not a private recreation ground or stadium, and could not have been without substantial expenditure. The Rugby Union town planning witness gave evidence that `The City Council imposed the designations because the land was able to be used in that way ... '

At this point we should remember the Council's authority for designation of private reserves. Clause 4 of the Second Schedule states `the designation of land or buildings used for purposes of value to the community ... ' In the unimproved state, the land would not and could not have been used for stadium purposes.

The reality is that the Council would not have placed private and public designations on the vacant, unfilled, scrubby gully. The artificial reality (if it can be described as such) is that the land, as at August, 1970, had two designations, but a request to the Council to uplift them would in all probability have been granted forthwith.

Any other proposition would seem unrealistic and untenable.

The conclusion must be that designations on the vacant, unfilled scrubby gully would have been of no practical effect as at August, 1970. The unimproved value should have been simply the value as Residential C land, i.e. $245,000.

WHY NOT 100 PERCENT CHANCE?

Why did the Court decide on 90 percent, and not a 100 percent chance of uplifting the designations? Basically, the Court appears to have been hamstrung by the approach agreed to by the valuers, and also the different percentage chances of 80 and 95 percent between the Maori Trustee's valuers and the Valuer-General.

The Court decision will be of little value for future valuations, because the present-day legislation not only prevents private designations, but, in the case of proposed public reserves, designations cannot be placed on the land unless the owner agrees to sell it for such purposes.

At the beginning of this review, the question was asked why did the Maori owners end up having to subsidise the Wellington Rugby Union's rental on Athletic Park? The Court cannot be blamed because it was constrained by, I believe, the approach agreed by the valuers. The Court was, in effect, merely asked to decide the percentage chance of having the two designations removed from the land, and had to take into account the evidence of the valuers.

At least the Maori owners can take some comfort that the Court did not accept the Rugby Union's argument, that there was only a 10 percent chance of the designations being lifted. Had the Court agreed with the 10 percent chance, the unimproved value would have been reduced by 53.3 percent, and would have resulted in a total rent loss of $109,620 over the 21 year term of the lease.

Parliament would not have intended, nor envisaged, that rentals fixed under the Maori Reserved Land Act 1955 would be reduced as a result of lands being designated for specific purposes. The matter is far too serious to be left to valuers and the Courts. Parliament should, therefore, correct the injustice.

The Office Sector in Auckland's City Centre

by Simon Markham, Department of Planning and Community Development, Auckland City Council

Simon Markham is employed by the Auckland City Council Department of Planning and Community Development as a senior planner with the Data and Policy Team. He is a member of the New Zealand Planning Institute.

Although his text relates to the Auckland scene it may well prove interesting to other valuers in larger city centres throughout New Zealand.

1. Introduction

This paper is the text of an address to the N.Z.I.V. Auckland Branch, 7 August, 1985. It discusses recent work by the Council's Data and Policy Team on the future of the Auckland city centre, and the office sector in particular. The views expressed are the author's and do not represent those of the Auckland City Council. The scope of the paper is as follows:

(i) the demand for floorspace use, as indicated by past employment trends and future employment levels;

(ii) floorspace supply, both past, and that anticipated over the next few years;

(iii) an attempt to reconcile supply and demand with reference to changes in the ratio of floorspace per worker, and implications for the vacancy rate;

(iv) general issues affecting the office sector.

The analytical viewpoint adopted in the paper is a public sector one, concerned not to outguess the individual moves of firms this year or next, but rather to consider the logical outcome, the aggregate effect, of their decision making, and therefore what the underlying longer term trends are, and where they are leading the city centre.

2. Floorspace Demand

This work on the city centre began in 1982/83 when the Data and Policy Team was asked to report on the centre's "economic future". The core of that exercise was to forecast changes in employment of the various activities in the city centre - employment being the one key indicator of economic activity for which relatively good data was available.

We divided the types of activities into 36 sectors each of which is. broadly homogenous, for example, office activities such as legal services and accountancy. We compiled historic data on this basis and performed a regression analysis of each sector. This statistical exercise was then used as the basis for a forecast. That is, we applied our knowledge and that of consultants to the factors affecting the sector in question to produce an employment forecast, guided by the results of the regression analysis.

The total number of jobs in the city centre between 1973 and 1983 fell by about 8,000 from 66,000 to around 58,000. We expect this fall to continue at much the same rate over the 10 years to 1993, but have for planning purposes adopted a more optimistic view. This suggests total city centre employment at around 54,000 in the early 1990s.

As far as office based employment goes this cannot be traced with great precision as the data we have is based on divisions of economic activity rather than land use categories. The following figures do not include those working in offices attached to shops and warehouses and the like, but then for present purposes it is employment based in office buildings which is of interest.

We estimate about 22,000 such jobs were in the city centre in 1973, about a third of the total at that time. The data suggests a net gain of about 1,500 office jobs by 1978 but in the five years to 1983 the equivalent of these were apparently lost again. Despite this we are optimistic about the office sector. Business and financial services are specialising in the city centre, and as a subgrouping of the office sector it grew at a reasonable rate over the 1970s. We anticipate under our planning forecast a net gain of nearly 3,000 office jobs over the 10 years to 1993.

I'm not sure whether the record of little or no employment growth is of surprise or not. In one sense it doesn's seem amiss because it is a feature of many city centres. For example, total office employment in both Sydney and London was static over the 1970s - both centres which experienced building booms and slumps in the early 1970s, and London again in the early 1980s.

In another sense it is of particular concern to the City Council. Its Central Area Plan was published in 1974. The development controls to which it gave rise and which are embodied in the District Scheme, are based on the presumption of total employment growing by about 40% over the 1971-1996 period, with at least 22,000 more jobs over those 25 years being office based. Indeed, office employment growth was anticipated to more than double because then as now decline in manufacturing and warehousing was forecast.

As far as Auckland city centre goes there appears to us three main reasons why total office employment has not grown at anything like that previously expected.

(i) Labour shedding by city centre firms in the face of long term recession during the 1970s. This applies not only to the private sector, but also to the public sector through employment policies designed to at least reduce the creation of new jobs.

(ii) The impact of technological change on office sector labour requirements. We have no hard data on this, but it does appear that office technology has restricted the rate of increase in office clerical jobs. The impact on employment may not be significant were the economy expanding at the time. A much higher proportion of office jobs are and will be of a professional and technical, rather than clerical, nature as a result of this.

(iii) Probably most importantly, has been office job suburbanisation, be it through relocation, or establishment of the job outside of the city centre in the first place. We estimate about a 30% growth in office jobs, or 12,500 more in the "rest of the urban area" over the 1973-1983 period. This long standing and deep-seated suburbanisation trend in the private sector is reinforced by public sector decentralisation policy. We have emergent sub-regional "Government" centres at Henderson, Takapuna and Manukau, which for example, will be boosted by the administrative manpower requirements of GST and the like.

The suburbs and the sub-regional centres have had not only job growth but office building to match, of which I'm sure you'll be aware. If we look at the value of office building permit issues over the 10 years ended March, 1984, the urban area outside of the city centre took 52% of the total. This is new development whereas in the city centre a significant proportion of investment has been in replacement and upgrading of existing stock.

3. Floorspace Supply

As with employment data we spent a lot of time constructing the historical picture, so that we have a record, with room for improvement, of annually completed floorspace from 1960 to 1984. We've validated this against office floorspace totals from land use surveys of the city centre conducted in 1964 and 1978.

In December last year we determined, on the basis of what was under construction at the time, and anticipated floorspace for which planning consent had been applied for, what the supply profile over the 1985-87 period looked like. You'll note that we've assumed everything that developers have applied for they get. To that extent we're dealing with a logical floorspace outcome rather than a forecast of completions.

We've also looked at what's been replaced and estimated a long term ratio of demolished to replacement floorspace of around 25%. Where we don't have actual net floorspace data to hand for the new buildings, we've assumed net at 80% of gross for office floors, having already excluded car parking and plant levels and the like.

Recently we've updated the floorspace data to take in notifications to Council over the last six months. These include projects for which a "confidential and without prejudice" preliminary planning check has been sought projects scheduled if they proceed at all - for completion in 1988 and letting through into 1989.

At December last year we estimated about

600,000 sq. metres of office floorspace in the city centre an increase of 116,000 sq. metres since the middle of 1978.

The logical outcome of that under construction and recently notified intentions for completions through to 1988 is for about 760,000 sq. metres at that time - a net increase of 52% over a 10 year period.

We've roughly estimated the total investment in city centre office buildings involved in this increase at about $950 million in 1984 prices we can well and truly call the present period the "billion dollar building boom" since there's probably $300 million or so involved in the non-office development.

The data for completions over the next few years compiled last December suggested the 1987-88 period would be a significant one, with about 75,000 sq. metres available for ifrst occupancy at that time. Projects notified to us over the last six months would if they go ahead, push this up to around 100,000 sq. metres, so that this period looks to be a key one for the letting market.

4. Floorspace Worker Ratios and the Vacancy Rate

To summarise thus far. We've had little overall growth in office employment and relative to this we're forecasting a reasonable increase over the next few years. Certainly the city centre has to perform markedly better relative to the rest of the urban area in this respect than it did in the 1970s.

We are also experiencing a major increase in office floorspace. The linkage between this and employment is through the floorspace-worker ratio. From our point of view there is scant hard data on what is happening to the average amount of floorspace per worker across the office sector as a whole.

The survey data that we do have for Auckland suggests almost no change between 1964 and 1978. An average of 19.5 sq. metres per worker was recorded in the land use survey in 1978. For various groupings within the office sector the range was 13.1-28.6 sq. metres - the range is wide and the relative rates of growth among these groupings will influence the overall rate of change in the ratio.

Data from Wellington indicates much the same - little overall change in the ratio over a long period. For the post-1980s buildings however, there is some indication of an increase by up to a fifth. The possible causes of this increase are:

(i) New technology which creates its own space requirements while, following introduction, stabilising employment levels.

(ii) For all grades of office worker the higher labour productivity arising from new technology contributing to a general increase in accommodation and space standards.

(iii) Because new technology has had most impact on the more routine clerical jobs, then an increasing proportion of total office employment is in the higher professional and administrative grades who demand relatively higher space standards.

(iv) The provision for firm expansion in the amount of office space leased is promoting an increase in accommodation requirements.

As regards this last point I would make the distinction between leased space and occupied space. It seems to us that many firms have leased floors in, or indeed whole, new buildings on the presumption of expansion within that context. If we went out and surveyed the average amount of floorspace in some recently completed but fully let buildings tomorrow we would, I suspect, find a fairly low employment density, but one which is transitional and is likely to rise. This process is in part based on the optimism surrounding the many legal and accountancy firm mergers which have "fuelled the boom".

I would also make the point that while employment densities in the new space may be considerably lower than from whence the occupants came it will take some time for the increase in floorspace per worker to rise right across the office sector.

For the purposes of our work we have adopted alternative assumptions about the ratio ranging from no change through to a 20% gain by 1993 over 1978 levels - from 19.5 sq. m. to 23.4 sq. m.

Bearing in mind the assumption about floorspace supply and demand involved in the exercise, as at June 1985 the analysis implied a vacancy rate in 1988, half way through the employment forecast period, of between 3101o and 42% - the lower value allowing for a rise in the floorspace per worker ratio. At any one time a certain amount of vacant floorspace is required to keep the rental market in balance. Opinions differ, but this probably around 10%, so the analysis suggests that the oversupply of office floorspace in Auckland city centre could range between a fifth and a third of the total.

However, we are now talking about completions in the second half of the employment forecast period and so we need to also allow for job growth beyond 1987. I outline a "vacancy scenario" for early in the next decade. It assumes an end to the boom. This allows for office employment growth. over the 1988-93 period to be accommodated in completions through to the late 1980s, under optimistic assumptions about floorspace worker ratios. This implies total occupied lfoorspace of 555,000 sq. metres, total vacant lfoorspace of 205,000 sq. metres, total vacant lfoorspace of 205-000 sq. metres, a vacancy rate of 27%, and oversupply at around 20%. About 50% of the space would be less than nine years old.

This does not suggest that buildings under construction will stand empty for long periods on completion, nor does it mean that further new office buildings will not be planned, built

and profitably leased. But it does suggest that as firms trade up their standard of accommodation there will be a growing pool of vacant older floorspace. A year ago we would have said this is the pre-1960s and 1960s space we are talking about. However, the boom has persisted and I cannot escape the conclusion that severe letting problems could arise in some 1970s buildings if all this planned floorspace comes about. I would also suggest that a key period will be 1987-88 I referred earlier to the large amount of completions at that time - so that the possibility of long leasing periods for some new buildings arises.

It also appears to us that as we are getting ever more prestigious and well appointed lfoorspace, we are getting a "boom on top of the boom". It seems credible to suggest that some completions in the second half of the 1980s will be tenanted by some of those who took up new space in the first half, and who are shifting after one or two 3-yearly lease periods.

We know very little about the frequency of office moves and so how fast this process might occur and attendant changes such as in the floorspace worker ratio happen. It does appear that such shifts in search of the prestige space are relatively price insensitive.

5. Discussion

If you accept substantial office oversupply looming at the total level then I would pose the following questions:

First, can the city centre office market maintain its rental levels with high vacancy rates concentrated at its lower end?

Second, what effect is the upward thrust in values and rents the boom is bringing out, having on tenants. at this end of the market and who can't afford to trade up - will they stay in the city centre or be driven out?

Third, and acknowledging that we can all think of firms which have moved into and out of the city centre, what is the real significance of this to the letting market? Informed opinion we have canvassed suggests that only 10% of space taken up annually is by firms new to the city centre. I suspect a similar amount is relinquished by those leaving.

At this point I would raise one or two general issues. In some of the discussions I have had about the city centre and office development I detect an air of expectant inevitability about the boom-slump cycle - it is certainly a common occurrence - London, so I read, is preparing to go into its fourth post war building boom with individual office developments supplying in excess of 100,000 sq. metres of floorspace.

In this work on Auckland's office sector our implicit concern is with the adverse impacts of marked fluctuations in property investment, leading to periods of over and under supply of office floorspace. These include:

inefficient resource allocation;

poor utilisation of existing resources;

the inflationary effects of periods of rapid increase in property values and rents;

a volatile labour market in the construction industry;

the scope for developers and funding institutions to experience severe financial difficulties;

* incomplete redevelopment programmes;and,

* user uncertainty in an eratic letting market.

We feel that by providing as much information as we have, and by indicating the logical outcome of development trends, we may contribute to evening out the flow of development with city centre growth occurring on a much more sustainable basis.

Finally, I would raise two key issues as I see them.

First is the question of investment as opposed to user demand for office development. Here I am thinking of the rise of the publicity listed property company over the last few years. Combined with the much more entrepreneurial bent to the traditional construction companies than in the past, the appearance of legal firms and others as one-off development entrepreneurs which are also taking a risk on sub-leasing, and the deregulation of the finance sector, there is a major new dynamic to downtown redevelopment which planners as one group have yet to, come to terms with.

Second, and in view of the very large amount of early-mid 1980s vintage general purpose office space which the city centre will soon possess; how suitable is this for the fully automated office user of the near future?

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Computer Wise

ELECTRONIC SPREAD SHEETS FOR VALUERS

by R. V. Hargreaves

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Bob has been a regular contributor to "The Valuer" on this subject over the past two years, keeping valuers informed on the type of hardware available and suitable applications. This latest article illustrates the practical application of spread sheet programmes.

When you purchase a microcomputer for business use it is very likely that an electronic spread sheet programme will either be included as part of the software that comes `bundled' with the computer or be one of the first programmes that you buy. The first electronic spread sheet programme marketed was called `VisiCalc' and this has turned out to be one of the most successful computer programmes ever developed for business use. Brannstrom (1) reports that `VisiCalc' has sold over 250,000 copies and set the standard for a number of competitive programmes such as `SuperCalc', `MBA', `MultiPlan', `1-2-3', 'Symphony' and `Jazz'.

The popularity of electronic spread sheet programmes is mainly due to the increased flexibility that they provide over menu driven programmes. Such programmes can be purchased off the shelf and customised to fit the requirements of the user. In addition spread sheet users do not need to learn a computer programming language such as `Basic' or `Pascal' and can generally progress more rapidly than under other alternatives.

HOW DOES IT WORK?

The idea behind electronic spread sheets is to replicate a standard manual worksheet consisting of a large sheet of paper divided into rows and columns in the form of a grid. The size of the electronic spread sheet depends on the type of a grid. The size of the electronic spread sheet depends on the type of programme being used but would typically be at least 60 columns wide and 250 lines long. Instead of using a pencil and paper the user types the information into any cell in the grid. The programme requires the user to define the relationship between cells by entering an arithmetical formula. Most spread sheet programmes contain all the standard mathematical functions including net present value. The information contained in one cell can rapidly be copied into other cells and the spread sheet can be easily expanded or contracted.

The main advantage of using an electronic spread sheet is that the computational power of the computer can rapidly answer `what if' questions by recalculating the results after changing the initial assumptions. For example, when using the hypothetical subdivision approach a valuer may wish to test the effect of altering key assumptions such as section prices, yield, discount rates, development costs, and holding period. Changing, say, the section prices will also necessitate altering all the other directly related cost items including real estate and legal costs, reserve contribution, and rates. If the client asks a lot of `what if" questions then it may take hours to rework the data using normal methods. Once the initial electronic spread sheet has been set up recalculations can be done in seconds. Spread sheets are also an excellent tool for doing cash flow analysis. Rather than using traditional rules of thumb for calculating interest a valuer could estimate the actual overdraft requirements on a subdivision and how much interest will be payable under a given set of assumptions.

It is the author's experience that correctly entering all the relevant figures and formulae required to set up a work sheet or template can be quite time consuming for novice computer users. While it is true that some people with previous computer experience and the right aptitude can become productive in say four hours, it might take the rest of us more like 40-60 hours before becoming comfortable with electronic spread sheet programmes. This means that it is probably

unwise for most valuers to attempt to develop their own templates for anything other than frequently performed tasks such as sales analysis, cash flow projections, and insurance certificates.

Fortunately there is another option available and this is to purchase commercially developed templates to go with the electronic spread sheet programme. Carlisle (2) describes a set of real estate investment templates resigned for use with the `Visicalc' programme. Dumm (3) warns that it is important to understand the assumptions used in the templates that are purchased off the shelf. Off the shelf templates can be modified to meet the requirements of the user and are usually designed in a professional way so that the print out is able to be incorporated directly into a valuation report. Since users can make much faster progress using pre-written templates it is likely most valuers will wish to pursue this option.

