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The NEW ZEALAND VALUERS' JOURNAL is the official publication of the New Zealand Institute of Valuers. The JOURNAL is published four monthly and the Publications Board welcomes researched articles from qualified individuals concerned with valuation, business management of a valuation practice and property related matters.

Each article considered for publication will be judged upon its worth to the membership and to the profession. The Editor reserves the right to accept, modify or decline any article. Any manuscript may be assigned anonymously for review by one or more referees. Views expressed by the editors and contributors are not necessarily endorsed by the New Zealand Institute of Valuers.

Complete editorial policy review process and style instructions are available from the Editor. Deadline is no later than 30th of January, May and September of each year.

Format for Contributions

All manuscripts for publishing are to be typed double-spaced with wide margins, on one side only of A4 sized paper and must be suitable for scanning. Computer disk copies (IBM compatible 3.5") are encouraged.

Original photographs, diagrams, tables, graphs and similar material intended to illustrate or accompany an article should be forwarded separately with the text. Where possible include a table of values used to generate graphs.

Illustrations should be identified as "Figure 1 (2,3,etc)". The approximate places where illustrations are to be inserted through the text should be clearly shown in the manuscript.

A brief (max 60 word) profile of the author, a synopsis of the article and a glossy recent photograph of the author should accompany each article.

Primary (a-level) heads should be typed in all capitals and bold, secondary (b-level) heads with inital capitals and bold and tertiary (c-level) heads should be italicized. Do not number headings.

Footnotes, Endnotes, References and Acknowledgements are to be listed at the end of the article in the following format:

Footnotes, Endnotes	*References and Acknowledgements*
1. Comment	Author; Title; Publication
2. Comment	Author; Title; Publication
3. Comment	Author; Title; Publication

Manuscripts are to be no longer than 5000 words, or equivalent including photographs, diagrams tables, graphs and similar material.

Articles and correspondence for the NEW ZEALAND VALUERS' JOURNAL may be submitted to the Editor at the following address:

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EDITORIAL COMMENT

Good Progress

The February Council meeting was a good example of wise leadership and positive thinking. It takes any organisation time to shake down to a new strategy and direction. The NZIV is no exception. Some members have indicated a degree of impatience over the changes expected since the 1995 AGM but an organisation as large and as deliberate as ours takes a little longer than most to change its direction. It's a bit like a supertanker trying to turn. It can result in one hell of a mess if there is a misjudgment on the part of the crew.

Councillors have an unenviable task, particularly during times of change. Most are senior practitioners or executives. They all give up valuable time to attend a raft of meetings, all on behalf of members. The time foregone is not just their own but it is that of families, business partners and personal interests. One particular stress to some is the need to balance the instructions of their branch membership with that of the general good of a national body. By the nature of their position councillors become privy to a range of critical information at the council table which may not, and often cannot, find its way to every city, town and hamlet in New Zealand. That is why there is a need for a common meeting place so that information, ideas and new developments can be readily exchanged.

Members are particularly well represented by their councillors and just as well supported by a fine secretariat. It is important that members take time to make enquiries and think about the bigger picture than just the problems of their little patch. A strong national body is essential to assist its component parts. Local irritations are more easily resolved when the cow has the energy and the freedom to swish the tail.

February's meeting produced good initiatives on marketing, equal opportunities and publications. Councillors felt that where marketing is concerned, the organisation must concentrate on "helping members to help themselves". This can be achieved through more focused education and hands on assistance, rather than swamping potential clientele with advertising. (There are some excellent articles on marketing and self improvement in this issue).

As a result of the recent publications survey there is to be a significant, but not surprising change to our regular publications. The *NZ Valuers' Digest* will replace *NewsLine* and it will also incorporate quite a number of regular features of the Journal. The NZ *Valuers' Journal* will focus more on authoritative long term reference material for the practitioner while the Digest will cater for news, views and interviews across the whole gambit of the valuation, consultancy and land economics fields. For more on this see page 9.

As a once male dominated profession we seem to have made good progress in adopting the principles of equal opportunities. Many of the initial apprehensions have now disappeared and it is heartening to see the contribution women valuers are making to both the profession and to the Institute. There. is no reason why we can't, with absolute confidence, incorporate women valuers in all marketing messages, and in fact promote women valuers as role models. The use of gender inclusive language in all communications, reports and written papers is as good a way as any of saying "hey - we're all part of the valuers' network"!

From The President's Pen

During the past three months, I have received a number of reports relating to the Institute and to other property matters. These have included a review of the functions carried out by Head Office, the duties and responsibilities of the staff members, the new Constitution of the International Valuation Standards Committee; the first version of the revision of the NZIV rules, and the summary of responses from members who completed the survey on publications. I was disappointed at the small number of members who responded to this survey, however the comments were valuable and have provided the focus groups with plenty to consider including the future directions of our publications.

I have also studied reports on Equal Employment Opportunity initiatives, critical issues relating to education, and matters relating to the Pan Pacific Conferences to be held in Sydney in April and in Auckland in the year 2000.

Individual members have kindly sent me articles on a wide range of issues. Two in particular caught my attention. One was an article entitled "Secretive Professions Lose Spirit of Public Service". It was written by Dr Simon Longstaff, Executive Director of the St James Ethnic Centre in Australia.

Dr Longstaff warns that the professions may be on the road to oblivion, noting that professional people are becoming nothing more than self-interested service providers operating competitive businesses in the market. He reminds his readers that members of the professions are expected to act in the spirit of public service and are bound to put the interests of others before their own. He asks the question as to how many so called "professional people" have now become "hired guns". If this is significant, what place in society is there for the professions, should they be opened up to more competition, or should they be required to give more importance to the provision of impartial public service?

The second paper is from the American Appraisal Journal and is entitled "Successful Marketing for Appraisers", that paper is reproduced in full in this issue of theNew *Zealand Valuers' Journal.*

Council held a meeting in February relating to the marketing of the Institute as a whole and where that fits, with the marketing of individual members' services.