Electronic spread programmes are increasingly being used by the current generation of valuation students at Massey. Farm management lecturers, J. Lockhart and D. Gray (pers, comm) have developed stock reconciliation, 12 month cash forecast budgets, and feed budgets for sheep and beef, and dairy farms using the `Multiplan' programme. R. Reichert and N. Park (pers. comm) have also used `Multiplan' to develop cash flow projections incorporating discounted cash flows for income producing urban properties.

INTEGRATED PROGRAMMES

There is currently a movement towards 'integrated' programmes where the one programme incorporates a number of important functions such as electronic spread sheets, graphics, word processing, and file management. Examples of this type of approach are used in `Appleworks', `MBA' and `Symphony'. The integrated approach has been made possible by improvements in programming methods, and faster computers with increased memory. Part of the reason for the success of spread sheet programmes is that on the whole they are reasonably `user friendly' and getting better. For example, I have found that `Multiplan' is much easier for me to use than the original `Visicalc' largely because of the clear instruction manual and the prompt line on the screen that helps the user with the various commands. One of the difficulties with integrated programmes is that as the level of complexity increases users will need to spend more time learning to use the programme.

APPLICATIONS

Spread sheet programmes have a wide range of uses in valuation practice. McMullin (4) describes how he has made use of `Visicalc' in his U.S. valuation practice. Possible applications on the local scene might be as follows.

(i) Market Approach:

Spread sheets can be used for adjusting sales data using the dollar adjustment or percentage adjustment as described in Chapter 14 of Jefferies text (5). An example of a simple spread sheet using the percentage adjustment method and developed by the author is shown in Table 1. (At this stage the `Valpak' sales retrieval programme is not compatible with electronic spread sheets and thus can't be interfaced.)

Table 1: Sales Adjustment:

	Sale 1	Sale 2	Sale 3	Sale 4	Sale 5
SALE PRICE	100000	120000	90000	125000	115000
ADJUSTMENT %					
Date Sale _...	10	0	10	5	10
Locality	-5	5	10	-5	0
House Size	10	-5	5	-5	-3
House Age	-3	-5	-10	8	0
Section Size	8	5	20	-5	-1
TOTAL % ADJUST	20	0	35	-2	6
ADJUST. SALE PRICE	120000	120000	121500	122500	121900
AVERAGE ADJ. PRICE	121180				

(ii) Cost Approach:

Spread sheets have direct application to replacement cost insurance estimates. The standard replacement cost form can be replicated on an electronic spread sheet and the details of the subject property then stored in electronic form. The relationships between various building components would be expressed in terms of multiples which would determine the basic cost relationships. The replacement cost certificate could be rapidly updated from year to year by use of the current modal rate. Some local valuers are already making use of this approach. (Some of the more sophisticated word processing programmes can also be used for replacement cost certificates provided the programme has adequate computational facilities. This approach has been adopted by several valuation ifrms).

(iii) Income Approach:

Value is often defined as the present worth of the future benefits for a property. The future benefits for income properties are expressed in terms of cash flow. Spread sheets are an ideal way for valuers to get more involved in the sophisticated cash flow analysis increasingly being demanded by investor clients. An example of a 10 year cash lfow projection for a block of five investment lfats is shown in Table 2. In this example (which is based on a project completed by second year students) income and expenditure has been increased each year by 10 per cent. Should the valuer wish to use different rates of increase, decrease, or to hold costs constant, then it is simply a matter of entering the appropriate formula into the cell relating to that particular budget item.

Table 2: Investment Flats, Ten Year Cash Flow:

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Rents	28000	30800	33880	37268	40995	45094	49604	54564	60020	66023
Less Vacancies	840	924	1016	1118	1230	1353	1488	1637	1801	1981
EFFECTIVE GROSS	27160	29876	32864	36150	39765	43741	48116	52927	58220	64042
Management	1400	1540	1694	1863	2050	2255	2480	2728	3001	3301
Rates	1618	1780	1958	2154	2369	2606	.2866	3153	3468	3815
Repairs	2000	2200	2420	2662	2928	3221	3543	3897	4287	4716
Insurance	400	440	462	485	509	535	562	590	619	650
TOTAL EXPENSES	5418	5960	6534	7164	7856	8616	9451	10368	11376	12482
NET INCOME BEFORE TAX AND DEBT SERVICE	21742	23916	26330	28986	31909	35125	38664	42559	46844	51560

(iv) Feasibility Studies:

Spread sheets also have direct application to feasibility studies where the residual approach for valuation is being used. Examples of this are the hypothetical subdivision and property residual approaches. In the subdivision statement shown in Table 3 the user assigns values to the left hand column of ifgures and the values in the right hand column are automatically calculated.

SUMMARY AND CONCLUSIONS

Electronic spread sheets are a tool that allows valuers to become more productive in their day to day work. Spread sheets have the attraction that they can be tailored for individual requirements without the need for the user to learn a computer programming language. When using spread sheets valuers should avoid `reinventing the wheel' and utilise existing templates as much as possible as this approach will result in consider-

able time savings during the development phase.

Spread sheets are likely to be particularly useful when doing cash flow projections for rural and urban income properties.

Table 3: Subdivision Statement:

		$
Gross Realisation		300000
Number of Sections	12	
Average Sale Price	$25000	
Area of Land (ha)	1.09	
Less R.E. Commission	9100	
Less Legal Exp. Sale	1920	11020
Net Realisation		288980
Less Profit and Risk (%)	0.25	57796
OUTLAY		231184
EXPENSES		
Realisation Period (years)	2	
Development Period (years)	1	
Interest Rate (%)	0.14	32365
Rates		4000
Roading Costs/ ($m)	700	
Length Roading (m)	110	
Total Roading Costs		77000
Amount Earthworks (m3)	1000	
Cost Earthworks ($/m3)	3	
Total Cost Earthworks		3000
Engineering Fee (%)	0.07	5600
Advertising (per section)	150	1800
Survey (per section)	200	2400
Electricity (per section)	800	9600
Gas (per section)	100	1200
Telephone (per section)	200	2400
Reserve Contribution (%)	0.075	20625
TOTAL EXPENSES		159990
Net Value		71194
Less Legal Costs Purchase		1500
BLOCK VALUE		$69694

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PORTFOLIO MANAGEMENT

by R. Kerr, F.A.I.V., F.S.L.E.

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The following article is reprinted by permission from the proceedings of the Eighth Triennial congress of the Australian Institute of Valuers, Melbourne 14-19th April, 1985.

Portfolio management is likely to become of increasing importance in the New Zealand property valuing and management context within the next few years. The theme of the Congress was "The Valuer - A new role emerging?"

The Valuer's Role In Portfolio Management

My recent experience relates to property portfolios managed by an unlisted property trust and not to mixed funds which also invest in mortgages, equities and other investments. My paper will therefore be confined to real estate with an emphasis on procedures adopted by an unlisted property trust.

Units in unlisted trusts are sold through licenced investment advisers and we have found that investors required a positive return over inflation and income tax. Their investment should provide income while preserving the purchasing power of funds.

In order to determine the positive return an investor might expect, we will first consider the inflation rate in Australia over the past ten years (all Groups Index -weighted average of six state capital cities year ending June quarter).

1975	16.9%	1980	10.7'%
1976	12.2%	1981	8.8%
1977	13.5-7,	1982	10.7%
1978	7.8'%	1983	11.2%
1979	8.9%	1984	3.8%

To complete this exercise, income will be affected by current taxation levels:

Residents:

Taxable Income $	Tax on Taxable Income $	% on Excess i.e. Marginal Rate
4,595	Nil	26.67
12,500	2,108.26	30.00
19,500	4,208.26	46.00
28,000	8,118.26	47.33
35,000	11,431.36	55.33
35,788	11,867.36	60.00

It is generally accepted that we should aim for a positive rate of growth of 5-6 points above inflation.

The recent recession highlights the increasing difficulties faced by individual investors when investing in real estate and has caused an awareness of the extensive property skills that *are re*quired by successful investors. Some of the problems investors experience are:

1. Rising interest rates and a resultant shortfall in cash flow when interest payments on borrowing exceed net rental income.
2. A reduction in property values, particularly residential, resulting in the necessity to restructure gearing.
3. The inability of tenants to pay higher rentals in difficult economic times.
4. The difficulties of selling real estate during a recession, to meet financial commitments.

These problems, along with quite large superannuation payments due partly to early retirement policies and retrenchments, have caused an increasing number of investors to consider managed investments including property related portfolios such as property trusts.

There is a view that Australia's recession ended in the June quarter of 1983. The economic recovery in the September and December quarters of 1983 was reflected in real gross domestic product, a reduction in the unemployment rate and a fall in the inflation rate.

The economic recovery was influenced by four factors:

- an improved situation in the world economy
- the wages pause
- recovery from drought in the farm sector
- expansionary Government economic policies.

History shows that in a capitalistic economy recession is followed by boom which is followed by recession. Therefore, past events generally will be experienced again to some degree.

The cycle is shown in the well known and perhaps overexposed "economic clock" which was originally prepared by London's "Evening Standard" from a study of trade cycles over a period of 150 years.

While various parties may interpret economic conditions differently from time to time, the economic cycle does exist and the pattern should continue:

ra

The cycles highlight the view that property investments (and therefore property trusts) should always be considered over a long term i.e. a minimum investment period of 3-5 years but preferably 7-10 years. The longer periods enable recessions to be weathered and for investors to benefit from rising values as a result of the cyclical recovery in prices.

What is Portfolio Management?

The definition of "portfolio management" was stated in the text book "The Valuation *of Property* Investments" to be:

"A continuous process of reviewing the portfolio to determine the areas where action can be taken with a view to improving the return from an investment.

A restless activity involving:

(a) analysing each investment property and comparing its actual performance against the expectations on acquisition and its comparison with other forms of investment in the portfolio;

(b) seeking ways and means of improving the performance of a particular investment;

My property portfolio manager emphasises that he cannot be expected to achieve our required results if we select poor investments from the outset or if we over optimistically assess a property's potential. Therefore, a fund manager's philosophy and purchasing strategies are just as essential as the operational role in portfolio management to achieve successful long term investments.

I have therefore considered this subject under various headings followed by comments on each topic.

1. Philosophy:

Objectives

Projections

Revaluation Procedures.

The portfolio manager must firstly be *aware* of the purpose of the particular fund with which he is involved and its short and long term objectives.

For instance, there are three types of unlisted property trusts:

(i) Where the fund manager buys established and securely leased investment property, or

(ii) The fund manager is a developer and develops property specifically for that fund.

In this instance a property could be sold or transferred to a fund at either cost or value; factors which have a significant influence on overall performance.

(iii) The fund manager seeks investment opportunities and buys existing properties for refurbishment or extensions, or develops new properties, funding projects until they are leased. All entrepreneurial or development profit in this situation accrues to the fund.

Entrepreneurial activity will depend to a great extent on the type of trust or fund and the capital and/or income growth required. These factors also have a bearing on the level of gearing that is likely to be involved.

The Manager should develop a performance model to meet capital growth and income objectives against which the potential of prospective property purchasers will be measured. It is likely that the details of such a model would not be disclosed to valuers as a manager would not wish to publicise performance strategies to competitors.

However, such a model would establish short and long term aims as a guide to every aspect affecting a funds performance such as liquidity requirements, borrowings, rental and capital growth rates, re-gearing and future purchases. Historical trends would influence these decisions but as we all know, economic conditions fluctuate widely over the long term and the probability of change,-. will also form part of the assessment process.

A policy on revaluations would also be determined.

e.g.

- Valuations to be carried out frequently, perhaps as net income rises, or
- Regular valuations to be undertaken at pre-determined intervals, from say each three months to perhaps each three years.

2. Property Investment Strategies:

Geographic Spread

The manager must decide whether property investment will be confined to a particular state or spread throughout Australia.

In fact, a further decision will be made as to whether properties will be purchased in capital cities, provincial cities or country centres.

Location:

Once a policy relating to geographic spread is determined the manager must decide in general terms, whether investments will be purchased in primary, secondary or fringe locations.

As a general rule most major funds will not invest in residential real estate due, in part, to the political problems which may emerge e.g. rent control, onerous tenancy laws, tenant action groups etc.

Broad decisions may be made along the lines that industrial properties will not be bought in manufacturing areas as our lack of competitiveness against that of overseas manufacturers may create an oversupply of factories, resulting in a fall in rentals, increased vacancies and consequently a reduction in values.

Property Types/Mix:

Funds usually seek a mix of commercial, industrial and retail property and as trends change over time a flexible policy must be formulated.

I believe a suitable mix might be:

Offices	60%-70%
Industrial	15%-20%
Retail	15%-20%

Final decisions will depend on cash flow, the availability of properties and adjustments to the economy which may alter demand for properties in a particular segment.

Size/Value of Properties:

Funds operate to different criteria. For instance, some buy smaller properties say to a maximum of $1.5m, as they believe these are readily saleable, while others buy only large properties.

The next step might be in the range of $1.5m upwards while a few larger funds start at $5m. The philosophy here is the large properties are relatively efficient to manage and may be of a better overall standard including location, presentation and quality of design and construction.

Such decisions are again influenced by the flow of funds to invest, apart from investment strategies.

Tenancies:

A single tenancy subject to a long term lease with regular rent reviews suits the strategy of some managers while others prefer multi-tenancy situations.

These factors are influenced to some extent by the regularity of rent reviews and their effect on revaluations, and whether a property has to be or may need to be sold at a certain date. There is little use in buying a sound income stream if an obsolescent building or poorly located property will ultimately be sold with vacant possession.

3. Feasibility Studies:

Studies will be undertaken on various bases depending on the aims of a particular fund, the term of years involved and whether the fund is growth or income orientated e.g.

(1) A typical growth trust has a life of 10-12 years and will return investors an annual income of 2-3%, while capital growth projections usually range from 12-16% p.a. compound.

(2) An income trust subject to a similar life span, should initially return investors 9-10% p.a. while growth projections might be in the range of 8.5% p.a.
These growth factors relate to the increase in property trust unit prices as distinct from rises in property values.

The studies should initially be prepared on a market value basis, so that managers "keep their feet on the ground," while further reports will relate to any special value to the particular fund e.g. interest on development projects, or loss of rental during leasing up may not be capitalised.

I believe it is necessary to research the past history of existing properties and to plot the following projections relating to both existing buildings and development projects:

- Potential short and long term rental growth, the extent of likely capital growth and the fund's revaluation pattern.
- an assessment as to whether outgoing recoveries will be maintained.
- current and projected rental levels and the leasing up factor in respect to development projects.

  Obviously, all the usual research must also be carried out for developments such as planning the building, selecting materials, estimating costs, assessing marketability and most importantly preparing contract documentation in detail.
- further studies will be undertaken as to highest and best use, and programmes for extensions, refurbishment or even whole or partial demolition which may be contemplated now or in the future.

Shopping centres require a special mention due to their overall complexities and indeed warrant a separate paper on the subject.

In the case of a property trust with a fixed termination date, the manager must also consider the sales appeal of the property at the end of the trust's life, on both vacant and tenanted bases.

Initial studies must be carried out with great care to ensure that a fund should not be forced to contemplate the sale of an unsatisfactory property, for the following reasons:

(1) Property trusts, for instance, are not taxed on capital growth if properties are retained for 10 years or more. The sale of an unsuitable property investment may incur tax on any profit.

(2) A property which performs below a fund's established investment model reduces the overall performance of that fund. The sale of such a property, even if that is the only alternative available to the fund manager, may not overcome the loss investors have suffered.

4. Purchasing Procedures:

Perhaps this area is of more interest to real estate agents than valuers but the main points are itemised briefly:

(a) Existing Buildings: It is rare for several suitable alternative investments to be available at any one time and the Australian market is relatively small with sound properties being tightly held.

This sometimes results in managers being faced with acquisitions that do not conform with established investment models, or remaining liquid until the right property becomes available.

Entrepreneurial managers may see potential in properties that have been on the market for long periods and by development or refurbishment plans they become active rather than passive investment managers.

(b) Property Development

There have been few changes over the years in the methods of development available to fund managers.

Joint Ventures where development profit (or profit and risk) is shared by the manager and developer on an agreed basis, depending on risks taken by each party.

Design and Construct where the developer acts as builder, architect and project manager selling a complete package at a predetermined price.

Developer's Role. In this case, the fund acts as the developer, incurring all risks and

obtaining whatever profit arises from the project.

5. Property Management:

The fund manager, in initially establishing philosophy, will have decided whether properties will be managed internally or contracted out to managing agents.

It is my view that the latter course of action will produce the best results as agents are actively involved in the marketplace and have the benefit of the research and experience of their various sales and professional departments.

All aspects of the performance of each building will be monitored by the manager so he is aware of the relationship of that performance with the organisation's investment model and of other properties both within and outside the portfolio.

Property management is a critical aspect of portfolio management and in many ways as important to a fund's performance as initial purchasing procedures. As a valuer researches every aspect of management for the preparation of a valuation, I will deal with those methods a little later on.

6. The Valuation of Real Estate for a Portfolio:

Funds provide a significant source of income for valuers while conscientious valuers certainly earn their fees and their input is of great assistance to fund managers, particularly those who are inexperienced or largely unskilled in property matters.

A well prepared and thoroughly documented valuation report by a valuer independent of the fund manager reassures investors and others associated with the industry, (such as licensed investment advisers) of that manager's competence in the initial purchase. They also know that independent revaluations are a true reflection of an investment's value and thus a manager's performance can be measured and monitored.

Points of comments are:

(a) Instructions

A valuer's instructions should be in writing and include the basis on which the valuation is to be carried out e.g. Open or fair market value.

The valuer should note these instructions in the valuation report and include a definition of his understanding of the basis of valuation - for instance, "fair market value".

(b)... Bases of Valuation

The methods of valuation for investment properties usually are capitalisation of net income, analyses of comparable sales and perhaps a check method by the "internal rate of return" approach. The workings should be included in valuation reports in detail.

Comparable Sales:

While the comparable sales method seems straightforward enough, it is far more complex than many valuers appear to acknowledge. As fund managers we are also able to monitor movements in the market, in the same way as a valuer with adequate research facilities and the timing of purchases is a significant reason for one fund outperforming another.

However, it is noticeable that some valuers prefer not to "read" the market past the date of the last recorded sale, which may have occurred some time ago and with prices from a series of sales indicating an upward trend. Generally speaking, valuers appear to make every attempt not to exceed purchase price notwithstanding available evidence to the contrary.

I realise, of course, that the abovementioned comment might be expected from a portfolio manager.

A valuer generally is able to analyse sales of city office buildings and industrial properties in detail as most purchasers or agents will provide full details of transactions to professional valuers.