As you will discover when you read the article it raises four specific questions:

1. Why do appraisers need to turn their attention to marketing?
2. Whom should they target?
3. What services should they offer?
4. How should they conduct themselves?

The writer makes it clear that valuers need to demonstrate the benefits of valuation services, particularly to price sensitive clients. They can do this by demonstrating the cost benefits of the valuer's skills. It is the content of the valuation report that is of utmost importance and benefit to the client. The paper refers to the professional's general dislike of marketing his/her services and the thinking that it gives them a "pedlar image". It discusses the fear of the 90% rejection ratio that is common with cold calling. The writer covers "how" to market and notes that this is the steepest obstacle for most of us. I commend this paper to you all.

I believe that with our background, our experience, our qualifications and our knowledge, we have all the strengths to get over the basic hurdle of the fear of rejection. Once we do this we will find a significant increase in work available for each of us as qualified professionals. We are all capable of marketing our services.

This philosophy ties in with the strategies currently being promoted by the Chief Executive Officer and myself in encouraging the larger users of valuers thattheywill benefit by using the services of members of the New Zealand Institute of Valuers. But we must all individually play our own part in marketing our own individual skills.

You are aware that continuing professional development (CPD) is now mandatory with the requirement to complete 20 hours of relevant professional development per member. I want to reiterate that the basic premise of the New Zealand Institute of Valuers' CPD requirement is that it is relevant to the individual's development. It does not have to be all valuation based, but it is important that all our members do comply with a professional development programme and are seen to be moving with the times by improving their knowledge and skills since qualification and registration.

I am sure that all members will want to join with me in congratulating Bill Cleghorn upon his award of the Queen's Service Medal (for public service) in the latest New Years Honours List. Bill is the retiring Branch Councillor for Rotorua/Bay of Plenty. He has been a councillor for 14 years and he has had a significant involvement with Institute affairs, particularly in the development of our education initiatives. Well done Bill!

lain Gribble
President

PEOPLE IN PROPERTY

David Paterson

David Paterson is one of the newest Councillors to be appointed to the New Zealand Institute of Valuers, having just completed his first year.

David joined the Institute in 1982, and has since held positions of Branch Secretary, Vice Chairman and Chairman. He was appointed Councillor for Southland in 1995, following the retirement of long standing Councillor, Wade Briscoe.

David admits it was "slightly daunting" to think of filling the shoes of a predecessor who had held the position for 18 years, but looking back over his first year, he says it has been an enjoyable experience.

"There have been some very big changes to the structure of the Institute over the last year and it has been interesting to be a part of that."

He says it is important to have a professional body looking after the interests of its members, but sees the small membership base and competition from other property professions as a major problem. "There is a degree of apathy out there, and a feeling that members belong to the Institute because they have to, rather than because they want to."

"It is up to us as Councillors to turn this feeling around. This requires strong leadership and appropriate services to members. At local level, branch committees need to provide workshops that cater for a wide membership base."

Born in Southland to a farming background, David was educated at Central Southland College in Winton and graduated from Lincoln College in 1980 with a Bachelor of Agricultural Commerce. He went on to complete Post Graduate studies in Commercial/Industrial valuations and management at Massey University.

After joining Valuation New Zealand in 1980, David spent four years in Dunedin undertaking rural valuations before moving to Invercargill in 1985. He was promoted to Senior Valuer in 1988.

As with many valuers, David enjoys the variety the job has to offer.

"The variety of work has always appealed to me. It can range from staff issues of training and supervision, to valuing anything from a vacant residential site to the Fiordland National Park."

David enjoys all types of sport, and plays golf whenever the opportunity arises.

Married to Sandra, they have four young children Jeffrey, aged eight, Bradley, aged four, and Kelsey and Travis, twins aged one and a half years.

Ross Calderwood

Brought up on a farm near Ashburton, Ross Calderwood had dreams of becoming a farmer. However a "debate with an electric mincing machine" in his uncle's butcher shop left him minus a right hand and his father urged him to follow a profession that used "brains rather than brawn". That profession turned out to be Valuation.

Although Ross believes successful farming does in fact take a lot of brain power, he completed a Diploma in Agriculture and a Diploma in VFM at Lincoln University and became a rural valuer in Timaru in 1960.

Despite his physical disability, Ross also went on to play a variety of sports, reaching representative levels in rugby, tennis and athletics.

Ross has now served with Valuation New Zealand for 36 years, and says he has no regrets. "It's been a worthwhile experience that has allowed me to get a look around New Zealand and all its off-shore Islands," he says.

With a preference for rural valuation, Ross also held positions in Napier, Te Kuiti and Christchurch, before moving to Head Office in Wellington in 1985 as Assistant Chief Valuer.

The move to Wellington meant less practical valuation work and more administration. His duties covered the "total spectrum", both rural and urban as well as overseeing national valuation projects, dealing with staff matters including appointments, and more technical work. In 1988 he was made Manager of Valuing Services. "For a person who likes to be out and about, it was a bit of a shock."

Ross's involvement in Institute affairs includes positions of Assistant Secretary, South Canterbury Branch (1962-64), Committee, Waikato Branch (1968-69), Committee and rural examiner for Canterbury/Westland (1973-80), Councillor, Valuer General nominee (1992 continuing) and Executive (1993 - continuing).

His appointment as Valuer General nominee gives him the role of policy adviser and political "watch-dog" for the Valuer General and Minister.

"It's been interesting, I've really enjoyed it. I have been interested in Institute affairs, therefore I don't find the tasks onerous because I am keen to see the profession progress," he says.

Ross is married to Elaine, and has four adult children - Amanda-Jane, who manages technical draughting engineers in the petro chemical industry, Findlay, a merchant banker, Hamish, a company manager, and Campbell, a mechanic.

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Major Changes to NZIV Publications

An outcome of the November 1995 publications review was a decision by council to focus on publishing a more easily read, user friendly "digest" of topical news and developments.

The *NZ Valuers' Digest* will replace "NewsLine". It will include features from both NewsLine and the Journal such as CPD programmes, reports, personality profiles, legal issues, technology forum and professional cards etc. Articles will be topical and brief, with a blend of photos, graphics and some colour. Emphasis will be given to keeping members updated with ongoing developments particularly with regard to education. We will also focus on local, national and international market movements. There will be sections devoted to farming, property development, finance and to students issues: plus many others. Contributions will be sought right across the board. The intention is to add value both for subscribers and for advertisers.

TheNZ Valuers'Journal will continue but it will become a no" frills journal with quality reference material being the prime objective. A balance of contributions will still be sourced from practitioners, academics and outside journals.

The new publications are to be published alternately every two months. This coming May all members will receive the *Digest*. That issue will include the 1996 Annual Practicing Certificate directory as an insert. The combined May publication will be distributed free to lawyers, financiers, architects etc. with the intent of promoting our members, the NZIV and hopefully encouraging some new subscriptions. In July all members will receive the new style *Journal*. It will be slightly smaller in page size than at present. It will have a hard back spine similar to most other professional journals.

Advertising in the APC Directory will, in future, be directed to the more regular and more *readable Digest*. This income will go some way towards ensuring the maintenance of a high quality presentation of the *Digest*.

Statscom will remain in its present form. The ongoing developments of electronic storage and retrieval will continue to be addressed.

The Editor
W 0 Harrington

LAND TITLE LINK

A Direct Access and Delivery Service for Land Titles Office (LTO) Customers

How do you obtain your title information now? Do you walk down to the local LTO, perhaps send one of your staff or maybe request an agent to do it on your behalf? Are you looking for the day when you can see the Certificate of Title on a computer screen at the touch of a button? Maybe download that data so you can enter it in your file or report?

I am sure that will be possible in years to come once titles and supporting documents are computerised. In the meantime, to improve the delivery of current statutory search products the LTO is about to introduce a service called Land Title Link.

Products

Land Title Link will enable a customer to connect to the LTO computer system and make inquiries on the existing LTO databases:

- LT Index (to titles/owners/descriptions)
- LT Journal (work in progress, detailing tracking) and
- LT Plan Journal (plans in progress and tracking)

The results will be displayed on either the customer's PC or printer. Access to the databases will be available from 7 am to 7 pm each working day.

Title, document and supporting plan records are held at each LTO in either paper or microfilm format. These records will not be available on line. Land Title Link has been designed to enable a customer to:

- request copies of records
- choose the method of delivery (fax, mail, DX or pick up)
- choose the time frame for delivery (less than one hour or same day)
- request copies of records from 7 am to 7 pm.

The selected documents will be manually extracted, copied and dispatched during office hours (9 am to 4 pm).

How Land Title Link Will Work

A Land Title Link user will need:

- a PC with Windows software
- a modem
- a Pacnet line
- ideally a printer and a fax.

Land Title Link users will be supplied with an emulator software package on 3.5" disk plus user manuals and a training disk.

Each time a "result" screen is provided or a search copy dispatched, the transaction details will be recorded against the user's account. Invoices will be sent monthly and will show details including:

- who requested the information
- date of the request
- what was provided
- customer reference.

Availability

A prototype service launch is planned for early March 1996 in North Auckland (Auckland) and Southland (Invercargill). The prototype service will run for one month. More customers will be added to the service in North Auckland and Southland regions in April 1996. Availability of the service will be increased over the following few months region by region. Additional regions will be added in the following order: South Auckland (Hamilton), Wellington, Canterbury (Christchurch) and Otago (Dunedin), with Gisborne, Taranaki (New Plymouth), Hawkes Bay (Napier), Nelson, Marlborough (Blenheim) and Westland (Hokitika) being added at the same time.

Costs of the Service

The costs are:

- a $150 joining fee
- a $50 annual subscription
- Each successful database result screen will cost $1.

Title, document and Deposited Plans will cost $7 if delivered by mail, DX or collected, and $8.50 if by fax. If a copy is requested urgently (less than one hour) the cost increases to $15. All costs are GST inclusive.

More Information

If you would like more information please contact:

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Adding Value For Clients

Forecasting Real Estate Market Behaviour

MASSEY
UNIVERSITY

by Professor R V Hargreaves

Introduction

A leading NZproperty professional was recently heard to say that valuers are very good at describing the physical details oftheirsubjectproperty and analysing historical sales information. However, he also commented that most valuers are positively reluctant to offer forecasts about the future.

The reluctance of valuers to go on record as forecasting future events in the real estate market is understandable. Not only is the valuer faced with the possibility that the forecasts may turn out to be inaccurate, but there is also the possibility that a client may sue .a valuer on the basis of "bad" advice. Experienced valuers often argue that the possibility of having to defend their valuations in court forces them to rely on actual sales evidence and not speculate on what "might be". Although valuers are reluctant to make forecasts about the future, this author argues that in reality they have no option but to do so. If we agree that the value of a property is the present worth of the rights to the future income from the property, then the question is how to calculate future cash flows. Furthermore it can also be argued that the clients will be in a better position to make property decisions if they have access to information about what is likely to happen in the future.

The individual buyers and sellers operating in the real world market do make predictions about the future income streams that particular properties will generate. The market consensus on this is reflected in the price at which the property sells. To this extent it is conceded that valuers do not need to go beyond analysing current market sales. However, valuers operating in thin markets may find that the most recent sale was perhaps six to twelve months ago and since then the economy could have changed considerably. For example, in New Zealand interest rates can easily move up or down by 10% over a six month period. Similarly volatile exchange rates and overseas product prices can quickly impact on the real estate market.

This paper is an attempt to bridge the gap between historical market information and forecasting future real estate market behaviour. The research is being carried out by the Massey University Real Estate Analysis Unit (MUREAU). The forecasts reported with this paper are based on regular surveys of expert panels of property practitioners.

Establishing Expert Panels

The use of expert panels is well established in economic forecasting and market research. For example, the NZ Institute of Economic Research (NZIER) regularly carry out surveys of business confidence. Economists employed by a number of banks also conduct surveys of their clients' future business intentions.