However, it is a major task to analyse all leases, current rentals as compared with market, building outgoings etc. in order to, arrive at a conclusion. At least two and possibly three yields will then be determined e.g. passing yield, equated yield and yield on market rentals.

It is noticeable and surprising that valuers generally round off yields to the nearest .25 of 1%, notwithstanding the result of sales analyses or the fact that Australia converted to metric measurement many years ago. For instance, some valuers will argue quite determinedly that valuations simply cannot be written at capitalisation rates of say 6.1% or 6.4'% but must be 6.0% 6.25%, 6.5%, 6.75% or 7%.

However, to illustrate this point let me quote the yields from six comparable sales as shown in a recent valuation report:

Initial Yield: 6.45% 7.8% 5.43% 5.6% 6.0% 5.85%.

Equated Yield: 7.3% 8.2% 6.25% 7.3% 6.85% 7.1%.

Along with yields the research will almost certainly refer to "price per square metre of lettable area" for the subject property and how it compares with other sales. This is a quick guide to value.

In making these assessments valuers must consider both the physical details of each transaction as well as abovementioned financial matters. The requirements of fire protection authorities, the cost of asbestos removal, refurbishment, repairs to mechanical equipment, and any other work that might be necessary to maintain rental growth must all be estimated and allowed for in the assessment of both comparable sales and the property being valued.

Generally speaking shopping centres require a great deal of research and are, in my opinion, far more difficult to value due to a multiplicity of factors that affect performance. The following points have emerged from recent submissions to our fund and show the need for great care when analysing sales:

1. The major retailers within a centre, such as a discount department store and food outlet, may occupy the major floor area while contributing relatively less rental than specialty shops.

As rental from major tenants (or their turnover provisions) may be quite low it could become necessary for specialty shops to bear an increasing rental burden to maintain growth. Perhaps growth in capital value will not be maintained under these conditions?

2. Specialty shop rentals are often linked to increases in the consumer price index which is now artifically low due to the removal of the Medicare levy from calculations.

   Future increases could well be restricted by the application of such review clauses with an adverse affect on rental and subsequent capital growth.

3. A few leases contain restrictive review clauses such as the limitation of increases to the consumer price index or some pre-determined ifgure, whichever is lower.
4. We sometimes find that the recovery of outgoings is limited thereby decreasing an owner's potential net income in the future.
5. Turnover of major tenants in some cases, has not risen for several years and consequently nor has the value of certain shopping centres in the medium price range. What is future growth likely to be?
6. Valuers must assess the trading area and consider whether existing or potential opposition will reduce or increase the turnover growth pattern of existing shopping centres.

Discounted Cash Flow Analyses Internal' Rates of Return:

Many people consider this to be an unnecessary approach due to the problems in projecting gross rentals, outgoings and subsequently net income, along with an end value over say, a 10, year period.

While, to some extent, this view may be correct, the preparation of the required input will focus a valuer's mind on whether a property is likely to perform in future and the reasons for its likely success or failure.

7. Reports

Reports must be comprehensive and apart from definitions, all working calculations and the usual inclusions, should include:

- Replacement costs for insurance purposes.
- Copy of typical lease.
- An indication that areas have been measured on-site, or that check measurements have been taken.
- An assessment as to whether fire protection requirements meet local ordinances and the likely cost of rectification.
- Comments on the suitability of a property for the particular fund.
- Reference to rental and capital growth potential.
- Comments on the standard of repair and maintenance items with particular reference to such specialised factors as asbestos removal.
- A rental schedule wth an analysis of existing rentals and outgoing recoveries compared with market levels.
- Evidence of comparable sales.

Certain trustees now require a statement as to whether property being valued is a suitable acquisition for the subject fund/trust. Under these conditions a simple statement of value does not suffice and the valuer will be required to consider whether a property's potential is likely to meet the future requirements of that particular fund.

In conclusion I would like to report a statement made by President Franklin D. Roosevelt during the worst depression suffered in the United States. "Real estate cannot be lost or stolen, it cannot be carried *away.* Managed with reasonable care, it is about the safest investment in the world."

With the assistance available from valuers today, I hope that we, as portfolio managers, will select properties which will continue to be safe and profitable investments for our clients.

Developing the Discount Rate

by Lincoln W. North, A.A.C.I.

This paper forms part of the seminar sponso red by the New Zealand Institute of Valuers and conducted by Lincoln W. North, A.A.C.I.

The seminar topic was "A critical analysis of the income approach to valuing revenue producing real estate." Lincoln North has a valuation practice in Toronto, Canada and has an international reputation as an Appraiser, Real Estate consultant, author and speaker.

EDITOR'S NOTE: An article by Lincoln North on "The Discounted Cash Flow Concept" was published in the June, 1985 issue of "The Valuer", Vol. 26, No, 2.

H. DEVELOPING THE DISCOUNT RATE

1. This subject has been explored to the point where an article has been published, representing the results of extensive interviews and research of this topic across North America. This article is included as resource material.
2. One element not discussed in this article is the frequency of discounting future receivables, annually in arrears vs. monthly in advance.

THE DISCOUNTED CASH FLOW METHOD

- DEVELOPING THE DISCOUNT RATE -

FOREWORD

The contents of this article represent the distillation of inquiries conducted throughout Canada and the United States, plus in-house research of this subject by the author over the past ifve years. This topic is a very dynamic issue. Thus the contents of this article will invariably be subject to review from time to time. Nevertheless, the basic rudiments associated with the selection and development of the discount rate should endure well into the future.

The discount rate is but one component of the Discounted Cash Flow Method of valuation. In this regard, it is difficult at times to comprehend the significance of only a portion of a given method of evaluating real estate, in isolation of discussing the entire spectrum. Nonetheless, the issues involved with the DCF procedure of valuation are significant enough to warrant special consideration of the discount rate alone.

Introduction

The most significant task associated with the evaluation of all income producing real estate is the selection or development of the appropriate rate or factor needed to convert the earnings of an investment property into an estimate of capital value.

The underlying methodology of selecting or formulating the discount rate for use in the Discounted Cash Flow Method of valuation is based on the same economic principles and financial considerations which bear on the construction of any,price-eamings ratio. Yet by reason of the fact that the Discounted Cash Flow Method is a process of finding the present worth of forecasted future receivables, including the reversionary value of the asset, the development of the appropriate discount rate (in contrast to a capitalization rate) takes on a much broader perspective.

The purpose of this examination is to explore the common methodology used by the investment community in selecting or developing the discount rate. If any anxiety exists with regard to the Discounted Cash Flow Method of valuation, it is attributable mainly to the difficulties involved in estimating and supporting the discount rate. Hopefully the findings of this investigation and diagnosis will shed some light on the matter and instill a measure of confidence in the common procedures of rate selection.

Regardless of the procedures which may be found most acceptable in theory and in practice, it must always be remembered that the development of the discount rate cannot be made in isolation of the attitudes taken in the process of forecasting future receivables. An inextricable relationship will always exist between estimated income and operating expense inflators, projected renewal rentals, allowances for releasing costs and vacancy levels, the methodology employed in establishing the reversionary value of the asset and the rate of return used to discount the resultant receivables into an expression of present value. It is the balance and relationship among all these factors which is necessary to produce a plausible end product.

Since real estate is but one object for the placement of investment capital, the formation of the discount rate must also be undertaken with due regard given to the rate structure of the entire capital market at the date of valuation. Discount rates associated with investment real estate will always have this interlocking relationship with expected yields prevailing on alternative investment opportunities.

The Discount Rate

The arithmetic relationship between present values and future values is the compound interest rate or the compound discount rate, depending on which point of commencement is used as a base. In the process of estimating present values, future receivables are reduced to present dollars through

application of appropriate discount factors. The rate employed in the process of finding the present value of future receivables is known as the discount rate.

When the discount rate is of such a magnitude that the resultant sum of the discounted amounts of all future receivables (of net earnings plus the net reversionary value of the asset) equals the initial cost of the investment, the discount rate is commonly referred to as the Internal Rate of Return. Stated conversely, the Internal Rate of Return may be defined as that discount rate (rate of return or yield rate) which will equate all future receivables to the original cost of the investment.

It might be argued that while an Internal Rate of Return is a discount rate, a discount rate is not necessarily an Internal Rate of Return - unless the present value of all future receivables equals the going-in cost of the asset. Nevertheless, the valuation process is a procedure of estimating the market value (or most probable selling price) of a property and consequently the discount rate which will produce this end result can be referred to as an Internal Rate of Return. Whichever interpretation is favoured, the term "discount rate" shall be used as the focal point of the ensuing discussion.

Developing The Discount Rate

The development or selection of the discount rate to be employed in finding the present worth or present value of a forecasted series of future receivables is usually accomplished through consideration of three alternative methods. Each method or procedure has it own particular merits and the investment community will tend to rely on the methodology which produces the most confident findings in respect to the issues at hand. It should also be mentioned that the three methods considered herein are not mutually exclusive.

For the purpose of this discussion, it will be assumed that the discount rate to be found is a pretax rate of return to be applied to a given forecast of net pretax cash flow earnings plus the pretax reversionary value of the asset. After-tax or post-tax evaluation would be accomplished by reducing the projected net cash receivables of income and reversionary profits to after-tax quantities and adjusting the pretax discount rate to account for the effective tax rate of the investor. Whichever approach is deemed relevant in the evaluation of the asset, the point of commencement for finding the market value of an investment property usually rests in developing and employing the appropriate pretax discount rate.

The ensuing discussion also relates to pre-debt discount rates, on the assumption that the property in question is to be evaluated on a free and clear basis. When appraising real estate which is subject to mortgage indebtedness, it is not uncommon to reduce net operating income and reversionary profits to after-debt quantities and, if necessary, adjust the discount rate to reflect changes in relative risk in the process of finding the value of the equity portion of the investment. Alternatively, the discount rate may be held constant and the property valued under each scenario, with the resulting difference indicating the leverage effect of the financing.

RATE SELECTION BY ABSTRACTION

The abstraction process is a procedure frequently used by real estate analysts who have access to all pertinent information pertaining to relatively similar investment properties which have recently traded in the marketplace. Essentially, this method of rate selection involves the arithmetic derivation of the discount rate which equates the present value of the forecasted receivables to the selling price of the property under analysis. The discount rate found by this. procedure is synonemous with the Internal Rate of Return produced by the particular transaction.

Through an examination and analysis of several recent sales of similar investment properties, one could obtain an indication of the prevailing market rates of return for such properties. By exercising reasoned judgment, the analyst would then compare the relative investment characteristics of the subject property to those of the various sales: making whatever adjustments are necessary to arrive at the discount rate deemed appropriate for the property being appraised. Procedurally, this is the same process a real estate analyst would employ in the direct comparison method of determining any current-earnings ratio (e.g., overall capitalization rates, equity dividend rates or even gross income multipliers).

As the abstraction process applies to the derivation of discount rates, vis-a-vis traditional current-earnings ratios, the analytical task is exceptionally more sensitive - and the results less objective. Current-earnings ratios are factual representations of the relationship between a known quantity of present earnings and the trading price of an asset at the date of sale. In contrast, discount rates abstracted from recent sales are based on the analyst's estimate of future receivables over a selected time horizon and an estimate of the reversionary value of the property at the termination date of the forecast period. Consequently, unless the analyst has employed the same forecasts as did the purchaser of the asset, the findings of the exercise would not necessarily reflect the criterion upon which the sale was actually consummated.

Granted, if the appraiser used the same criteria in the valuation process as was employed in the analysis of the sales, the chances of error in estimating value would be reduced considerably. Nevertheless, for a discount rate, found by abstraction, to be an objective and significant finding, the analyst must consult with the buyer in particular (or preferably both parties) to ascertain and understand the criteria and procedures which led to the formation of the eventual sale price and the discount rate evolving therefrom. Without having intimate knowledge of the factors and circumstances which influenced the decision-making process, the analyst could easily go astray through the infusion of highly subjective assumptions pertaining to the amount and timing of future receivables. Further, an unconfirmed discount rate, like an unconfirmed sales price, tends to become a meaningless bit of empirical market

data if the motivating circumstances which led to its derivation are unknown. As mentioned previously, an inextricable relationship exists between discount rates, projected future earnings and the estimated net proceeds associated with the reversion. Therefore, the entire spectrum of events which triggered the sale must be carefully understood before intelligent use can be made of an abstracted discount rate.

RATE SELECTION BY MARKET INQUIRY

The most common source of information pertaining to discount rates is the capital market itself, acknowledging the premise that all rates of return on investment capital are a function of the money market at a given moment in time. The investment community is continually monitoring the capital market, evaluating alternative opportunities for the placement of funds and corresponding rates of return. Real estate clearly falls within the arena of these prospective opportunities and consequently, the selection of an appropriate discount rate cannot be undertaken without reference to current investment attitudes and preferences. For this reason, the majority of persons involved in the appraisal or evaluation of a given realty project prefer to develop discount rates through interviews with investors active in the particular segment of the market to which the subject property would have appeal.

The process of rate selection through market inquiry is not a scientific or arithmetic procedure. Rather, it essentially involves in-depth interviews with persons in the investment community who would normally be in the market for the type of property under consideration. Frequently, it is necessary to specifically identify the property in question or, if the nature of the assignment is confidential, a model of a similar property. The interviewer should also be prepared to provide a comprehensive interpretation of the relative investment characteristics of the asset under investigation in order that the person interviewed can gain a proper perspective of the matter at hand. Persons interviewed will especially want to know about the subject property's prospects for growth in earnings and capital appreciation, for discount rates cannot be quoted or formulated in isolation of circumstances which govern the production of anticipated future receivables.

Another reason motivating the need to communicate with persons and companies constituting the investment community is to determine the attitudes which potential buyers attribute to general inflationary predictions, estimated market rental rates, income inflators which apply to the type of property being analyzed and other criteria related to the forecasting of future earnings and to the reversion. To illustrate this point, one investor might comment to the effect that a 16 percent discount rate would be appropriate in conjunction with a forecasted annual rate of growth in rental income of 6 percent. Another would-be purchaser might quote a basic discount rate of 14 to 15 percent, on the basis that the rental inflator is not expected to exceed 4 percent per annum. Further inquiries might lead to current market preferences of establishing the length of the forecast period, the methodology of determining the reversionary or terminal value of the asset and other criteria which constitutes the linkage between all factors coming to bear on the selection and development of an appropriate discount rate.

In summary, a diligent investigation through market inquiries is considered the best route to follow in the formulation of at least the basic discount rate to be applied to the forecasted earnings of the property being appraised. It is an active and timely means of rate selection, in contrast to the passive act of abstracting discount rates from transactions which have occured at some previous date. Even if an analyst prefers to employ the abstraction process or rate selection by summation, inquiries must be placed with persons in the capital market to (at least) determine the pulse of the market at the date of valuation and to provide other critical input needed to fine-tune data and findings emanating from other routes of investigation.

RATE SELECTION BY SUMMATION

The third method of developing or selecting the discount rate to be applied in the evaluation of a particular property may be referred to as the Summation Method. In this method or procedure, a given base rate or benchmark is established as a point of commencement: usually through market inquiries. Adjustments are then made to the base rate, to develop the appropriate overall discount rate applicable to the forecasted receivables of the property being evaluated.

The Summation Method normally relies on a Basic Discount Rate as the key reference point, or point of beginning, in the process of selecting the overall discount rate applicable to the property under investigation. At any given moment in time, a prevailing rate of return will exist within the investment community which might be described as the Basic Discount Rate for want of a better term. The Basic Discount Rate is essentially the threshold rate or hurdle rate which, in magnitude, is regarded as the minimum required rate of return needed to induce investment capital into a given market. As this discussion pertains to real estate, the Basic Discount Rate may be defined as the minimum acceptable rate of return which will induce investment capital into the acquisition of the most prime type of revenue producing real property.

The Basic Discount Rate is also a risk-adjusted rate of return, to the extent that the prevailing rate for real estate at a given moment in time would be formulated by investors in consideration of rates of return available on alternative investment opportunities: adjusted for relative liquidity, comparative costs of management-of-capital, relative demand for the product, basic inflationary considerations, comparative tax consequences and other cardinal factors which go into the initial adjustment process.

The Basic Discount Rate is not normally a rate which is adjusted for pecularities which will directly influence the projected cash flow receivables to be generated by the investment under investigation. Forecasted circumstances which are

expected to alter the nature and extent of cash flow earnings above or below a given set of parameters are usually accounted for by adjusting the projected earnings rather than the Basic Discount Rate. Consequently, it may be said that intrinsic factors pertaining to the property itself are normally accounted for in risk-adjusting the cash flows, rather than through modifications to the Basic Discount Rate.

Nevertheless, the Basic Discount Rate (once established) might command certain general adjustments in the process of establishing the overall discount rate to be applied to the earnings of the subject property, if the property being appraised is other than the most prime type of revenue producing real estate. These general adjustments are set forth and discussed under the heading of secondary adjustments, which follows.

Using the Basic Discount Rate as the base rate avoids the necessity of attempting to determine whether it evolved from yields, stock yields or other benchmark rates associated with alternative capital market investments. In short, the Basic Discount Rate is simply the going rate of return at a specific moment in time; representing the threshold rate at which investment capital will be drawn into the market for the most prime real estate, under a given set of anticipated inflationary conditions.

Alternatively, the final overall discount rate selected for a given property may be derived by the full summation process, using yields on stocks, bonds or other alternative investments as the base rate (in contrast to using the Basic Discount Rate as the starting point.)

One benchmark, or base rate, used by institutional investors in particular, is the current rate structure of long-term government bonds, provincial utility bonds or high-grade corporate bonds; these fixed-income securities as a group constituting one of the more common alternative investment opportunities. The range in the band of yield rates, or discount rates, pertaining to this particular segment of the capital market is fairly narrow; seldom exceeding a spread of from one to two percent.

Another benchmark occasionally used by the institutional investment community is the prevailing range in yields available in the mortgage market: mortgages being another alternative means of institutional involvement in the real estate market. Mortgage rates are a more sensitive reference point, however, since quoted interest rates may not represent a proper perspective of actual market activity. For instance, if quoted rates are exceptionally high at a particular moment in time, this segment of the money market may all but cease to function until such time as the offered rates find the borrower's level of acceptance and a rational buy-sell market is re-established. Of course, there are occasionally borrowers at any given rate, based on the compulsion of necessity.

Another point deserving emphasis is that if the rate structure of the mortgage market is used as a reference point in setting the overall discount rate for use in the DCF Method, care should be taken to determine the impact that participation, if in vogue at the date of appraisal, will have on the quoted contract mortgage interest rate (or coupon rate). The full expected yield on current mortgage money could be significantly higher than the corresponding coupon rate in a participating market.