Part of the NZIER business confidence survey work includes architects. The NZIER have shown that the amount of work architects have in hand is a very useful leading indicator about future work in the commercial construction sector. At the time of the stock market crash in 1987 many architectural practices rapidly went from a position of having plenty of work in hand to cancelled orders and staff layoffs. This all occurred at a time when there was still plenty of physical building activity and the "crane index" was at an all time high.

The idea behind the MUREAU research was to establish panels of property experts who would be able to make sensible forecasts about future property price levels and also the volume of transactions. To date, three panels have been set up to forecast the market outlook for various classes of real estate.

RURAL PANEL

The first panel to be established was a group of rural experts who consider the outlook for dairy, sheep/beef hill country, arable and finishing land, horticulture and forestry.

This group consists of leading rural sales managers and licensees, rural valuers and rural bankers. There are approximately 25 people on the panel. One third represents real estate sales and all panellists have a strong national or regional market overview. The balance of the panel comprises people in the rural finance sector, most of whom are also registered valuers. While the number of panellists may appear to be small, the reality is that there are only a few people with access to the information. By definition the number of "experts" in this market will be limited. One of the big advantages in using people at the property workface is that they can see market trends emerging before there is any market evidence available. For example when farm profitability is down, the number of farm sales is likely to reduce because potential purchasers cannot produce budgets that will satisfy their bankers as regards proposed debt servicing commitments. To consummate a sale, willing vendors are faced with either offering concessional vendor finance or reducing their asking prices. Similarly, when there are hard times on the farm, real estate agents find it much harder to make sales.

COMMERCIAL PANELS

The second panel of experts provides forecasts for the office, industrial, retail and apartment markets in Auckland. This pane] consists of around 35 experts in the areas of institutional property ownership, property companies, property developers, banks, valuers, real estate agents, commercial lawyers, property managers and property consultants.

The third panel of experts has recently been established to provide forecasts for the office, industrial, retail and apartment markets in Christchurch. The fields of expertise represented on this panel are much the same as the Auckland panel. A fourth panel of experts is being established for the Wellington commercial market.

MUREAU was seen to be in a unique position to carry out this research since the University was seen as being independent and not in business competition with any of the expert panellists. To gain the confidence of the panellists MUREAU signed a confidentiality agreement with all of the commercial panellists. An additional incentive is that the panellists receive a preliminary copy of the results of the survey well before the information is made public.

Survey Methodology

RURAL SURVEY

This survey is carried out on a quarterly basis. Questionnaires are mailed out to the panellists who are asked to respond by facsimile. The one page survey can be completed in a few minutes and asks questions about anticipated changes in sales volumes and prices levels for all the main classes of rural land use except lifestyle blocks. Lifestyle blocks were excluded because it was felt that this market was outside the current expertise of many of the rural bankers who specialise in lending to farm businesses. The survey is clearly aimed at providing a national perspective and does not attempt to break the farm classes down into regions.

The questionnaire distinguishes between asking the panellists for an opinion on work done in their own office and the wider rural market. The reason for this is that one rural lender may have a policy of expanding their rural loan portfolio and another may have a policy of just maintaining current market share.

The seasonal nature of rural real estate transactions means that quarterly comparisons cannot necessarily be made with the previous quarter. This point is illustrated in *Figure* 1 which shows the monthly volume of rural transactions (excluding lifestyle blocks) from May 1994 to April 1995.

To overcome this problem, respondents are asked to compare the current quarter with the same period last year. This in fact is the way that the main players in the market operate. The response rate for this survey is normally around 80%.

URBAN SURVEYS

These surveys are carried out on a quarterly basis. The questionnaires are mailed out and the panellists are asked to respond by freepost envelope or by fax.

The urban surveys use a slightly different format to the rural survey and ask questions about market confidence, expected changes in sale and rental prices of volumes of sales and leasing.

Figure 1

Total Monthly Farm Sales
from REINZ

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180'

May 94 Jul Sep Nov Jan 95 Mar
Jun Aug Oct Dec Feb Apr

Time

Figure 3

Fattening Farm Monthly Sales
from REINZ data

m
m
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Sep Nov Jan 95 Mar
Aug Oct Dec Feb Apr

Time

SURVEY RESULTS

The results of the surveys are published on a quarterly basis.

Turnover Rates

After the surveys have been operating for some time, it will be possible to evaluate the accuracy of the predictions. Some preliminary work has been carried out on the rural survey results to look at the predicted changes in the volume of rural sales versus the actual number of sales. The actual statistics are taken from the Real Estate Institute's, monthly rural sales statistics. *Figure 2* shows the total number of dairy farm sales from May 1994 to April 1995.

Peak dairy farm sales occur in May/June and peak sheep farm sales in December-February as shown in *Figure 3.*

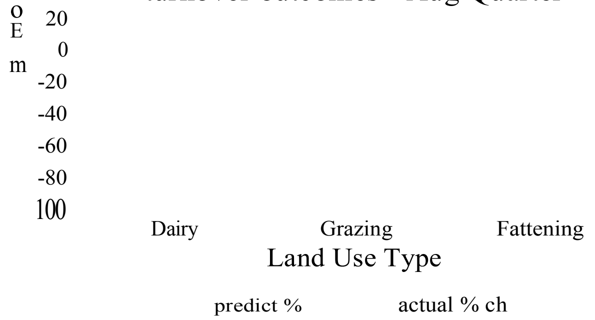
Figure 4 shows a comparison of 1994 and 1995 dairy farm sales over the main selling period.

It is noticeable that the volume of sales started to fall off in the second half of 1995 and this was very much in line with predictions made by the rural panellists.

Figure 5compares the percentage change in sales volumes for the main types of pastoral use with the net percentage of panellists predicting a change in sales volume. For example, 80% of the panellists predicted turnover for dairy farms would fall in the quarter ending 31 August. The actual outcome taken from REINZ sales was a 30% drop in turnover rates.

Figure 5

Comparing Predicted verses Actual turnover outcomes - Aug Quarter



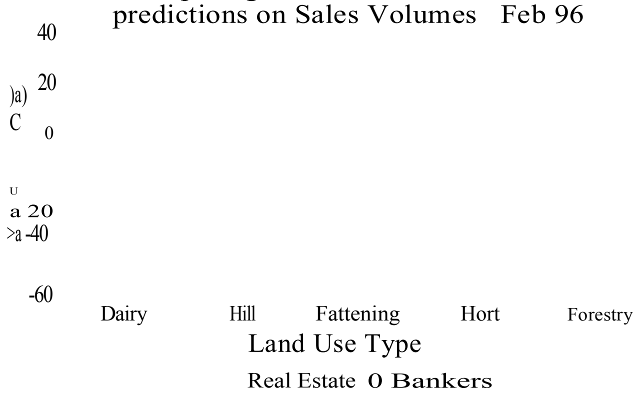
Analysis by type of respondent

There is a perception that real estate salespeople may have a more optimistic view of the future than rural bankers. *Figure 6* compares the responses from these two groups.

It is interesting to note that overall there is not an appreciable difference between the two groups. Perhaps the confidential nature of the questionnaire has allowed both groups to respond objectively.

Figure 6

Comparing Bankers with Real Estate predictions on Sales Volumes Feb 96

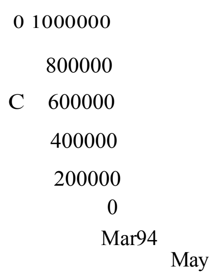


Analysis by price changes

This is the most difficult part of the analysis, because the REINZ statistics measure price changes by using the median sales price. When the sales volume is low, the median price tends to fluctuate considerably between months. A more reliable statistic is the Valuation New Zealand farm price index, but this is only published every six months and is usually well out of date due to time delays in capturing the sales information. Some median sale prices for the 1994 year are shown in *Figure 7.*

Figure 7

Median Price Data from REINZ



Summary and Conclusions

Future changes to the income stream of a property have much more impact on the value of a property than past events. Valuers find that unless sales information is completely up to date there is a danger that the market will have changed, and adjustments for the time factor will be necessary.

Bankers and real estate professionals are in a position where they have access to information about possible property transactions well before an actual transaction occurs and knowledge of a sale becomes public. The aggregation of this knowledge may provide a leading indicator to signal changes in the real estate market. While it is much too early to be definitive about the ability of the expert panellists to forecast real estate market behaviour, the signs are encouraging. The expert panellists were signalling changes to rural sales volumes well before the downturn occurred.

Another perceived advantage of the expert panels is that people are more confident about making forecasts if the confidentiality of individual forecasts is guaranteed. Quarterly forecasts are also likely to enable panellists to quickly adjust their views to incorporate new information such as changes to interest rates or export prices.

The Impacts of an Ageing Population

Predictions from Australian Study

by Georgia Zweep and Chris Breach

This edited reprint is from the second of a series of discussion papers produced jointly by the Australian Institute of Valuers and Land Economists (AIVLE) and the Macquarrie Bank entitled "The New Aged". (The first paper "Property Market Changes" was published in August 1994)

This paper targets an issue which demographic trends will show is just as relevant to New Zealand as it is to Australia.

THE NEW AGED.

More than one in five of all Australians will be "aged" by the year 2041. Previously a voiceless and invisible group, the older generation is emerging as a dynamic and articulate cultural force, shaping important social, political, economic and professional changes for the whole society.

Anyone 65 years or older is "aged" in the eyes of most Australian Government authorities. Fifty years ago, few people managed to live beyond 70. Now, according to the Australian Bureau of Statistics (ABS) greater longevity coupled with a better quality of life has lifted the average life expectancy for women to 80 and men to 74, with a higher percentage of people living well into their 80s and 90s.

The effect is the emergence of a new demographic group the 65 to 85 year olds. These "new aged" will live longer, enjoy fuller lives, and have greater economic and political power than any aged generation before them. They will create many opportunities for the wider community, and many burdens.

Right now, the property industry should be asking some serious questions. Are we ready to deal with the demographic and economic changes? How will the property industry be affected? What are the implications for valuers and other property professionals?

LIFESTYLES OF THE AGED

It is a mistake to assume that tomorrow's aged will make the same lifestyle choices as older people today. They will be more active, have higher expectations of life and will be more liberal with their money than any aged group before them.

It is a mistake to assume that tomorrow's aged will make the same lifestyle choices as older people today.

Each generation is the product of its developing years. Today's aged were children of the Great Depression, so it follows that they have a strong saving ethic and harbour conservative expectations of wealth. Those brought up in the 1940s are only marginally more outgoing with their money they want to spend some, but still save some. Above all they want to avoid debt.

Then there are the baby-boomers - tomorrow's aged. They have always been a strong cultural and economic force. They transformed society in the 1960s and the 1970s when they defined a new youth culture; then in the 1980s they matured and moved into business. Consumerism flourished and with it came high-fliers and high credit. As they move into old age, more changes are inevitable.

The baby-boomers are confident spenders and are not afraid of debt. Admittedly, the late 1980s and early 1990s have forced them to question their liberal attitude towards money. The experience has made them more discerning than before, but they generally remain confident.

Over the next 30 years the baby-boomers will shift from middle-to old-age. Medical and technological advancements promise them longer, more active lifestyles than their parents, and they will enjoy an extended sense of youth. Already there is new focus on tourism and leisure for active older people. Even commercial radio stations play `easy listening' or'classic rock' music to remind listeners of their formative years.

THE AGED WILL BE POLITICALLY ASSERTIVE.

By 2041, almost quarter of the population will be over 65. They will have more influence over society than the aged of today. They will be confident and asser-

Tomorrow's aged will have more influence over society than the aged of today.

tive, with a lifetime's experiences to draw on, a network of contacts and the time to marshal forces.