Other reference points in the money market used by the investors in formulating discount rates for realty investments are the prevailing yields on guaranteed investment contracts or certificates and, on occasion, expected yields in the stock market. Equity investors, in particular, would tend to give greater weight to average portfolio returns, yields on internally generated funds and to common stock performance trends. Some equity investors prefer to use yields on unseasoned equity issues as a benchmark, viewing real estate as being more comparable to the expected performance of a stock which is being publicly traded for the first time (with respect to market exposure and the availability of pertinent data).

In determining which benchmark is most appropriate, consideration not only has to be given to the type of investor who would normally be attracted to the type of property being evaluated, but also to the nature of the entire money market at the date of appraisal. Investor attitudes and preferences are subject to continual change depending on the relative ranking or desirability of alternative investment opportunities and their corresponding yields. This circumstance relates to all investors, large and small.

When the Summation Method is deemed appropriate as an alternative means of formulating the appropriate discount rate for a particular property, the following outline highlights the primary and secondary considerations which go into the formative process. As mentioned earlier in this discussion, the Basis Discount Rate is normally the key reference point or point of commencement in the summation process: leaving only a series of secondary adjustments to be accounted for (assuming the forecasted future receivables have not been so adjusted, or subject to such adjustments). However, if the overall discount rate is built up from alternative money market benchmarks, the full summation process would have to be employed.

Primary Considerations and Adjustments

The point of commencement in the following methodology of developing the overall discount rate by the full Summation Method is the establishment of the current yield on long-term bonds; being the most common reference point. Traditionally, long-term federal government bonds have been used as the base rate simply because these published rates are universally known throughout the investment community. Alternatively, the nature of the market or the preferences of a particular group of investors might command use of one of the other monetary benchmarks; in which event, however, the magnitude of the adjustments required to establish the Basic Discount Rate would normally be lesser in amount.

Of the three primary elements which constitute the difference between non-realty yields and the Basic Discount Rate for prime real estate, or

DEVELOPING THE BASIC DISCOUNT RATE
AND THE OVERALL DISCOUNT RATE BY THE SUMMATION METHOD.

Current prevailing yields on long-term government bonds, high-grade utility bonds or high quality corporate bonds. (The most frequently used base rate).

-Plus an adjustment for relative liquidity (or illiquidity)

-Plus an adjustment for management of capital

-Plus or minus an adjustment for the relative appeal or desirability of prime real estate as an alternative investment opportunity at the date of valuation

Basic Discount Rate applicable to the earnings generated by the most prime realty investment %o

Plus further adjustments, if necessary, to reflect the comparative investment features of the subject property vis-a-vis the most prime real estate investment

-The particular type of property being evaluated (if of higher risk, or lower appeal than the most prime property)

-The regional location of the property being evaluated and the specific location of the property within the region

-The overall physical and functional features of the property under study

-The relative type and quality of tenancy, strength of the lease structure, efficiency of operation and intensity of management

-The general influence which existing financing may have on the relative desirability or marketability of the property

-The relative attitudes taken in the forecasting process with regard to setting current market rents, rental inflators, expense inflators, the reversionary value of the asset and supplementary capital expenditures

-Any other factors which may have a bearing on the relative appeal and demand for the specific property in question

Overall Discount Rate for the Subject Property

the elements which must be accounted for in the process of building up the Basic Discount Rate, if necessary, one pertains to the subject of relative liquidity, or illiquidity. Real estate neither transacts through a common exchange nor may it be acquired or disposed of in short order. Even the most desirable realty investment requires sufficient time and adequate exposure to the market to effect a sale. A reasonable period of time on the market is not only needed to obtain a full and fair price for prime assets, but is equally necessary when conditions command involuntary disposal. For these reasons, the market tends to augment bond yields by an amount in the order of one-half to one percent to compensate for the relative extent of inherent illiquidity associated with even the most prime realty asset. Such an adjustment is called for regardless of the direct costs which may be involved in structuring a transaction.

A second feature which is an integral part of the Basic Discount Rate or which constitutes the need for an adjustment to bond yields in the process of developing the Basic Discount Rate by summation, is compensation for management of capital. In contrast to the day-to-day management of the property itself, asset ownership commands continual monitoring to maintain its value in the wake of constantly changing market conditions. Real estate is not a completely passive investment: albeit that some types of realty investments require less attention and involvement on the part of the landlord or asset administrator than others. As such, the investment community is inclined to further adjust bond yields by an amount of up to one percent to compensate for the relative extent of management of capital. Alternatively, an asset administration fee may be attributed to the expense structure of the property being evaluated, in lieu of adjusting a given base rate in the process of formulating the Basic Discount Rate.

While the combined influence of relative liquidity and management of capital usually results in an augmentation to long-term bond yields of up to one and one-half to two percent when formulating the Basic Discount Rate for the most prime realty investment, this composite adjustment would tend to be less if mortgage yields or other monetary yields are used as the point of commencement in building up the Basic Discount Rate. These latter benchmarks may already contain compensatory adjustments, vis-a-vis bond yields, for the elements of relative liquidity and management of capital.

A third element which bears heavily on the magnitude of the Basic Discount Rate, and which commands serious attention in the adjustment

process if the Basic Discount Rate is developed from a given base rate of yields on capital market investments, is the relative appeal (or comparative risk) of real estate as an investment at the date of analysis. In a market characterized by strong demand, the acquisition of prime real estate may rank near the top of an investor's priorities and preferences. If the Basis Discount Rate is formulated through the summation process under such conditions, only a nominal adjustment (if any) to a given base rate might be called for to reflect relative appeal. In fact, the appropriate adjustment could even be a negative quantity (seldom exceeding one percent, however). At other times, when investor preferences shift to alternative vehicles and the demand for real estate subsides the Basic Discount Rate will tend to rise and an upward adjustment of from one to two percent might be warranted to yield rates prevailing in the capital market.

When accounting for relative appeal, it should be remembered that one of the prime attributes of owning real estate, vis-a-vis paper investments, is the feature of long-term security of capital and reliability of income production. Further, real estate has traditionally been more responsive to inflationary trends than the majority of alternative investment opportunities. If a sharp increase in the rate of inflation is anticipated by investors, the relative appeal of real estate will usually increase unless counter-influenced by an extraordinary reversal in the basic structure of the economy. By itself, however, an expected surge in the general rate of inflation will result in higher realty price levels and a corresponding reduction in yield. Stated conversely, Basic Discount Rates will tend to fall when investors foresee a major increase in what might be defined as the average annual long-term rate of inflation.

In summary, the combined influence of the aforementioned primary considerations has traditionally tended to create a spread between long-term government bond yields and the Basic Discount Rate for prime real estate investments of from two percent on the low side, to four percent on the high side. Of all bond yields, long-term federal government bonds are the most common benchmark used by the investment community in the development of the discount rate by the summation method; if for no other reason than the fact that yields on these bonds are the most widely known and readily obtainable indices of capital market behaviour. If stock market yields or rates of return on other equity investments are used as a base rate in the summation process of developing the Basic Discount Rate, the composite adjustment for the aforementioned primary considerations will tend to be considerably lower. In fact, the Basic Discount Rate could tend to approximate the yield on alternative equity investments if the comparative investment characteristics were much the same as those offered by prime real estate. Nevertheless, the Basic Discount Rate pertaining to a real estate investment will usually tend to be higher than expected yields on common stocks bearing similar risk, simply to account for the element of relative liquidity.

Secondary Considerations and Adjustments

Following the development of the Basic Discount Rate by summation, further adjustments may be required to reflect the relative general characteristics of the specific property in question, vis-a-vis the most prime asset to which the Basic Discount Rate applies. If the Basic Discount Rate is determined directly from market inquiries and is used as the base rate, only the following factors would have to be considered in the process of determining the overall discount rate.

Occasionally, investors prefer to leave the Basic Discount Rate in an unaltered state: accounting for all supplementary considerations through adjustments to the forecasted earnings to be produced by the particular asset being analyzed. The prevailing point of view, however, is that general considerations should be attended to by modifying the Basic Discount Rate: leaving only specific intrinsic factors to be accounted for by risk-adjusting the cash flows.

One of these supplementary adjustments applies to the particular type of property in question. Attitudes and preferences of investors change from time to time, motivated in part by the overall nature of the real estate market, the balance between supply and demand, and by the content and mix of an individual investor's portfolio. The ranking, or order of preference for various types of investment properties, may also vary by regional or other geographic orientation. Normally, the adjustment for relative preferences in the type of property will seldom exceed one percent, unless a particular classification of real estate becomes subject to an unusual stigma.

The adjustment for relative location may be quite significant, location being one of the paramount factors influencing property values. The upper tier of the investment community generally prefers properties located within a major metropolitan area and will not be induced to invest elsewhere for much less than an additional one percent in the discount rate. If the asset is situated in an unstable economic environment from a geographical point of view, the adjustment may possibly be up to three percent over the Basic Discount Rate or the property may not be attractive to this tier of investor at all. The lower tier of investors, which seek properties having a lower cost of acquisition, may be impartial or indifferent to locational dissimilarities in a general sense: in which instance adjustments would not be called for unless extraordinary conditions prevailed. The important point to bear in mind with regard to locational adjustments is the relative weight the investor will assign to the security of capital and the reliability of earnings associated with perceived conditions related to differences in geographic areas.

The physical and functional characteristics of the property under study may warrant further considerations in the adjustment process. Such characteristics may be viewed in a relative context and in the perspective of the possible erosionary influence they may have on future earnings and capital appreciation, or the possible need for supplementary corrective capital expenditures. Alternatively, should the physical and functional

deficiencies be specifically identifiable and quantifable, the investor might prefer to reflect these circumstances in the projection of the future earnings to be discounted, rather than adjust the rate to be employed in the discounting process.

The type and quality of tenancy, the strength of the lease structure, the efficiency of operation and the competency and intensity of management is a further major concern among investors, to be considered in the secondary adjustment process. The most sought-after type of property, situated in a prime location, could be plagued by lack of a good anchor tenant, a below-average tenant mix, a poor quality of leases, an inefficient system of recharging and recovering operating expenses, etc. Some otherwise excellent investment properties occasionally suffer from the accrued influence of incompetent management and administration which could have carry-over effects on the future profitability of the property, or the particular type of property could be inordinately labour and management intensive. In all, the circumstances associated with these conditions could result in an aggregate adjustment of something in the order of one percent, unless these conditions have been wholly or partially accounted for in the projection of the cash flows to be generated by the property.

The general influence which existing financing exerts on the marketability of the property might command a separate adjustment to the Basic Discount Rate. While the specific merits or adverse influence of financing will normally be accounted for in the establishment of the earnings to be discounted, some investors are inclined to bonus the Basic Discount Rate if the existing financing is complex in its structure or is perceived to impart an onerous inhibition on the future ownership or future saleability of the asset.

Another secondary adjustment which has been isolated for specific discussion, is that which pertains to the attitudes taken by the analyst in the forecasting process. If future rental incomes and occupancy costs are well-founded on current hard factual evidence, escalated at realistic rates over the length of the investment horizon, in all likelihood no adjustment in the development of the overall discount rate would normally be warranted. On the other hand, if the inflator rates and the methodology of estimating the reversion are perceived to be overly optimistic, the Basic Discount Rate will normally be subject to a corresponding bonus as a neutralizing adjustment. A similar adjustment might be warranted if attitudes pertaining to re-financing, the perceived need for supplementary capital expenditures and the like, appear to be unrealistic in terms of market expectations. The main perspective with regard to the forecasts of future earnings is that these projections must closely parallel the anticipated inflationary pressures which come to bear on the earnings capability of the property in question. A realistic outlook is acceptable at par but an overly-optimistic attitude is normally adjusted for accordingly.

An example of a further adjustment would be one to reflect the perceptions of a particular individual investor or a special sub-group within the investment community. The overall discount rate applicable to the earnings generated by an unlevered investment might be somewhat different than that which would apply to cash flows produced by a well-financed project. The discount rate associated with the acquisition of a partial interest might well differ from that which would apply to acquisition of full title. Any number of circumstances could warrant additional adjustments.

Finally, there may be other factors which have a direct bearing on the value of the asset in question and which may have to be addressed separately in the adjustment process. Also, with the passage of time, the investment community may define additional criteria to be evaluated separately in the analysical process of building up an overall discount rate. Whatever the circumstances are, or may become, it behoves the inquisitive analyst to keep an open and inquiring mind and not to regard the foregoing methodology of developing an overall discount rate as rote procedure.

With regard to the general magnitude of the overall discount rate which will evolve from the aggregate of all the adjustments covered in the foregoing discussion, it will most probably range from a low of two to three percent above the prevailing yield on long-term federal government bonds, to a figure of six to eight percent above this same base rate (or four to five percent above the Basic Discount Rate). For a prime investment property which is in "good health", reasonably well located, and whose future earnings are based on realistic expectations of the market, the eventual establishment of an appropriate overall discount rate will tend to fall within the lower end of this range. Overall discount rates applicable to second ranked properties will gravitate toward the upper quartile of this range and third ranked properties may command overall discount rates of from eight to ten percent above the Basic Discount Rate and, on occasion, nearly double the magnitude of the Basic Discount Rate.

Other Methods of Rate Setting

Alternative methods exist in the marketplace for developing the discount rate to be applied in the DCF Method of valuation and others will invariably come into vogue from time to time. As long as alternative methodology has its foundations in the structure of the capital market, such methods and procedures will be valid representations of objective analysis.

Nearly all of the alternative means of selecting or developing the Basic Discount Rate are comparatively arbitrary. One procedure is simply to surcharge the anticipated rate of inflation in the general economy by a rate ranging from six to ten percent: this singular adjustment representing the need to provide for an element of real growth in the present value of the investment and to reflect, in one step, the majority of the relative differences in comparative investment characteristics referred to previously in this discussion. Another procedure used by the investment community at large, is to surcharge the current interest rate on conventional first mortgages by an amount of from three to five percent: said singular adjustment representing the agnre-

gate inducement factor needed to bring the investor into the real estate equity market. In both instances, the Basic Discount Rate so discovered would be subject to further consideration in the process of developing the final overall discount rate deemed appropriate to the property under examination.

More subjective criteria may be employed by individual investors in striking their threshold rate or minimum acceptable rate of return. Among the benchmarks commonly used are: The investor's opportunity cost to finance; the risk profile of a corporation's share capital; the prevailing yield on an investor's existing portfolio or a segment thereof: the weighted marginal costs of capital: etc. All of these focal points to name but a few, come to bear on the structure of Basic Discount Rates prevailing in the market place at a given moment in time.

Regardless of the nature of prevailing alternative methodology and rules of thumb, or seemingly new criteria, they should not be cast aside prior to due deliberation of their relative merits. For example, the astute analyst might be inclined to discard the use of gross income multipliers in the evaluation of multiple-family residential income properties: on the basis that such a yardstick has no relevancy in rational investment analysis. Yet, if this type of real estate tends to trade as a function of gross earnings, and if this is how values are struck in the market, one would be remiss to become overly technical. Also, it must be remembered that capital market analysts tend to avoid the use of overly technical methods of evaluating securities and other instruments which constitute an investor's alternative involvement in the marketplace.

Conclusion

A diligent and thorough investigation of the market via personal interviews with investors, coupled with an examination of the ingredients of actual transactions, remains to be the best route to follow in the quest of appropriate discount rates. Certainly a firm grasp of the Basic Discount Rate will be obtained from such investigations, leaving the analyst with the responsibility of exercising reasoned judgment in the process of developing the eventual discount rate deemed most appropriate and applicable to the property under study.

Alternatively, market conditions might warrant the development of an overall discount rate through application of the summation method, using rates of return produced on alternative investment opportunities as a point of commencement. This method has its roots in the structure of the money market which, it is submitted, is the basis of all commercial transactions. The procedures outlined in the discussion of the summation method are meant to present the cardinal issues which have to be considered in the structuring process to determine the Basic Discount Rate or to modify the Basic Discount Rate enroute to the development of the final overall discount rate. The process itself is not meant to be interpreted as a specific formula to be employed; rather, the process is intended to outline the critical factors which come to bear on the structure of discount rates. Finally, each of the elements isolated for discussion in the summation method are highly dependent upon each other: so much to say that they are not mutually exclusive.

In summary, it is recognized that whatever discount rate evolves through even the most diligent and thorough investigation and analysis, the resultant value emerging from application of the Discounted Cash Flow Method of valuation must be matched with the value found by other diagnostic procedures to ensure that the end product represents a plausible and realistic market price for the property being evaluated.

1. METHODOLOGY OF APPLICATION

1. Two models were prepared and demonstrated at the seminar to illustrate the application of the DCF process. The first of the two models is included as an example.

   It pertains to the valuation of the net rental income receivable from a single tenant. The tenant, in this instance, is a retail merchant whose effective rental income is based on a combination of a prescribed basic minimum rent or a stipulated percentage of retail sales, whichever is greater. Consequently, this model also illustrates the procedure of calculating the effective rent, in addition to the discounting process.