The aged will demand better representation, age sympathetic regulations and legislative reform. New political issues will include:

- increased public expenditure on services for the aged, at the expense of youth services;
- increased public health infrastructure;
- tax policies that complement aged people's income and investment strategies;
- more age-focused medical and technological research and development.

THE IMPACT OF THE AGED ON FINANCIAL MARKETS

Many aged are wealthy. It is common for people to build their wealth throughout their lifetime. People who live longer have more time to accumulate assets, and this will impact on savings, investment and spending cycles in the future.

The full effect of the burgeoning aged has not yet hit the superannuation and investment markets. When it does, there will be greater activity in and higher demands on superannuation funds and other investment vehicles.

There is also the question of how a lifetime of wealth will be dispersed. The aged may require all their accumulated assets to survive retirement. If there is any wealth left over, a smaller number of inheritors will benefit, due to smaller families. This is likely to promote flow-on activity in debt and equity markets and in other investment vehicles. New hybrid ownership vehicles already exist, and will flourish.

In any case, greater longevity implies that the current preference for investment vehicles with acapital growth focus will shift to those offering a reliable stream of income. Secure annuities such as government bonds will have more appeal than riskier stocks. Investors will want to weigh regular return with capital growth. Direct investment in tenanted property provides a desirable balance, as do property trust vehicles with regular income streams.

THE SHIFTING BALANCE BETWEEN THE AGED AND THE YOUNG

Next century, most people will spend more time caring for their parents than they spend looking after their children.

The ABS produces a dependency ratio which measures the burden of dependants on Australia's working population. The higher the figure, the greater the burden. In 1990, the aged dependency ratio was 0.17. Children under 15 had a ratio of 0.33. In 2041, the aged ratio will be 0.36, while children will have stabilised at around 0.29. The lower child dependency ratio indicates that there will be a decrease in outlays on children's services, such as day care and education. Yet this is unlikely to offset the growing demand for services for the aged because public health and welfare for the aged are more expensive than for the young.

People will spend more time caring for their parents lliarl they speru7 looking a.lier their children.

Lobbyists claim that Government provision for aged care is already inadequate and that the responsibility falls back on the community. The Carers' Association estimates that more than 600,000 people currently care for a frail or severely disabled person in a domestic environment.

Who will look after the growing number of aged people when the community is at work? There will be significant opportunities for the private provision of services such as hospitals, medical centres, carer bureaux. Respite care organisations will be as common as child care facilities.

WHERE WILL THE AGED CHOOSE TO LIVE?

In the past, people remained close to their families in old age. While this is still true in rural areas, most aged are more mobile today. Aged people now prefer resort or retirement areas and rural townships. Most of them move within their own state from

How Many Aged Will There Be? The proportion of aged people is growing. In the five years to 1991 Australia's total population grew 8%, but the aged population grew 16%. In 1993, 12% of the population were 65+. By 2041 this group will represent 22% of the population. The period 2011 to 2031 will experiencethe most dramatic growth as babyboomers reach retirement age.

Source ABS

Median Age Trends, Australia

43
41
39
37
35
33
31
29
27
25

1 9471 9 1961 1 966 1 i 11 976 19811 986 19911 996 20012006 2011201 6 202 12026 2031

Actual Projected

Source: ABS

Age Distribution, Australia

100%
80%
60%
40%
20%
0%

1991 Actual 2011 Projected 2031 Projected

■ 65+ ■ 45-64 0 25-44 171 15-24 ❑ 0-14

Source: ABS

	Population 1991		Growth In Population 1986-1991	
Statistical Division	Total ('000)	Aged 65+ (%)	Aged 0-64 (%)	Aged 65+ (%)
Richmond-Tweed (NSW)	179.5	14.8	29.5	16.4
Moreton (OLD)	489.6	13.8	33.5	29.9
Wide Bay-Burnett (Qld)	195.5	13.3	19.9	13.7
Mid North Coast	240.9	15.2	28.4	14.5
Total	1105.5	14.2	19.2	21.0

Source: ABS

the capital city or inland areas to the coast, and climate is an important factor in their choice of location.

Climate is an important factor in the choice of location.

South East Queensland, the New South Wales coast (north and south of Sydney) and to a lesser extent coastal South Australia and Victoria are already popular places for people to retire. These areas will continue to attract the aged in high numbers well into the 21st century.

Between 1993 and 2041, Queensland and Western Australia will treble their aged population. The Territories have a lower base of aged people, and the youngest age profiles, so growth of the proportion of aged will be more dramatic. The number of aged in the ACT will grow five times and the Northern Territory, eight times between 1993 and 2041 (ABS).

Indeed, aged migration is an important factor in the population growth of specific areas. The ABS describes these localities as major magnet areas. That is, regions where the aged represent a higher proportion of the population than the national average (currently 11.3%); and where ntorc than 40% of the growth in aged population occurred because of net internal migration.

Four regions met this criteria in Australia's 1991 Census:

- the Richmond-Tweed region;
- the Mid North Coast of NSW
- 1\lorton, Queensland; and
- ediW Bay-Burnett in Queensland.

Between 1986 and 1991, these major magnet areas accounted for 44% of the increase in Australia's aged population (ABS).

Typically, people moving to major magnet areas are recently retired couples. Widowed people (mostly women), tended to move away from the major magnet areas. It is likely that the death of a spouse encouragcs people to move back to their family, or closer to support services. Aged people were less likely to move anywhere if they still worked (ABS).

Major Magnet Areas

Major magnet areas are regions where the aged represent a higher proportion of the population than the national average (currently 11.3%) and where more than 40% of the growth in aged population occurred because of net internal migration. Four region met this criteria in the 1991 Census:

the Richmond-Tweed region;

the Mid North Coast of NSW

Moreton, Old

Wide Bay-Burnett, Old

Source: ABS

AGED MIGRATION HAS IMPLICATIONS FOR THE PROPERTY INDUSTRY:

- It creates demand for property in the major magnet areas.
- It depletes demand for property in the urban areas vacated by the aged.
- It encourages growth in the construction of residential and retirement style accommodation in major magnet areas.
- It creates stronger reliance on medical and health services and for aged-friendly transport infrastructure in major magnet areas;
- It generates stronger demand for recreation facilities for the aged in the major magnet areas.