SCHEDULE OF PROCEDURE AND RESULTANT FORECAST OF TOTAL RENTAL INCOME

Year	Pere Incr..	Retail Sales		S.T.V. or Breakpoint		Excess Sales		P.O.S.R.		Average Refit		Basic Minimum Rent		Total Rent
Base		$175,000		(Base Year Retail Sales)										
1	+10%	$192,500	-	$166,667	=	$25,833	X	6%		$1,550	+	$10,000	=	$11,550
2	+12%	$215,600	-	$166,667	=	$48,933	X	6%	=	$2,936	+	$10,000	=	$12,936
3	+ 8%	$232,848	-	$220,500	=	$12,348	X	6%	=	$741	+	$13,230	=	$13,971
4	+ 6%	$246,819	-	$220,500	=	$26,319	X	6%	=	$1,579	+	$13,230		$14,809
5	+ 4%	$256,692	-	$220,500	=	$36,192	X	6%	=	$2,172	+	$13,230	=	$15,402
6	+ 7%	$274,660	-	$255,250	=	$19,410	X	6%		$1,165	+	$15,315	=	$16,480

VALUATION OF THE PROJECTED RENTAL INCOME

(as at January 1, 1984)

Year of Receipt	Total Rental Income	Discount Factor at 16%	Present Value
1984	$11,550	0.8621	$9,957
1985	$12,936	0.7432	$9,614
1986	$13,971	0.6407	$8,951
1987	$14,809	0.5523	$8,179
1988	$15,402	0.4761	$7,333
1988 Reversion to Equity	$206,000	0.4761	$98,077

TOTAL PRESENT VALUE OF THE LEASED FEE ESTATE: $142,111

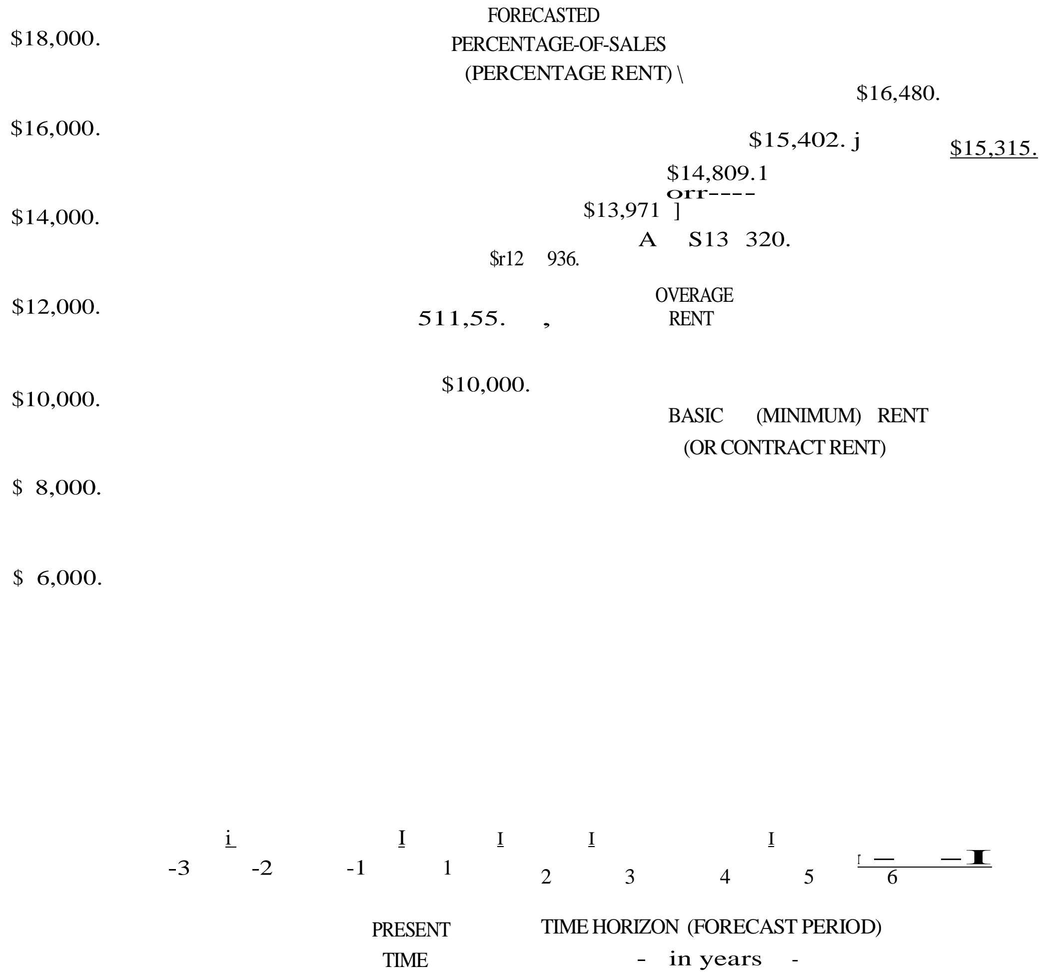
Rounded to: $140,000

Reversion Value of the Premises at the end of 1988

Forecasted Rental Income in 1989 $16,480

Capitalized Value of the Reversion, at 8% $206,000

GRAPHIC PORTRAYAL OF PROJECTED RENTAL INCOME



Legal Decisions

CASES RECEIVED.

Notice of cases received are given for members' information. They will be printed in the "Valuer" as space permits and normally in date sequence.

The Proprietors of Atihau-Whanganui Incorporation, and, Ian Frederick Malpas, and, Corin Scott McGregor (and others), and Walker Cracroft Wilson. Court of Appeal of New Zealand CA 35/82. Judgment 18th September, 1985.

Harvey David Perkins, and, Stanley Murray Perkins, (and others). High Court of New Zealand, Invercargill Registry M 89/82. Judgment 12th June, 1985.

The Minister of Works and Development, and, The National Mutual Life Association of Australasia Ltd., Fletcher-Main Line Limited and Jubilee Investments Ltd., High Court of New Zealand M. 613/82. Judgment 28th August, 1985.

CASES NOTED.

Cases `noted' will not normally be published in the "Valuer".

Copies of cases `received' and `noted' may be obtained from the Registrar of the Court under whose jurisdiction the cases were heard. (A charge is normally made for photocopying.)

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

M. 1580/83

BETWEEN

ERNEST ALBERT JAMES HOLDAWAY of Auckland, Retired Farmer

Objector.

AND

COMMISSIONER OF INLAND REVENUE

Commissioner.

Hearing: 25th, 26th March and 3rd April, 1985.

Counsel: R. A. Green and G. D. Clews for Objector. P. J. H. Jenkin and K. Robinson for Commissioner.

Judgment: 13th June, 1985.

The taxpayer bought a block of residential land which, after a lapse of some years, he proceeded to develop in two stages.. All stage one lots except one were sold by 10 August, 1973, the date after which such sales or other disposition of land became subject to tax on profits.

The taxpayer then sold the remaining stage one lot and a number of the stage two lots. The profits from those sales were not returned for income tax purposes.

The Commissioner issued amended assessments which included calculations of profit allegedly made from the sales. Objections to those amended assessments were disallowed by the Commissioner.

The taxpayer sought to eliminate from profit such factors as inflation, zoning changes, the provision of amenities to the area and other factors which influenced value but were not directly attributable to carrying out the scheme. The Commissioner challenged that approach and instead assessed profit on an historical cost basis.

The main issue concerned the method of determining profits or gains according to the true construction of the legislation.

1. A taxable profit would be treated as containing the element of inflation. To assess profit by reference to value at time of sale would require clear words to that effect. Section 67 (4) (f) of the Income Tax Act 1976 was not expressed in that way. The profit derived from the scheme was the sale price less expenses, including cost or value of the commodity at the time of commencement. (Lowe v C of IR (1981) 5 NZTC 61,006 followed.)

2. Not all profit from sale was caught, only that which had as its source the carrying out of the scheme. Therefore the increase in value from the date of initial purchase of the land to the commencement of the scheme was excluded.

3. The value of the land was not the value to the owner but the true market value, namely what a prudent buyer would pay for it. What the owner had spent on it would be relevant if it enhanced value. The fact that the land was free from a reserve contribution claim must be recognised and given effect to in ascertaining value.

4. The preferable method of valuation was by reference to comparable sales if available. Indexation was useful as a check or a guide but should not take the place of market evidence.

JUDGMENT OF HENRY J.

Case Stated pursuant to the provisions of s.32 of the Land and Income Tax Act 1954 and s.33 of the Income Tax Act 1976.

In July 1951 the Objector purchased a block of land comprising some 21 acres situated adjacent to Coronation Road, Northcote, Auckland. In April 1967 a plan of subdivision was prepared relating to an area of that land comprising 16 acres 1 rood 25 perches.

The plan depicted 62 residential lots together with two lots designated as reserve land. This plan of subdivision was consented to in July 1967 by the appropriate local authority. then the Waitemata County Council. The subdivision was put into effect in two stages, the first being completed in 1970 and the second commencing in October 1972. All Stage 1 lots with one exception, had been sold by the Objector prior to 10 August 1973. The relevance of that date is that s.88AA of the Land and Income Tax Act 1954, which with its successor s.67 of the Income Tax Act 1976 is the legislative provision in question, applied to all sales or other dispositions of land made after that date. Stage II of the subdivision contained 33 lots, none of which were sold as at 10 August 1973. Later in the income year ending 31 March 1974 the Objector sold the remaining Stage I lot, and in the income years ending 31 March 1975-78 inclusive he sold 20 of the Stage II lots. No profits from the sale of these lots were returned for income tax purposes. The Commissioner issued amended assessments which included calculations of profit allegedly made from the sales, and objections to these amended assessments were lodged but disallowed by the Commissioner.

The present case stated has resulted which raises two main issues. The first concerns the true construction of s.67 (4) (f) of the Income Tax Act 1976 (formerly s.88AA (1) (e) of the Land and Income Tax Act 1954), and the second concerns the true value of the land in question at such date or dates as may be relevant, Although the period covered by the case stated includes both statutes, I shall refer to the 1976 Act as there is no relevant variation between them.

A. Section 67 (4) (f) Income Tax Act 1976:

The inclusion as assessable income of profit or gain from the sale or disposition of land for present purposes is governed by s.65 (2) (f) of the 1976 Act, which provides:

"65. (2) Without in any way limiting the meaning of the term, the assessable income of any person shall for the purposes of this Act be deemed to

include, save so far as express provision is made in this Act to the contrary, -

(f) All profits or gains derived from the sale or other disposition of any land within the meaning of section 67 of this Act, being profits or gains to which that section applies:"

Section 67, so far as is now relevant, provides:

"67. (4) For the purposes of section 65 (2) (f) of this Act, the assessable income of any taxpayer shall be deemed to include -

(e) All profits or gains derived from the sale or other disposition of land where -

(i) An undertaking or scheme, whether or not an adventure in the nature of trade or business, involving the development or division into lots of that land has been carried on or carried out, and the Commissioner is satisfied that that development or division work, not being work of a minor nature, has been carried on or carried out by or on behalf of the taxpayer, on or in relation to that land; and

`(ii) That undertaking or scheme was commenced within 10 years of the date on which that land was acquired by the taxpayer:'

(f) All profits or gains, not being profits or gains which are included in the assessable income pursuant to any of the paragraphs (a), (b), (c), (d) and (e) of this subsection, derived from the sale or other disposition of any land to the extent that those profits or gains are derived from the carrying on or the carrying out of any undertaking or scheme, whether or not an adventure in the nature of trade or business, involving the development or division into lots of that land, and the Commissioner is satisfied that that development or division work (being work involving significant expenditure on earthworks, contouring, levelling, drainage, roading, kerbing, or channelling or on any other work, service, or amenity customarily undertaken or provided in major projects involving the development of land for industrial, commercial or residential purposes) has been carried on or carried out by or on behalf of the taxpayer on or in relation to that land."

It is common ground that there was here an undertaking or scheme carried on by the Objector, that this commenced in April 1967, being more than 10 years after the land was acquired, and that the profits and gains from that scheme are not covered by paragraphs (a), (b), (c), (d) and (e) of s.67 (4). The real issue concerns the methods of determining those profits or gains, according to the true construction of the legislation. The submission on behalf of the Objector centres on the use of the words "to the extent that . " The submission is that where, as here the scheme involves the subdivision of a block of land into lots and the individual sale of those lots over a period of time, it is necessary to compare the prices ultimately received from sales not only with the value of the land at the date of the commencement of the scheme, but also with its value (as a block or part of an undivided block) at or about the date of each respective sale. It is only in this way, it is submitted, that the profit derived from the carrying out of the scheme can be isolated. What is sought to be eliminated from the element of profit are all other factors as, for example, inflation, zoning changes, the provision of amenities to the area and so on. which influence value and which it is said are not directly and solely attributable to carrying out the scheme.

Put into practical terms, what it is submitted should be done to calculate profit is this. First, the gross profit is obtained by subtracting from the proceeds of sale the aggregate of the original cost of the land and the direct costs and expenses of subdivision; second, subtracting from that figure the difference between the original cost of the land and its block value at the date of commencement of the scheme: third, subtracting from the resulting figure the difference between the block value of the land at the date of sale and its block value at the date of commencement of the scheme. That is challenged by the Commissioner. The respective contentions of the parties come down to whether or not any general increase in the value of the land between the date the scheme commenced and the date of sale of the lots is to he included in the calculation of profit.

In construing the section, it is useful to keep in mind the history of the legislative provisions, which was helpfully outlined by Mr Green in the course of his detailed and comprehensive submissions. What is now s. 67 of the Income Tax Act 1976 was introduced as s. 88AA of the Land and Income Tax Act 1954 by s. 9 of the Land and Income Tax Amendment Act 1973. Prior to that amendment the inclusion of profits and gains from the sale of land as items of assessable income were covered by s. 88 (c) of the Land and Income Tax Act 1954. That section had three limbs. The first limb taxed profits or gains derived from the sale or other disposition of any real or personal property or interest therein if the business of the taxpayer comprised dealing with such property. The second limb taxed all profits or gains derived from the sale or disposition of any real or personal property or any interest therein if the property was acquired for the purpose of selling or otherwise disposing of it. The third limb taxed those profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit. Section 9 (2) of the Land and Income Tax Amendment Act 1973 amended s. 88(c) by replacing the words "real or personal property or any interest therein" with the words "personal property or any interest therein (not being property or any interest therein which consists of land within the meaning of s. 88AA of this Act)". The effect of that amendment was that the first two limbs of s. 88 (c) applied only to personal property. The third limb, however, remained applicable to both real and personal property.

Section 9 (3) of the Land and Income Tax Amendment Act 1973 inserted a new paragraph (cc) into s. 88 which included in assessable income all profits or gains derived from the sale or other disposition of any land within the meaning of s. 88AA of the Act. Section 9 (5) of the 1973 Amendment Act provided that the amendments to s. 88 (c), s. 88(cc) and the new s. 88AA applied with respect to any profit or gain derived from any sale or disposition made on or after the 10th day of August 1973. Section 88AA became s. 67 of the Income Tax Act 1976. The 1976 Act came into force in respect of the income year commencing on 1 April 1977. Section 88(c) became s. 65 (2) (e) and s. 88 (cc) became 1. 65 (2) (f).

In relation to the income years in question in the present case s. 67 (4) (f) has undergone one minor amendment since it was originally introduced as s. 88AA (1) (e) of the Land and Income Tax Act 1954. That amendment was the incorporation of a reference to paragraph (d) when that paragraph, which deals with rezoning, was introduced in the Land and Income Tax Amendment Act (No. 2) 1975.

Section 67 (4) (e) (or more accurately its predecessor s. 88AA (1) (d) of the 1954 Act) was considered in detail by the Court of Appeal in Lowe v Commissioner of Inland Revenue [1981] 1 NZLR 326, and the judgments contain statements of principle relating to construction which are of relevance. I refer, for example, to the judgment of Richardson J. at p.342 (all references quoted in Lowe are to the 1954 Act and must be read accordingly):

"It may equally be said that in a general way, in imposing a new regime for the taxing of gains on certain land transactions Parliament has in s. 88AA demonstrated an intent to extend the tax net and include some gains previously regarded as capital in nature. However, I do not find the reconciliation of general objectives and the quest for the assumptions underlying the new section helpful in determining the precise scope of para (d). The objectives of the provision in that regard and their attainment in the circumstances are not sufficiently clearly discernible at the limits of its operation. Accordingly I have preferred to follow the approach indiciated in the classic statement of Rowlatt J. in The Cape Brandy Syndicate v The Commissioners of Inland Revenue (1920) 12 TC 358, 366; [1921] 1 KB 64, 71•

"Now of course it is said and urged by Sir William Finlay that in a taxing Act clear words are necessary to tax the subject. But

it is often endeavoured to give to that maxim a wide and fanciful construction. It does not mean that words are to be unduly restricted against the Crown or that there is to he any discrimination against the Crown in such Acts. It mean this, I think; it means that in taxation you have to look simply at what is clearly said. There is no room for any intendment; there is no equity about a tax; there is no presumption as to a tax; you read nothing in; you imply nothing, but you look fairly at what is said and at what is said clearly and that is the tax."

Looking fairly at para (d) in its statutory context I consider, for the reasons I have given, that the legislature has set out the criteria to be applied in determining whether "subdivisional and development activities affecting land commenced within 10 years after the date of its acquisition are taxable, and that it would be inconsistent with the scheme and language of the provision to read in a further requirement that the profits or gains must be income in character. In short, the legislation has identified the gains which are deemed to be assessable income in terms which avoid the necessity for any discussion of how much planning and organizing activity is required in such a case to constitute a commitment of assets to income earning activity and so to determine what gains would, but for its provisions, constitute capital or income respectively."

And to that of McMullin J. at p.355:

"It is against this legislative background that s.88AA (1) (d) is to be considered. Because liability to tax is a creation of statute, any provision which is said to create it must do so without ambiguity (Russell (Inspector of Taxes) v Scott [1948] AC 422, 433; [1948] 2 All ER 1, 5, per Lord Simonds). Nevertheless the primary inquiry must be as to the meaning to be deduced from the words of the applicable provision. In interpreting a taxing statute there are no special canons of construction. The relevant principle was set by Lord Russell of Killowen in Attorney General v Carlton Bank [1899] 2 QB 158 as follows:

"I see no reason why special canons of construction should be applied to any Act of Parliament, and I know of no authority for saying that a taxing Act is to be construed differently from any other Act. The duty of the Court is, in my opinion, in all cases the same, whether the Act to be construed relates to taxation or to any other subject, namely to give effect to the intention of the Legislature as that intention is to be gathered from the language employed having regard to the context in connection with which it is employed. The Court must no doubt ascertain the subject matter to which the particular tax is by the statute intended to be applied, but when once that is ascertained, it is not open to the Court "to narrow or whittle down the operation of the Act by seeming considerations of hardship or of business convenience or the like. Courts have to give effect to what the Legisature has said: (ibid, 164)."

Section 67 (10) is also of importance, as it has express reference to para. 4 (f) and to that paragraph alone.

It states:

"67. (10) For the purposes of paragraph (f) of subsection (4) of this section the Commissioner may ascertain the value of any land at the date of the commencement of any undertaking or scheme referred to in that paragraph in such manner as he thinks fit."

Turning then to s.67 (4) (f), the first matter to note is that profit must be derived from sale or disposition of land. Lowe's case, as confirmed by the Privy Council, now establishes beyond question that in assessing profit derived from sale the historical cost approach is to be applied, and the element of inflation (or presumably of any other value-increasing element) is not to be excluded but will form part of the ultimate profit. In Lowe the taxpayer had attempted to argue that the source of the profit was inflation and that therefore the profit was not derived from the sale. This argument was rejected. Richardson J. said at p.352:

"The final contention advanced for the appellants was that, to the extent that the profit arose from the effects of inflation on land values over the period during which the particular lot sold was held by the appellants, its source was inflation and it did not constitute a profit "derived from sale" of the land. It was submitted that the inflationary ingredient in the ultimate sale so arising was arising or accruing over that period: the sale was merely the occasion on which and not the source from which it was derived.

Apart from raising considerations similar to those which have led me to reject the appellants' fourth submission, this contention turns on the distinction which the appellants seek to draw between a profit realised on a sale and a profit derived from a sale. It is a fine distinction and the justification for attaching such significance to it is not discernible in the scheme of the new s.88AA. That section is directed to realized profits on land transactions. What was up to the point of sale a potential gain may fairly be said to have been derived from the sale; that is in the absence of statutory provision for the exclusion of the inflelionary element in the calculation of the taxable profits."

It is therefore clear that unless it appears that the legislature has excluded the element of inflation, a taxable profit will, in the New Zealand context, be treated as containing that element. That has been the traditional and consistent approach adopted over the years.

Section 67 (4) (f) goes on, however, to restrict the profit derived from sale to that which is also derived from the carrying on or carrying out of the scheme. It is not all profit from sale which is caught, as is the case under paragraph (e), but only that which has as its source the carrying out of the scheme. It follows immediately from those words that increase in value from the date of acquisition down to the commencement of the scheme is excluded, for the simple reason that any profit arising during that period of time cannot have as its source a scheme which did not exist. What is the position as regards increase in value thereafter? When the scheme comes into existence the land in effect becomes a potential source of income for tax purposes, and for that reason it is necessary to fix its base value so that profit can be measured. Hence s.67(10), giving the Commissioner a discretion as to the method of ascertaining that base value. The profits which thereafter flow as the land is sold part by part or lot by lot have as their source the scheme of subdivision. The fact that an element of the profit arising from the increase in value of the asset from its base may be inflation or any other factor does not mean that the scheme ceases also to be the source of the profit. The carrying on of the scheme involves the development of the land for sale purposes, and its sale. When it is sold the profit which results. comes from, and has that scheme as, its source. Take a theoretical example of a subdivision of land. Profit is derived from sale (profit A) ; some of profit A is in turn derived from and arises in the course of carrying on the scheme (profit B); and some from an increase in value before there was any scheme (profit Q; some of profit B can be traced to inflation, some to a zoning change, some to the construction of a bridge, some to the whim of a wealthy purchaser, and some to the ordinary impact of supply and demand. All these latter elements, although separately identifiable and perhaps even quantifiable, still form part of the entirety of profit B.

Put another way, the fact that profit is due to inflation does not mean that it is not due also and in the first instance to the carrying on of a scheme. The difference between paragraph (e) and paragraph (f) is that the former catches all profits. The latter catches only those which the scheme has been effective in producing and which can be related to it in the commercial accounting sense.

Although the present issue was not before the Court in Lowe, there are passages in the judgments which lend support to this construction. The references are again to the 1954 Act, in which paras. (d) and (e) are identical to paras. (e) and (f) of the 1976 Act. Cooke J. said, at p.334:

"But (e) differed from (d) in ways material to the present point. Under both paragraphs the profits had to be derived from the sale or other disposition

of land and there had to be an undertaking or scheme involving the development or division into lots of that land. Under (d), however, the date of the acquisition of the land by the taxpayer could be all-important, as (d) did not apply unless the undertaking or scheme was commenced within 10 years of that date. Whereas under (e), although there was no time limit, the profits were caught only to the extent that they were derived from the carrying on or the carrying out of the undertaking or scheme. We are not now directly concerned with (e), as the Commissioner has not sought to found his assessment on that paragraph; but it would appear that for the purposes of (e) it may be necessary to compare the price ultimately received from sales with the value of the land at the date of the commencement of the scheme. The initial cost to the taxpayer at the time of acquisition would not necessarily be a yardstick under (e). That accounts for subs.(5). [Subs.(10) of the 1976 Act]. In an event that subsection may have been only inserted out of caution."

Richardson J. said, at p.347:

"The second provision is concerned with the calculation of profits or gains under para. (e) of s.88AA (1). That is the only paragraph where a value as distinct from the allocation of cost is required for the purpose of calculating the profit or gain involved. This is because under (e) the profits are taxable only to the extent that they are derived from the carrying on or carrying out of an undertaking or scheme. In order to make that calculation it is necessary to have as the base figure the value of the land at the commencement of the undertaking or scheme - just as the transfer of assets between trading and private account requires an assessment of their value at the time they were committed to or withdrawn from the income earnings activity as the case may be (Sharkey v Wernher [1956] 3 All ER 493, Bernard Elsey Pty Ltd. v Federal Commissioner of Taxation (1969) 121 CLR 119; 1 ATR 403, and 5 NZTBR Case 49). It is against that background that subs. (5) provides that for the purposes of para. (e) the Commissioner may ascertain the value of any land at the date of commencement of any undertaking or scheme referred to in that paragraph in such manner as he thinks fit."

I can see no useful purpose for s.67 (10) if the Objector's argument is to be adopted. There is on that approach no need to have an intermediate valuation carried out at the date of commencement of the scheme. All that is required is an assessment of value at the time of sale which, after making allowance for development cost, is then applied to historic cost. Section 67 (10) becomes meaningless. Furthermore, s.67 (4) (f) does not itself envisage the necessity of valuation at date of sale, and the absence of any equivalent to or extension of s.67 (10) must therefore become significant.

In ordinary accounting terms, once the land is the subject of a scheme for the development and division into lots for sale, its then value will be the basis from which assessment of ultimate profit is made. To assess profit by reference to value at time of sale would require clear words to that effect. Paragraph (f) is not expressed in that way, on the contrary in my view it says that all profits which flow, on sale, from carrying on the scheme are taxable. The "business", if I can describe it so, commenced when the scheme commenced. It then had •a commodity which it proceeded to sell. The profit deriving from that business was the sale price less expenses, including cost or value of the commodity at the time of commencement, namely when it took on the character of a revenue asset.

Having regard to the rejection of the inflation argument in Lowe, and the observation to the effect that historical cost had been assumed to be the only appropriate approach (see Cooke J. at p.337 line 48), it is pertinent to refer to the evidence given by Mr R. C. Pope, an experienced and respected chartered accountant. He gave as his opinion that the approach propounded for the Objector was unsupported by accepted accounting practice, other than the concept of current cost accounting. It is that concept which Lowe has said does not apply, certainly to para. (e), and I think by inference also to para. (f). As I see it, the flaw in the argument for the Objector is in contending that elements of profit such as inflation cannot be derived from carrying on a scheme. In my view they are if they occur during the currency of the scheme and are attributable to its operation. In the present case therefore those elements of profit, in so far as they arose after the commencement of the scheme, are derived from the sale of land and also from the carrying on or carrying out of the scheme.

For the Objector, Mr Green submitted that the words "to the extent that . . . " required the undertaking of an apportionment exercise. With that I agree. He went on to submit that what was to be apportioned was the initial profit from sale. I agree. It is that portion of the profit (also to be calculated under para. (e)) which is derived from carrying on the scheme. Mr Green then submitted that there must be a further analysis "'so that by the appropriate exercise of judgment the amount of profit truly attributable to, the carrying on of the scheme can be ascertained". It is this further step which, in my judgment, is neither authorised by the legislation nor required to give the words their plain meaning. The apportionment is a single stage exercise, and what is to be ascertained is simply that part of profit which flows from the scheme. The words "derived from the carrying out of the scheme" do not themselves require a'further analysis of profit into categories. Factors which influence value do not require analysis, even assuming such a task would be practical. What is important is the profit which the subdivisional process brings in each income year, that process commencing with (here) the completion of the plan of subdivision, and finishing when the last lot is sold. A general increase in the value of land occurring during that process which increases the profit in any sale must still form part of the profit derived from the scheme.

I therefore conclude that the Commissioner was not in error in assessing profit without reference to or ascertaining the value of the land at or about the time of sale, but with reference to its value at the date of commencement of the scheme or undertaking.

B. Valuation of the Land:

As a consequence of my finding on the first issue, the only relevant date of valuation is that of the commencement of the scheme which is accepted as being April 1967.

Expert evidence as to the value of the Stage II block was given by Mr A. R. Gardner, Mr S. N. Dean and Mr M. E. Gamby. There is a marked difference between the valuation contended for by the Objector for whom Mr Gardner gave evidence, and that contended for by the Commissioner for whom both Mr Dean and Mr Gamby gave evidence. Mr Gardner assessed the 1967 market value of the land as a block at $82,500.00, Mr Dean at $43,000.00 and Mr Gamby at $46,000.00. To resolve the dispute therefore requires a consideration of the evidence.

The land is situated between Coronation Road and the upper end of Stanaway Street, Northcote, with frontages to both roads. It is in a good residential location, generally handy to most amenities and well served with recreational areas. It has an easy to medium fall from north to south down the crest of a ridge, and has excellent sea views from the high areas with landscape and suburban views from the lower slopes. As at 1967 it was suitable for good quality residential development. It was developed into 33 residential lots in what was described as an economic and entirely appropriate method of development. Its zoning was residential A under the operative Waitemata County Council district scheme.

All three witnesses recognized that there are two principal methods of valuing subdivisional land. One is on a notional subdivision basis, which is designed to establish what a purchaser intending to subdivide the land would pay for it. The other is by a comparison wth relevant sales of other blocks of land available for subdivision and development. Each valuer carried out the notional subdivision exercise, and also had regard to what were respectively considered comparable block sales.

In summary, the notional subdivisions were as follows:

	Gardner	Dean	Gamby
Section value (average)	$5,376	$3,927	$4,127
Developmentcosts	52,765	54,992	55,597
Block value	82,500	43,600	48,500

Mr Gardner did not consider there were any comparable block sales relevant to a valuation at 1967. Mr Dean reached a figure of $40,000.00 and Mr Gamby $45,000.00 by that method. Looked at broadly, the two main differences of opinion on the notional subdivision approach are, first, the realisation figure or value of the average section, and second, the calculation of development costs. As regards the second of those, although there are as would be expected, several differences in detail, the significant and effective difference of approach is the incorporation into that calculation by both Messrs Dean and Gamby, of a reserve fund contribution, a factor which has been excluded by Mr Gardner. I propose to consider that aspect first.

The factual position is that the scheme of subdivision as approved by the Waitemata County Council included a provision transferring certain areas of land to the County for reserve purposes. The land concerned was part of the Stage I development, and by reason of the provision, the balance of the land to be subdivided was released from any future requirement of reserve contribution. It is not in dispute that there was here one scheme or undertaking, which for practical purposes was to be carried out in two stages. It was for this reason that April 1967 was selected as the commencement date for Stage II. The problem arises from the fact that it was not until 1973, at which time Stage I had (with the exception of one lot) been completely sold, that profit and gains from this subdivision became taxable income. At that time, the reserve contribution requirements had been satisfied and Stage II was not liable to any further contribution. I would have no hesitation in holding that in respect of any valuation of Stage II as at a date after 1973, no reserve contribution allowance should be taken into account. It would be ignored by any purchaser of that land as being an expenditure which would not in fact be incurred. But what of a valuation of Stage II as at 1967? In my judgment the question of reserve contribution should still be ignored or excluded from any 1967 valuation. The scheme itself was so constructed at that time to avoid the imposition of any reserve contribution on Stage IT. A purchaser of that block of land at that time would be aware that the subdivision could be implemented without that obligation. The contribution required by s.28 of the Counties Amendment Act 1961 was in this case to be satisfied by setting aside the requisite area of land for public purposes and the scheme as a whole was committed to that. The whole of that area was in Stage I, a factor which obviously affected the overall value of that particular block. It did not affect Stage II, and in my view it would be quite unrealistic in valuing it to treat it as subject to an obligation which would not arise. As at April 1967 Stage II would have a market value assessed on the basis that. it was a subdivisible block of land exempt from reserve fund contribution.

The main thrust of the argument for the Commissioner was that the purpose of the subdivisional exercises was to establish the value of the block to the owner, and as he had to pay the reserve contribution, be it by cash or setting aside land, it was accordingly a cost to him of the subdivision. In my view it is not the value to the owner which is to be ascertained, but the true market value, namely what a prudent buyer will pay for it. The willing seller/willing buyer test. What the owner has spent on it will be relevant if it enhances value. If value is to be ascertained by a notional subdivision exercise, then the fact that an item of expenditure normally to be expected is for any reason inapplicable, means that the value will be increased accordingly. If, for example, a road had been constructed on the land for general access purposes before any subdivision was contemplated, but nevertheless became suitable as part of the subdivisional roading, the value of the land for subdivision purposes would have been enhanced and a buyer of the land would not in assessing its value deduct the cost of putting in a road already there, The fact that the land is free from a rese e contribution claim must in my view be recognized a nd givenrv effect in ascertaining value. The reality of the situation cannot be put to one side.

Accordingly, if that factor is excluded from the valuation, Mr Dean's figure for development costs becomes $45,567.00 and Mr Gamby's $45,859.00, both to be compared with Mr Gardner's initial figure of $52,765.00. I do not think it necessary to analyse those differences any further they are due to several factors, including the calculation of actual development costs as opposed to indexation from 1973, to minor items such as power board charges, and to the interest allowed on outlay which would vary according to the amount of the outlay and the actual interest rate applied. Looked at overall, the differences are not significant and in reaching a final valuation a broad judgment needs to be exercised.

I turn then to the other areas of major dispute, namely the gross realisation figures. To arrive at his average of $5,376.00 per lot, Mr Gardner relied primarily on his October 1972 valuation which he then indexed back to 1967. As I understood him, Mr Gardner then confirmed the resulting figure by reference to comparable sales. Mr Dean valued each section as at 1967 in reaching his average of $3,927,00, and Mr Gamby divided the lots into a series of groups or bands each comprising between one and five lots, and grouped in prices according to view, size, contour and aspect in reaching his average of $4,127.00.

I have given careful consideration to the evidence of all three valuers. The indexation exercise adopted by Mr Gardner was by use of the Valuation Department's Section Price Index for vacant residential sections on the North Shore, which had June 1985 as its base. That index was applied to his October 1972 lot values. Although that is a method of valuation which has its uses and merits, in my view the preferable approach is by reference to comparable sales if they are available. Indexation is no doubt useful as a check or a guide but cannot, in my judgment, take the place of market evidence. It is I think significant that while Mr Gardner's realization figure is substantially higher for 1967, it is in fact lower than either of the other two valuers for 1973, and again for 1978. Their respective figures are again comparable to one another for those two years. That is to be considered in the light of what was a lack of detail as regards the sales used by Mr Gardner for his 1972 valuation, for although he referred to having taken into account some 80 sales they were not scheduled for critical examination. In respect of 1967 there was a list (Appendix 3) adduced relating to some 15 lots, which did not to my mind support the average figure claimed. By contrast both Mr Dean and Mr Gamby produced detailed schedules in support of their valuations which, I think, when taken in conjunction with the evidence given as to the comparison of those with the subject land, demonstrate their validity. I was also impressed by Mr Dean's experience and knowledge of the area and the reasons given by him in support of his figures. That then deals with the two major items of dispute in the notional subdivision approach, and by making the adjustments for reserve contribution, Mr Dean's value becomes $53,000.00 and Mr Gamby's $58,000.00.

Evidence was also called as to comparable block sales. Mr Dean referred to four block sales at or near the relevant date, and Mr Gamby relied on two and referred to a further two sales of fully subdivided blocks. Mr Gardner was of the opinion that there were no comparable block sales. I think those referred to do have relevance, although the need for adjustments (some quite substantial) to draw a direct comparison does detract from the weight to be given to them. There is validity in the criticisms levelled by Mr Gardner in his evidence on this score. What I think those sales indicate is that the total value of the land now in question was comparatively close to the notional subdivision figure reached b Mr Gamby, which approximated $6000.00 per acre.-They are accordingly a check on and confirmatory of that assessment.

I have been unable to discern any error of approach adopted by Mr Dean or Mr Gamby, and none was demonstrated in the course of the hearing. There is always of course room for variation when such a subjective exercise is undertaken, but the differences between Mr Gardner on the one hand and Messrs Dean and Gamby on the other cannot be reconciled on that basis. In my view the weight of evidence, considered overall, is in favour of the latter, and after due reflection it is evidence which in general I accept. It is not, as I see it. my function to carry out my own independent valuation. but rather to assess the evidence adduced before me and ascertain what it establishes as to value, taking into account that the onus of proof lies on the Objector. With the one exception relating to the reserve contribution issue, I do not see any need to make

material alterations to the valuations put forward on behalf of the Commissioner, and I am satisfied that in broad terms that evidence should be accepted and acted upon.

In coming to this conclusion I have not overlooked the factors relied upon by Mr Gardner, nor the criticisms made by Mr Clews in cross-examination and in submissions. Overall, I am left with a firm impression that the two valuers did apply proper principles and took into account relevant factors, supporting these conclusions with adequate base material. Mr Gardner was, I think, a little over-generous in his assessment of the block value and did not have available sufficient base material to withstand the challenges made to him.

In the circumstances, I think it appropriate to adopt the higher of the two valuations submitted for the Commissioner, namely that of Mr Gamby. I think the notional subdivision approach in this particular case, reasonably accurately reflects the market value of the land. Allowing for the reserve contribution adjustment and other minor adjustments, I would round off the final figure to $60,000.00, which is what I find to be the value of Stage II as at April 1967.

The case stated poses the following question:

"THE question for the determination of this Honourable Court is whether the Commissioner in making the assessments referred to in paragraph 6 hereof acted correctly in including therein the profit derived by the Objector from the sale of the said sections, as set out in the Commissioner's statement (Exhibit "E") and if not, then, in what respects should such assessments be amended."

The answer to the question is:

1. The profit derived by the Objector from the sale of the sections should properly be included in making the assessments and in so deciding the Commissioner acted correctly.
2. The profit derived from the sale of the sections should be calculated on the basis of the value of the land at 1 April 1967 and in so doing the Cammissioner acted correctly.
3. The value of the land for the purposes of such calculation should be $60,000.00 and to that extent the Commissioner did not act correctly in making the assessments, which should be amended to reflect that value accordingly.

Leave is reserved to apply further on any matter arising.

J. N. HENRY, J.

IN THE HIGH COURT OF NEW ZEALAND
INVERCARGILL REGISTRY
No. M 89/82.

IN THE MATTER of the Arbitration Act 1908.

BETWEEN HARVEY DAVID PERKINS.
Applicant.

AND STANLEY MURRAY PERKINS.
First Respondent.

AND THE TRUSTEES EXECUTORS AND AGENCY COMPANY OF NEW ZEALAND.
Second Respondent.

AND JOHN HENDERSON OLDFIELD.
Third Respondent.

AND JOSEPH WADE BRISCOE.
Fourth Respondent.

Hearing: 20th February, 1985.

Counsel: K. C. Marks and J. C. D. Guest for Applicant.
A. P. C. Tipping and R. G. R. Eagles for First Respondent.
A. A. P. Willy for Third and Fourth Respondent.

Judgment: 12th June, 1985.

JUDGMENT OF HARDIE BOYS J.