As society ages, the Australian property industry will be confronted with many changes. Coupled with technological advancements (the super highway, telecommuting, hot desking), the next 50 years will be very interesting for property.

IMPLICATIONS FOR PROPERTY

Residential Property

For decades residential developers have targeted new families, first-home-owners and investors. The empty-nesters have been ignored.

Retirement villages will compete with more inu{ginati"e options.

In coming years there will be opportunities for developers and property marketeers to cater more for the aged. Retirement villages will still be viable, but they will be competing with more imaginative housing options.

The aged will want to maintain a high standard of living, but on a smaller scale. Some will sell their family residence and move into a smallerhome with lowermaintenance requirements. Others may choose to convert their family residence to dual occupancy, allowing them to share the space and remain at home. Others may choose to demolish their home and replace it with three or four town houses, opting to live in one and sell or rent the others. Some will retire to home units, with modifications including more elevators, intercoms, on-site health care, convenience shopping and security and medical call bells.

Many aged people will reject retirement. They will want a home that complements their working lifestyle. Some may install office facilities in their homes. People living in retirement villages may want business services such as office suites, phone answering services, word-processing, photocopying and facsimile machines close at hand.

Local councils will be under increasing pressure to accommodate the changes to residential development. Past housing policy has created cities with large houses on big blocks of land. Many councils resist the push for dual occupancy and cluster housing, and provisions for retirement villages are often inadequate.

There is also the internal migration issue. Climate is an important function of location for the aged, and South East Queensland and coastal NSW are popular with retirees. Aged-friendly residential construction and sales in these areas will flourish, at the expense of the markets the retirees left behind.

There are many residential property issues the industry should discuss. For example:

- Will there be a great increase in the development of town houses, dual occupancy and cluster housing?
- How many valuers know the differences between these multi-unit developments and their respective planning requirements?
- How important will,convenience retail outlets be as a component in major residential developments?
- Will `residential resorts' emerge, uniting the features of a residential estate with those of a holiday resort?
- Will there be greater demand for property close to major public transport routes and shopping centres?
- Will single dwelling properties be converted to dual occupancy and cluster developments?
- Which residential markets will flourish and which will languish?
- How many property advisers know how to harness residential development opportunities for their clients?

Tourism and Leisure Property

The obvious corollary to more leisure time and more wealth among the aged is growth in demand for tourism and leisure facilities.

Organised tours for the aged already exist, but older travellers will want more independent and diverse travel options.

Many baby-boomers are well educated and well travelled. While they will continue to visit the traditional destinations such as Europe and the Tropics, many will hanker for something more challenging. Packaged adventure holidays catering for the older traveller, such as cycling and hiking tours, are already popular. There are also educational tours incorporating culinary, wine or fishing tuition. These `info-tours' at novel destinations will become more popular as an alternative to golfing and shopping in the established resorts.

The *corollary to more leisure time and wealth among the aged is,rowth in demand for tourism.*

Resorts aimed directly at the aged have not yet emerged but there is scope. Club Med succeeded in the 1970s and early 1980s largely because it appealed to baby-boomers. The same concept can work when the focus shifts to older holiday makers. Many aged travellers will want to experience the culture of their destination. Boutique hotels will continue to flourish to serve these tourists, and the larger hotels will be forced to diversify their homogenised image. Aged travellers will demand comfortable transport and accommodation. There is likely to be more demand for business-class travel, or at least for better economy-class facilities. Airports, train stations and bus terminals will need more comfortable facilities and rest areas.

There will also be growth in at-home leisure. Activity and social clubs will become more popular. There will be development opportunities for light sport and games facilities such as golfing, fishing and bridge clubs.

Issues for consideration include:

- What form will niche resorts for the aged take, and how will they operate?
- Will boutique hotels compete more strongly with the homogenised hotel chains?
- What are the valuation considerations for aged resorts?
- What is the viability of aged resorts to developers?
- If the clubhouses for the aged flourish, how will they operate?
- What are the profit expectations for recreation and community centres for the aged?

Retail Property

The retail property market will be influenced by the way aged people choose to shop, and by the goods and services they will demand.

Many aged people feel alienated by contemporary regional shopping centres they are too large and the crowds can be threatening. They prefer convenience centres closer to home, and even local ribbon development with adjoining parking. The layout and tenancy mix in retail centres must adapt to aged' preferences if they are to capture this market.

There is likely to be a shift away from bulky goods because older people usually have all they need. The possible exception is increased demand for compact white goods and furniture - a half-sized refrigerator, television or sofa for a smaller home unit. A spin-off will be growth in the volume of second-hand furniture on the market.

Older shoppers will want items that make their lives more comfortable. *They* will buy health products, pharmaceuticals, cosmetics for the aged, mature women's fashion, clothing for people with stiff joins, comfort equipment like back supports and walking aids and home safety devices such as medical call bells and intercoms.

World Comparisons

Australia has a large aged population. In 1992, 11.4% of the population were 65 or over,

This is similar to other developed nations, including New Zealand; but it is much higherthan Its otherneighhours, In New Guinea, 2.5% of the population are aged, in Indonesia, 4%.

Source' *ABS*

Retail centres will also incorporate aged-focused travel agencies, social clubs, activity centres and health clinics.

Delivery will become an important component of retailing. Major supermarkets already have parcel pick-up, and some home deliver. The practice will become more widespread.

The layout and tenancy mix in retail centres must adapt to aged' preferences.

Shops will form the nucleus of resorts and residential villages catering to the aged. Retailers will offer delivery, laundry, lawn mowing, printing, even mini-office facilities for those who want to keep in touch with the business community.

There is also the question of how the aged will shop. Will people prefer credit to cash? Will home shopping and mail order services replace certain types of retail outlet?