This is an application under s 12 of the Arbitration Act 1908 for the setting aside of an award made by the third and fourth respondents on 21st August, 1981 in a matter arising between the applicant and his brother the first respondent. For a number of years the brothers (whom I shall for convenience refer to by their Christian names) farmed in partnership, first with their father, and then following his death with the second respondent as trustee of his estate. The farm comprised three blocks. The largest, "Ironwood", of just over 1000 hectares, has been in the family for many years, was owned by the father, and is retained as part of his estate, there being a life interest to the widow, with the brothers now being solely entitled in remainder, It is of an unusual shape comprising one large area to the west and one much smaller area to the east, joined together by a quite narrow strip: a little like a distorted letter "u". Stanley's home is on the western part, Harvey's on the eastern. The other two blocks making up the farm were purchased more recently and are held by the brothers as tenants in common in equal shares. One, "Henderson", of 127 hectares, adjoins "Ironwood" immediately to the east. The other, "Tussock", or "the Run", of 880 hectares, is some six kilometres away to the east.

The Dispute

The brothers were unable to work harmoniously together and eventually they decided to partition the farm. It is not clear whether a dissolution of partnership was intended from the outset but of course if that did occur it would mean that while their mother was alive they would each have to farm part of their land in partnership with the trustee. The most appropriate way in which to effect the partition was the subject of discussion and negotiation, and then in August 1979 of a report commissioned from the fourth respondent Mr Briscoe, a registered public valuer. Mr Briscoe gave it as his opinion that an equitable partition would be for Harvey to have the eastern part of "Ironwood", the eastern portion of the western part, and the strip joining the two, the whole of "Henderson" and the northern part of "Tussock". However the land to Stanley would be slightly more valuable, and Stanley would have to pay Harvey $20,295 (out of a total value of $1,439,000) to achieve equality. This proposal was acceptable to Harvey but not to Stanley, principally because the line dividing "Ironwood" was placed too close to his house.

Matters were taken no further until late in 1980, when there were further discussions, and then on

19th May, 1981, in the course of a lengthy meeting, it was finally agreed that the partnership should be dissolved as from 1st July of that year, and that independend valuers should be engaged to achieve a fair partition of the land. In due course a deed was prepared and executed, but only after Harvey had rejected what was first drafted and had caused the whole matter to be reopened. The deed is dated 24th July, 1981. It is a comprehensive and detailed document, and it contains these provisions as to partition:

"(f) SUBJECT to the next succeeding clauses, the partitioning of the land shall be carried out by registered valuers to be employed by the parties hereto and whose decision both as to the siting of the partition line or lines and the relative values of each of the two partitioned units shall be final and binding on all parties executing this document.

(g) AS soon as possible after the execution hereof, each of them STANLEY MURRAY PERKINS and HARVEY DAVID PERKINS shall appoint a duly qualified and registered public valuer to act on his behalf in this regard and the two valuers so appointed shall be requested to agree on the appointment of a third registered public valuer who shall act as umpire and the appointment of these valuers shall be in accordance with the terms of reference annexed hereto and marked with the letter "A" which terms of reference shall be deemed to form part of this deed.

(h) IN the absence of fraud or other misconduct on the part of the valuers or any or either of them, each party hereto and all other parties executing this agreement shall accept the decision of such valuers as final and binding in all matters."

The terms of reference are as follows:

"1. EACH party shall appoint a registered public valuer.

2. BEFORE embarking upon their work the valuers shall themselves appoint a third registered public valuer to act as their umpire.

3. IN the event of any failure of the two valuers to agree the decision of the umpire shall be final and binding.

4. ALL costs incurred by all valuers shall be borne equally by S. M. and H. D. Perkins.

5. BECAUSE of previous determination and consideration of the issues, it is agreed that Mr Wade Briscoe, or any valuer with whom he is in partnership or who is employed by him or such firm shall not be appointed as umpire.

6. IN brief, the valuers are asked to consider and determine two questions relating to the dissolution of the partnership of S. M. and H. D. Perkins as follows:

(a) Where should the demarkation line or lines for the physical division of the land be made?

(b) Having determined this, what are the values as at the 1st day of July, 1981 (being the date of dissolution) of each of the partitioned units created by such demarkation line and what is the consequential figure (if any) required to be paid by one party to the other to achieve equality of value as between them?

7. IN determining the appropriate division line for this partition the valuers are asked to give due and fair weight to the following matters:

(a) That the partnership has always been an equal partnership.

(b) The desire of both parties to be left with units that are as equal and logical as possible from a practical farm management and working point of view.

(c) The desire of both parties to be left with units that are as near as possible equal in area, stock carrying capacity, and monetary value.

(d) The fact that the subject property is very substantial and accordingly diverse as to terrain, soil types, weather conditions, and pasture type and condition.

8. THE land is in two physically separated blocks which may for the purposes hereof be referred to as "the Run Block" and "Ironwood".

9. IT is agreed that on the partition of Ironwood, S. M. Perkins shall retain his existing home and the land generally around his homestead and other buildings within the green line on the plan marked "D" annexed hereto and that H. D. Perkins shall retain his own home and the land generally around his homestead and other proposed buildings within the green line on the plan marked "E" annexed hereto.

10. THE valuers are to complete their deliberations and valuations on the basis that the following improvements or alterations had been completed or in place before they came to consider their task:

(a) An area of approximately 150 acres on part of the Run Block, which obviously is in present need of re-grassing, is to be re-grassed at the equally shared expense of both parties as soon as reasonably practicable, and this land should be valued as if the grass was already successfully re-sown.

(b) A new woolshed superbin and implement shed are planned for construction in the vicinity of H. D. Perkins' house in the very near future, and these will be constructed and completed at the expense of the partners and his land should be valued as if these had already been completed.

(c) All new boundary fences along demarkation lines will be fenced at the equally shared expense of the parties and the property is to be valued as if these fences were already constructed.

11. ALL land is to be valued at 1st July, 1981 but as if the improvements referred to in the preceding paragraph hereof had already been completed."

It was not contended that this document is not a submission to arbitration: note Steele v.. Evans (No. 2) [1949] NZLR 548, 556 (C.A.).

Paragraph 5 of the terms of reference resulted from a discussion as to whether Mr Briscoe should play any part at all. Although the only agreement reached was that he should not act as umpire, Stanley has deposed that he had assumed Mr Briscoe would not be involved because all present clearly understood that his earlier report would play no part in the valuers' considerations. Mr Griffiths, Trustees Executors' local manager, was present at the meeting. He deposed that although Harvey at first claimed that Mr Briscoe's report was logical, and that he saw no need for a further report, later in the meeting, when the need for the appointment of valuers was accepted, it was made clear that Mr Briscoe's earlier suggestions would not be relevant, for the whole matter would have to be looked at afresh. Mr Griffiths' evidence was confirmed by Mr Keith, of the stock and station firm with which the partnership dealt. Indeed he recalled suggesting the appointment of valuers from outside Southland, to ensure that there was a completely fresh approach.

Harvey however obviously took a different view, for he approached Mr Briscoe and asked him to accept appointment as the valuer to act on his behalf, and Mr Briscoe agreed. I quote from Harvey's affidavit:

"9. THAT it was my belief that the arbitration was required for the primary reason of the first respondent's objection to the proposal to divide the land in a way which placed the boundary close to his farm buildings and homestead, and I submitted to the arbitration on this basis.

10. THAT I did not apply my mind to the possibility of any radical departure from the basic proposals set out in Mr Briscoe's original report.

11. THAT on appointing Mr Briscoe as the arbitrator nominated by me I was not warned by him or advised by any other person that Mr Briscoe's views of the matter could radically depart from those expressed earlier by him.

12. THAT my wife and I visited Mr Briscoe's office at Invercargill to request him to act as the arbitrator appointed by me and he accepted this appointment. That occasion would have been some relatively short time after the execution of the Deed, but 12 to 18 months after I had last had anything to do with Mr Briscoe.

13. THAT during my wife's and my visit to Mr Briscoe's office as referred to previously, we discussed general matters of interest such as the delay in reaching any settlement in issues between the first respondent and me. We also discussed his original report on the matter of the division of the farm land and I said that I was very pleased with those proposals and thought that they were fair. Indeed, that is why I wished to appoint Mr Briscoe as an artibrator.

14. THAT Mr Briscoe during the discussion referred to in the preceding paragraph did not indicate any withdrawal from his views expressed in his original report, and in fact we discussed his original proposals

in a way which left my wife and me in no doubt that Mr Briscoe still believed in those proposals.

Mr Briscoe also signed an affidavit in which he commented on the last two, of these paragraphs thus:

"Paragraph 13

I do not recollect any discussions in my office of the report which I had prepared in 1979 in respect of the farm property, when circumstances were significantly different.

Paragraph 14

I think it highly unlikely that I would have given any indication as to whether my views on the original report would have remained the same or would have changed. The whole matter required reassessment according to the specific instructions set out in the "Terms of Reference for Valuers". I would not contemplate proceeding by simply adopting a previous report prepared in different circumstances. I may not have given any impression that I was differing from a previous report but, at this time, it would have been inappropriate to either adopt or reject any previous document. In accordance with my general practice I started afresh and in accordance with the Terms of Reference for this particular occasion."

Mr Oldfield was appointed by Stanley, who was not known to him, and he and Mr Briscoe duly appointed their umpire, Mr Oldfield inspected the farm on 8th, 9th and 10th August and Stanley showed him over it. He also spoke with Harvey. On 11th August he met Mr Briscoe, who had not been back there since 1979, and they inspected the property together. Mr Briscoe went back on 14th August and went over it again with Harvey, and on the same visit spoke to Stanley. Both valuers thought they had given the brothers ample opportunity to make comments or representations, although it is not clearly established that either specifically invited them to do so. Neither however asked for any further opportunity. Stanley does not complain of any lack of opportunity, but did not think it essential that he should have it. Harvey on the other hand stated that he discussed Mr Briscoe's original proposal with him, and suggested an amendment that might satisfy Stanley, and that Mr Briscoe replied in a manner that led him to believe that that proposal "would form the basis of Mr Briscoe's views on the division". Mr Briscoe did not recall this conversation, and did not acknowledge saying anything that would have given Harvey this belief.

On 20th August there was a meeting between the brothers, the solicitor and Mr Briscoe to obtain clarification of paragraph 10 (b) of the terms of reference and as a result a supplementary deed was executed. It recited that "the valuers have together embarked upon their task" and that they had raised this question of interpretation. It then went on to describe in full detail the woolshed and yards that were then being built and declared that they would be a charge to the partnership; but that the implement shed and super bin would not be a charge on the partnership, and were not to be taken into account by the valuers.

The following day, the award was completed. The valuers had not found it necessary to call on the umpire. No formal hearing had taken place, and no formal opportunity given to the parties to present evidence or make representations. The award was released only after each brother had paid his share of the costs. The award by and large completely reversed the division Mr Briscoe had proposed in 1979. It gave Stanley the western part of "Ironwood" and the northern part of "Tussock", and Harvey the eastern part of "Ironwood", all of "Henderson" and the southern part of "Tussock". And because the valuers considered that their division had achieved an equality of value, there was nothing to pay. Stanley is content with the award, but Harvey considers that he has been badly treated, having been allocated land that is "materially less attractive and of less value" than that allocated to his brother.

Harvey has since sought the opinion of two other registered public valuers, experienced in farm valuations. Mr A. P. Laing of Dunedin furnished a report in which he recommended, as best implementing the terms of reference, a partition that appears identical to that in the award, except that the boundary dividing "Ironwood" is moved slightly to the west, giving Harvey a little more land. However he differed significantly 'from the award in his valuation, for he considered that to achieve equality on the boundaries he drew, Stanley would be required to pay Harvey $135,000. Mr J. G. Newson of Otautau proposed a slightly different solution, giving Harvey somewhat more of "Ironwood", thus reducing the payment by Stanley to $79,750. He also valued the two holdings as the award divided them, and estimated that the land awarded to Stanley was worth some $264,500 more than that awarded to Harvey (out of a total value of the whole property of $2,407,500). Although Mr Laing did not undertake a similar exercise, it is clear from his own figures that he would put the disparity even a little higher.

The Course of the Litigation

On 26th November, 1981 Harvey issued a writ against Stanley and the trustee. He wanted to have the deed of 24th July set aside and it was obvious that his reason was dissatisfaction with the award. The statement of claim alleged that the deed was "defective, unlawful and not binding", for six reasons: duress and undue influence on the part of Stanley and the partnership's solicitor; mistake, in that he executed the deed in the belief that the partition would approximate that proposed in Mr Briscoe's initial report and that each brother would "receive an equally attractive, equally manageable and equally profitable farming unit"; misconduct on the part of the arbitrators, in that they failed to give due and fair weight to the matters set out in paragraph 7 of the terms of reference; illegality in the form of noncompliance with the Land Settlement Promotion and Land Acquisition Act 1952; frustration; and finally, that enforcement of the deed would be unjust and unconscionable. It was then alleged that it was just and equitable that the partnership be dissolved, and the relief sought was simply an order for dissolution. The statement of defence acknowledged that the partnership should be dissolved, and sought various related orders, including one fixing the partition line. On 15th September, 1982 the statement of defence was amended, and a counterclaim was brought, seeking orders requiring implementation of the deed and the valuers' award. Harvey's defence denied that he was bound by either the deed or the award.

On 11th October, 1982 Harvey filed a motion to set aside the award, or alternatively for it to be remitted to the arbitrators for reconsideration. The grounds put forward related to the result of the award and not to matters of procedure and were these:

"1. THAT the said John Henderson Oldfield and Joseph Wade Briscoe misconducted themselves in failing of give due and fair weight to the matters in Clause 7 of their terms of reference being as follows:

(i) That the partnership has always been an equal partnership.

(ii) The desire of both parties to be left with units that are as equal and logical as possible from a practical farm management and working point of view.

(iii) That desire of both parties to be left with units that are as near as possible equal in area, stock carrying capacity and monetary value.

(iv) The fact that the subject property is very substantial and accordingly diverse as to terrain, soil types, weather conditions, and pasture type and conditions, and pasture type and conditions.

2. THAT the award made by the arbitrators was defective in that the proposed partition did not achieve equality and there was in fact a difference in attractiveness, farming potential and market value between the two parts of the partitioned land."

The first paragraph repeats the allegation in the statement of claim. The second paragraph reflects other allegations in the statement of claim, although the allegation that the award was consequently defective is new.

On 15th October, 1982 an amended statement of claim was filed, It introduced (as paragraph 10) an allegation identical to that in paragraph 2 of the motion, and also sought an order setting aside the deed. Again there was no prayer for relief in respect of the award itself. The significance of paragraph 10 related solely to the plea of mistake.

On 27th January, 1983 Harvey's solicitors moved for an order that the action and the motion be heard together. This was opposed by Stanley, the trustee and the valuers and when the matter came before. Cook I on 21st April he agreed with them. He saw the two matters as quite distinct.

On 13th June, 1983 the statement of claim was amended again. It introduced an allegation that the deed had been discharged. It amplified the allegations of mistake and frustration, placing in the 'forefront of both the allegation that so far as Harvey at least was concerned the award would approximate the partition proposed by Mr Briscoe. The allegation in paragraph 10 that the award was defective was repeated, but the allegation of misconduct, in failing to, implement paragraph 7 of the term of reference, was dropped.

The action was tried by Roper J on 8th and 9th August, 1983. The allegations of duress and undue influence were abandoned at the outset. The allegation that the award was defective was not gone into. Of the others, all but two were abandoned during the hearing. The two remaining were illegality and discharge and in a reserved judgment delivered on 20th September, 1983 Roper J found against Harvey on both. The validity of the deed was upheld in all respects.

On 22nd February, 1984 an amended motion was ifled, adding two further grounds, this time relating rather to procedural matters, namely:

"2. THAT the Fourth Respondent misconducted himself by being an arbitrator to the award which was materially different from a previous opinion stated by him as to the subject matter of the award and he further misconducted himself by not requiring the umpire appointed by the arbitrators to decide upon the conflict of positions.

3. THAT the arbitrators further misconducted themselves in that they failed to adopt a procedure which conforms with the rules of natural justice and in particular:

(i) They did not see the parties at any time with each of the parties present with the other.

(ii) They did not give either party a chance to make submissions to both of them sitting together as arbitrators.

(iii) They failed to warn the Applicant that the previous written report of the Fourth Respondent on the subject matter of the arbitration was not going to form the basis of their award and therefore deprived him of the opportunity to make submissions on the matter.

(iv) They did not give the parties any general indication of the boundaries which they were proposing and therefore denied the parties the chance to make submissions or to call evidence.

(v) They did not conduct a hearing.

(vi) They did not give the parties a chance to call any formal evidence.

(vii) They did not give the parties an opportunity to be represented by counsel."

This was further amended on 20th May, 1984, by deleting the alternative prayer that there be a reconsideration of the award and adding a prayer that the valuers be discharged. It was agreed at the hearing before me that if the award is set aside, it would be proper that they should be discharged. I record too that it was also agreed that the award is of the kind in respect of which relief under s 12 of the Act may be obtained.

The essence of Harvey's case as presented to me does not appear from the statement of claim or the original motion. It is that Harvey ought to have been told that the report of August 1979 was not to be the basis of the award, so that he could have had the opportunity to make submissions, and if necessary call evidence, as to what he regarded as a proper partition and a proper valuation. This is specifically ground 3 (iii) of the motion in its final form, but it is also taken up in the other subparagraph of ground 3, and in ground 2,

Delay

Mr Tipping and Mr Willy both took the preliminary point that the motion should be dismissed simply by reason of the delays that have occurred: first, the delay of over 13 months between the date of the award, 21st August, 1981, and the date the original motion to set it aside was filed, 11th October, 1982; and secondly (and this relates to grounds 2 and 3 of the amended motion only) the delay of 21 years between the date of the award and the date upon which the principal complaint was first raised, 22nd February, 1984. No point is taken of the time that has elapsed since February, 1984, for that has not been Harvey's fault.

The Act does not prescribe a time within which an application under s 12 must be made. The Courts have adopted the principle that it must be made within a reasonable time, reasonableness being judged in the light of all the circumstances affecting the applicant's ability to bring the application. If the time that has elapsed is unreasonably long, the Court has a discretion whether or not to dismiss the application on that account. In the exercise of the discretion, considerations such as the length of the delay, the reasons for it, the prejudice if any that would be done to the other parties if the application were permitted -to proceed, and the merits of the applicant's case are all of relevance. As authority for these propositions, reference may be made to Invercargill City Corporation Y. Dick [1960] NZLR 788, Kenneth Williams & Co. Ltd. v. Martelli [1980] 2 NZLR 596 and the judgments of Somers and Casey JJ in the Court of Appeal in the unreported case of Bradey v, Anchor Dorman Ltd. C.A.204/82, delivered on 6th April, 1984.

The delays in the instant case cannot be regarded as other than unreasonable. No explanation for them was given. On the other hand, I doubt that any prejudice can have been caused to the other parties.

In the case of the grounds raised in the original motion, which go to the substance of the award, I think I may assume that the explanation for the delay is a procedural one: that initially the validity of the award was not attacked because it was against the deed that the challenge was mounted; and if it fell, then of course the award fell with it. The original motion raised no new issues. It should I think be regarded as a means of obtaining, by a more appropriate procedure, but on the same grounds, an alternative remedy to that sought by the writ in respect of the particular aspect of the matter with which it dealt. There can have been no prejudice to the other parties by having this particular aspect raised in this new way. Furthermore, although the motion was the first occasion on which Harvey expressly opened up the possibility of the partition exercise having to be undertaken afresh, Stanley had raised it earlier in his own pleadings. There can therefore have been no prejudice in that respect either. Lack of prejudice is not the deciding factor, but when it is coupled with the way in which the particular issues were raised in the pleadings, the case - as raised by the original motion - is in my opinion not one where an enquiry into the merits should be refused by reason of the delay.

However the position with regard to the second and third grounds of the motion, which deal primarily with procedure and not substance, and which were introduced for the first time only on 22nd February, 1984, is altogether different. The delay here can fairly be described as inordinate. And the kind of explanation or excuse available in respect of the original motion cannot apply to these two new grounds. In his affidavit Harvey stated that he was expecting that before the award was made he would be given the opportunity to meet with the valuers, and the other parties; that he was surprised when the award was published without such a meeting, and with no further communication; and that "this surprise was heightened when the substance of the award was totally different from anything ever contemplated by me and radically different from the original proposals suggested by Mr Briscoe"; and that he still wished to be heard and to call evidence *on* a proper division. This affidavit was sworn on 15th May, 1984 and apart from the amended motion filed three months before, it is the first intimation of any complaint of this kind. I cannot but regard it with some scepticism, but that is a comment as to the merits, and I will return to them. Again, there can be no real prejudice to the other parties, certainly over and above any caused by delay in disposing even of the first ground of the motion. But in my opinion a party to an arbitration ought not to be permitted to raise after such a time complaints as serious as these, which if valid existed and were known to exist from the moment the award was published, unless there is a very compelling reason. To hold otherwise would be to, repudiate the basis upon which people go to arbitration, which is to secure a speedy and final resolution of their dispute. No compelling reason is to be found by way of explanation for the delay, and the issue therefore becomes one of the strength of Harvey's claim. For a strong case may provide a compelling reason for excusing even inordinate delay. I therefore move to a

consideration of the three grounds upon which the motion is based, taking them in reverse order, as Mr Marks did, because he considered this to be their order of importance.

Necessity for a Hearing

The question raised by paragraph 3 of the amended motion is not merely whether there ought to have been a hearing as a matter of general principle, but also whether there ought to have been one in the particular circumstances of this case, namely the nature of the enquiry and the fact that Mr Briscoe had previously prepared a report proposing a different solution from that which now commended itself to him and his colleague.

It was not suggested that the valuers were not arbitrators, or that their enquiry was not governed by Arbitration is a matter of contract, and the powers and duties of an arbitrator are those and only those which the parties agree to give him: Russell on Arbitration 20th Ed p 208. Thus where the procedure for the conduct of the arbitration is prescribed by the reference, that is the procedure that must be followed. Where no procedure is prescribed, the parties' intentions must be inferred, and the natural inference is that they intend a hearing, with the opportunity for each to present his own case and to hear, and so be able to answer, the case of the other. Experience shows that this is the best way of ensuring that justice is done. But the inference is not automatic. The nature of the inquiry, its subject matter, and the terms of reference may independently or in combination require the inference that the parties intended something less formal, even no hearing at all: Mustill & Boyd's Commercial Arbitration pp 250, 262-3.

In my opinion, the proper inference in the present case is that it was intended that no formal hearing should take place, but that the valuers should adopt their own procedure. The exercise was a specialist one and specialists were engaged to carry it out. The terms of reference, together with what they could see for themselves, might well have given the valuers all the factual material they needed. Ascertainment of the essential facts would not depend on credibility. Having obtained that material, their task was then to apply their specialist knowledge and skill in order to arrive at the result indicated by the terms of reference.

If I am wrong in this view, and if the reference did entitle the parties to a hearing in any event, then I consider both waived that right, for neither made any request or raised any query, even at the stage the supplementary deed was signed. And both paid their share of the costs and uplifted the award without comment or complaint. Indeed it is perfectly plain that no complaint would ever have been made had the award been more acceptable to Harvey.

However, notwithstanding that the intention was that a hearing was not necessary, the valuers were still required to observe the rules of natural justice and to act fairly: London Export Corporation Ltd. v. Jubilee Coffee Roasting Co. Ltd. [1958] 1 All ER 494, 497-8, per Diplock J. For example, had either party wished to make representations or to adduce evidence, then the opportunity would have had to be offered, and some kind of a hearing, fair to both parties, would have been required: Mustill & Boyd p 263. This of course did not arise. Again, questions of credibility can rarely be resolved without a hearing. Another requirement of fairness is that an arbitrator must not hear one party in the absence of the other. In this case, that requirement was not observed. Although, unfortunately, the valuers' procedure was thus irregular, I do not for a moment question their integrity. The terms of reference could have put the matter beyond doubt. And I make the point that the valuers sought to be fair. For although each spent more time with the brother who had appointed him, each also spoke to the other brother. There were no secrets about it. Both brothers were aware of what was happening, and concurred in it. There is no evidence that Stanley said anything to either valuer that might have been prejudicial to his brother's case, and indeed the only evidence as to the content of the conversations is Harvey's, as to what he said to Mr Briscoe. There is therefore no reason to think that any injustice has been done to Harvey.

That however is not the decisive consideration. The Court must be alert to the risk that the minds of the valuers may have been affected by something said by one party in all innocence, that the other could have countered had he known of it: Mustill & Boyd p 270. Concurrence in the procedure will not necessarily cure the irregularity: W. Ramsden & Co. Ltd.. Y. Jacobs [1922] 1 KB 640. This I think is the point of an observation by Prichard J in an unreported judgment to which Mr Marks referred, Turner v. A. & G. Mardell Ltd. (Rotorua, M 69/83, 29th July, 1983): "The fact that neither party asked for a 'formal hearing is not a circumstance which obviates the requirement that the arbitrator must act judicially".

Although paragraph 3(i) of the motion seems to be directed at least in part to this point, Mr Marks made no specific reference to it, and certainly placed no reliance upon it. I thus see it as a purely technical point, of little if any significance in my assessment of the merits of Harvey's case.

Given the nature and terms of the reference I do not consider that fairness any more than the contract, required the valuers to adopt any of the procedures postulated by subparagraphs (i), (ii), (v), (vi) of paragraph 3, and I therefore proceed directly to subparagraphs (iii) and (iv), which raise, in the context of the right to a hearing, the nub of Harvey's case.

It is appropriate first to observe that it was the duty of both valuers to embark on their assignment with open minds, and to reach their conclusions in accordance with the criteria set out in their terms of reference: Russell, p 233. Had Mr Briscoe done what Harvey appears to have suggested to him, and merely made some boundary line modification to his proposal of 1979, then he might well have been open to a charge by Stanley of bias or pre-determination. That objection of course might have come to nothing had the umpire been called in, but the fact remains that Mr Briscoe had a duty to both brothers. He was required to approach the matter in the light of contemporary conditions and values, not those of two years before. And this time he had very clear guidelines, whereas earlier his instructions appear to have been very much more general. Further, he had earlier been asked to produce a proposal for consideration and decision by others. Now, he was one of the decision-makers. In these circumstances I do not think that the valuers were under any obligation to warn Harvey that the award they intended to make was different from Mr Briscoe's report. Nor do I think that he had any right to think that they would warn him if that was their intention.

I have already referred to the affidavit evidence and to my scepticism about Harvey's expectations. None of the witnesses was cross-examined, so that I do not have that particular advantage in resolving the conflict between Harvey's recollection as to the discussions that took place and that of other deponents. But Mr Briscoe's account of the discussion in his office is much the more likely; whilst I have no reason to doubt the evidence of Mr Griffiths and Mr Keith concerning the meetings preparatory to execution of the deed. The negotiations were protracted and difficult, and partition of the land was the key issue. It could not possibly have been in anyone's contemplation that all that would happen would be a modification to a. proposal put forward, rejected and abandoned two years before. I consider that the specific exclusion of Mr Briscoe from appointment as an umpire confirms that his earlier suggestion was not even to be considered. In appointing him, Harvey may well have hoped he would adhere to that proposal, but I cannot accept that Harvey had any genuine or certainly any reasonable expectation that he would. And I reject the contention that Harvey ought to have had the opportunity to argue in support of it. After all, the valuers might well have satisfied Harvey by some other solution altogether. I therefore think that there is neither legal force nor intrinsic merit in paragraph 3 (iii) of the motion.

I confess that I do not understand the legal basis of subparagraph (iv) as a proposition independent of subparagraph (iii). Nor was I made aware of the nature of the submissions and evidence which Harvey claims he would have presented. I thus do not see any force or merit in subparagraph (iv).

Mr Marks placed considerable reliance in this area of his case on the unreported judgment of Vautier J in Lincoln Industries Ltd. v. Scott Group Ltd., Auckland, M.195/82, delivered on 4th October, 1984. The subject matter of the reference there was the valuation of plant

and equipment on the sale of a business; and the nominated valuers being unable to agree, the dispute was referred to their umpire. He had a number of discussions with representatives of the respondent in the absence of the applicant. And in his award, as a result of his own interpretation of the sale agreement, he made no allowance at all for certain dies and tooling which the valuer appointed by the respondent had valued at $30,000 and the applicant's valuer at $205,675. Vautier J set aside the award for misconduct in several respects, those presently relevant being that the umpire had "failed to act fairly by both parties by talking with one party in the absence of the other and taking evidence in the absence of one party and by deciding an important aspect on a point not put to the parties and without giving an opportunity for submissions to be made upon it". The first of these matters of course relates to the topic I have dealt with earlier, and the second, Mr Marks submitted, is akin to that raised in paragraph 3 (iii) and (iv) of his motion.

However in my view the cases are not parallel at all. The essence of the Lincoln Industries case in this particular respect is expressed in these two passages in the, judgment:

"What I think is of importance for my purposes is that it has been clearly demonstrated in my view that the umpire embarked upon a question of legal interpretation of a document, that the arbitrators and the umpire were not, it seems clear, specifically asked to interpret this document and that the umpire took no steps at all before making his award dealing with this legal question to ascertain whether either of the parties wished to make submissions upon the point. The matter of course becomes of even greater importance in relation to the matter of whether or not the arbitrator acted fairly when it is noted that the legal question postulated by him is used as the basis for omitting altogether from his valuation items to which one of the nominated valuers had attributed a value of $205-675. Furthermore, it is the same point as had been advanced at an earlier stage by Mr Scott on behalf of the respondent in his letter of 6th July, 1981 and the award upholds his argument."

"On the evidence presented I am constrained to find as a fact that Mr Lambert [the umpire] was fully aware that his view and that of the respondent's managing-director as to the dies not requiring to be valued were not accepted by the applicant. In such circumstances the applicant should clearly in my view have been afforded the opportunity to present submissions and also the kind of expert evidence now put before this Court in the affidavit of Mr Wright as to the question of valuation involved."

In these circumstances the fact that the applicant did not ask for a hearing was held not to be a sufficient answer. The crux of the matter was that the umpire raised and decided this important issue entirely on his own initiative, knowng that the parties took opposing views upon it, and that the arbitrators had not considered it. None of those unusual factors were present in this case, where the valuers simply set about the task entrusted to them.

There was always the possibility that one, perhaps both, the brothers might have been displeased with their conclusion, but in my view specific provision would have been required in the terms of reference for it to be necessary for them to present their proposals in a tentative form, to call for submissions, and then reconsider: how would the process otherwise come to an end?

The various complaints under paragraph 3 of the motion are primarily directed to the way in which the land was divided, not to questions of value and payment to achieve equality of partition. It is plain from the evidence of Mr Laing and Mr Newson that the partition itself was proper, in terms of compliance with the criteria in the terms of reference. Thus even if Harvey was in fact wrongly deprived of the opportunity for a hearing, even if the valuers ought to have pro ceeded in one or more of the ways alleged in paragraph 3 of the motion, no injustice has thereby been occasioned to him.

Misconduct by departure from original proposal

Under this heading I deal with the second ground in the amended motion. I need say little about it, for I have already indicated that it cannot be misconduct for Mr Briscoe to have departed from his previous proposal. It would have been wrong for him not to have done so, having come to the conclusion, as he obviously did, that the new proposal was to be preferred. I do not think his role was that of an advocate, requiring him to argue a particular proposition before the umpire. There was no need to bring in the umpire, because plainly, in terms of paragraph 3 of the terms of reference there was no failure of the valuers to agree between themselves.

In Steele v. Evans (No. 2) (supra) an award by two valuers of the chattels on a hotel sale was set aside for misconduct because the award was for an amount 90% greater than one of the valuers has assessed less than four months previously. The increase being otherwise inexplicable, the Court of Appeal held that the only inference to be drawn was that the particular valuer was affected by bias or partiality (per O'Leary CJ at p 559) or dishonesty (per Kennedy J at p 560 and Northcroft J at p 561). Mr Marks argued that the present case is very similar. But I do not agree. That was a very singular case, and the very simple facts led to but one conclusion. Here the lapse of time, the different circumstances and the clearly defined terms of reference all provide possible explanations for the different view Mr Briscoe took. Moreover, and most importantly by way of contrast with Steele v. Evans, the issue for resolution was not simple and clear-cut. It involved a variety of considerations, the balancing of many diverse factors. It was very much a matter of judgment. No doubt many possible schemes of partition could have been put forward. It was eminently a case that called for discussion between the valuers, mutual reflection and deliberation and the evolution of a scheme that took the best account of all that was involved. The valuers have not disclosed the process of their reasoning, but it does not surprise me at all that, fulfilling their duties conscientiously, they arrived at a quite different conclusion from that which Mr Briscoe, working on his own in different circumstances, on different values (they had meanwhile increased by a million dollars) had reached a considerable time before. And of course the evidence of Messrs Laing and Newson dispels any concern as to the honesty and integrity of the partition itself. There is still the difference of opinion about values, but that is another issue, which I discuss below. The particular ground now under consideration refers to the partition, and in my view it has neither substance nor merit.

Failure to achieve equality

Under this heading I refer to the two grounds set out in the original motion, which amount to an allegation that the award demonstrates on its face a failure by the valuers to take due regard of the criteria set out in paragraph 7 of the terms of reference. In view of the fact that Messrs Laing and Newson would both have divided the property in much the same way as the award, this complaint must be limited to the valuation aspect of the reference, which is the subject matter of the second rather than the first of these two grounds.

It is a basic principle that the Court will not set aside an award simply because it thinks the arbitrators have reached an erroneous conclusion on the facts. The parties have chosen their tribunal and must abide by its decision. There must be misconduct for the Court to interfere:

"It is no ground for coming to a conclusion on an award that the facts are wrongly found. The facts have got to be treated as found. . . Nor is it a ground for setting aside an award that the conclusion is wrong in fact. Nor is it even a ground for setting aside an award that there is no evidence on which the facts could be found, because that would be mere error in law, and it is not misconduct to come to a wrong conclusion in law and would be no ground for ruling aside the award unless the error in law appeared on the face of it. . " per Atkin Li in Gillespie Bros. & Co. v. Thompson Bros. & Co. (1922) 13 Ll.L.Rep.519 at p 524.

And see generally Russell at p 422 and Mustill & Body pp 503-4. The matter was canvassed in Steel v. Evans where O'Leary CJ pointed out (p 557) that inadequacy of amount is in itself no ground for a ifnding of misconduct; although in certain circumstances of which those in that case were an example, it might compel a conclusion of partiality. See also Mayor

etc of Wellington v. Aitken, Wilson & Co. and others (1914) 33 NZLR 897.

In the present case, two valuers have reached one conclusion, two valuers another. The total value of the land determined in the award was $2,400,000, $70,000 less than Mr Laing's assessment, $7,500 less than Mr Newson's. The difference between the award and Harvey's valuers, if I may so refer to them, therefore lies principally, probably entirely, in the separate valuations of the land apportioned to each brother, and the assessment of the relative worth of each part in relation to the other. The difference is certainly substantial in monetary terms, although a little less striking in relative terms: Mr Newson's estimate of the value of the land awarded to Stanley exceeds the value in the award by some 11%. There is no explanation for the difference, for the arbitrators have not sought to justify or explain the award. They, and Stanley, take the view that that is not a topic upon which the Court is entitled to embark. I agree. It is I think plain that the exact equality expressed in the award cannot be the result of any precise calculation, such as the multiplication of area by a fixed sum per hectare varying according to the individual qualities of specific areas; but rather that the valuers have taken a more general view. However in my opinion it cannot be said that that is indicative of misconduct. At most it may be indicative of some error or mistake, but that is not sufficient reason for the Court to set the award aside: Wilson v. Glover [1969] NZLR 365, 372. In a case such as this, where the arbitrators are experts, and no evidence was heard, the Court is not entitled to assume that there was no basis for the award: of British & Bennington Ltd. v. North Western Cachar Tea Co. [1923] AC 48, 60, per Lord Atkinson, and Mediterranean and Eastern Export Co. Ltd. v. Fortress Fabrics (Manchester) Ltd. [1948] 2 All ER186, quoted extensively in Wilson v. Clover. Thus I must accept that the conclusion that the brothers were awarded lands of equal value was an honest, genuine and proper one, which I am not entitled to review.

Summary of Conclusions

For the reasons I have given I conclude:

1. The grounds of objection to the award set out in the original motion are not sustainable.
2. The further grounds set out in the amended motion are not sustainable. The valuers did however misconduct the proceedings by discussing the case with the parties separately. However that error was not relied on by Mr Marks, there is no evidence that any injustice has resulted and in these circumstances I consider it of little merit.
3. The delay in advancing the further grounds set out in the amended motion was so great, and their merits so slim, that I would exercise my discretion against allowing the application even if any of those advanced were sustainable; and even though the one, not advanced, does have substance in law.
4. The motion is therefore dismissed. Costs are reserved for further consideration - by memoranda I suggest - if necessary.

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