On a more sombre note, dying will be a growth industry. Undertakers and retailers specialising in funeral paraphernalia will increase their profile.

Changes to retailing will alter property valuation and investment decisions. For example:

- Will mail order and remote shopping undermine demand for floor space in shopping centres and boost demand for warehouse space?
- Are existing centres adaptable enough to meet changing preferences of the aged?
- How can shopping centre layout be modified to cater for aged shoppers?
- -Will the very large retail centres and bulky goods centres become white elephants?
- If tenancy mixes change, will shopping centre profitability be affected?
- Do centre owners' long-term profit expectations acknowledge these considerations?

Commercial Property

As the population ages, so too does the labour force. Even so, future demand for office accommodation will not actually diminish, but it will grow at a slower rate. It will also be more complex.

In the past, population and labour force growth was the major generator of demand for office space. Now technology and modern work practices such as hot-desking and job sharing have complicated the equation by reducing the amount of space needed to conduct business. These issues are interesting for the office market and deserve further debate in their own forum.

What are the implications fog demand for C13D and suburban office space?

Relevant to this discussion is, how and where aged will choose to work. The aged represent a rich source of business knowledge and experience, and they will be more inclined to maintain some professional activities than the aged before them. For example, there have never previously been so many well-educated women. It is unlikely that they will be happy with a sedentary lifestyle.

Questions for the commercial property include:

- How many aged people will continue to work, and in what capacity?
- Will the aged choose to job-share or will they hold down full-time jobs?
- If the aged work longer, how will this affect our current expectations of labour force growth?
- Will building design be modified to accommodate older users?
- Will the aged establish small businesses such as consultancies, and generate demand for small suites and serviced offices?

Industrial Property

Industrial property will benefit from a larger aged population. New services such as meal delivery, laundry, cleaning and home shopping will emerge and prosper.

Medical, pharmaceutical and therapeutic manufacture and storage will increase.

These light industries will require medium sized warehousing and light industrial facilities throughout Australia's urban areas and close to their markets.

Medical, pharmaceutical and therapeutic manufacture and storage will increase. These industries will require specialised accommodation to cater for chemical processing, high-and low-tech manufacture and sterilised storage.

Industries for the dead and dying will also need industrial accommodation. Undertakers and retailers specialising in funeral paraphernalia will require light industrial space. New crematoria will be developed in non-residential areas, and existing cemeteries will become oversubscribed, creating demand for new sites.

Relevant issues for industrial property include:

- Will there be more demand for industrial development near hospitals as medical, pharmaceutical and therapeutic manufacture grow?
- What are the ideal locations for the aged services businesses?
- Is there enough land zoned industrial in the appropriate locations?
- What form will new cemeteries take and where will they be located?
- Will cemeteries be public or private enterprises and do they represent opportunities for developers?

Health Care and Hospitals

The medical profession and its associated infrastructure have a key role to play in the ageing of society. There will be significant growth in the number of local surgeries, medical centres, private hospitals, nursing homes, public health institutions and medical research activities.

There will be significant growth in the number of medical a1 anisations and ftstitutions.

Many of Australia's public facilities lack appropriate funding and are already over subscribed with patients because our public health system is inadequately equipped to deal with the growing demand.

There are abundant opportunities for private developers and hospital operators to build and manage new facilities. Atpresent, health care and hospital valuation and development expertise is highly specialised and too few valuers hold the necessary skills.

Issues the property industry needs to address include:

- At what rate will demand for health services grow?

- Can we improve valuation techniques for modern nursing homes, hospitals and other health-related property?
- What are the best locations for hospitals or nursing homes?
- Should medical research facilities be incorporated into new private hospitals and will this enhance profitability?
- Should developers create more nightstay accommodation or is day surgery an efficient way to deal with aged patients?
- What scope is there for medical centre chains and will this type of development appeal to building owners and developers'.

Changes to Building Design

It is not enou gh to build more town houses or club houses and then advertise to the aged. Buildings must cater for older users with special design features and facilities.

Developers hill be confronted with endless design modifications.

There are approximately 10,000 architects in Australia. Yet only a handful specialise in retirement villages, and few understand or provide the design requirements for the aged in the wider arena. Moreover, there has been no co-ordinated effort in any of the major magnet areas to adapt public building design.

Shopping centres already have level access, but many other buildings do not. Developers will be confronted with endless design modifications as buildings incorporate subtle but necessary changes such as:

- level access and low steps;
- more lifts, escalators, ramps and inclines;
- door knobs, levers and taps for arthritic joints;
- appropriately designed public seating and more of it;
- non-slip floor surfaces;
- hand rails;
- non-fluorescent lighting;
- special toilets;
- clear signage for poor eyesight;
- emergency evacuation routes for slower movers;
- easy boarding access for buses and trains.

Are We Professionally Equipped

Property professionals are on the brink of a huge learning curve. As we adapt to the needs of this new aged group, mistakes are inevitable.

The industry needs to prepare J '0r the changes now and be able to recognise the opportunities.

Demand for age-related services already exists, but the current lack of property professionals with specialised knowledge makes the provision of those services so much harder. For example, when valuation students learn about aged accommodation, the focus is on old-style retirement villages and on past expectations and statistics. Historical demographics provide no clues about the future and tenancy projections are rendered ineffective by extended life expectations.

It is essential that valuers and property professionals grasp the implications that these demographic changes will cause to direct property usage and to institutional investment.

The industry needs to prepare for the changes now and be able to recognise the opportunities. Better awareness of the trends is a good place to start. Professionals need to know about the aged - where they live, the services they need and their lifestyle choices.

More importantly, the industry must sharpen its skills, and there are many avenues to pursue. This is a critical point for all property professionals - we must prepare for the oncoming social and economic upheaval.

TECHNOLOGY INFLUENCES REAL ESTATE MARKETING

A national real estate councillor, Mr Noel Gillman, told *The Press* that New Zealand is moving more towards the American system of marketing real estate.

"New methods of marketing and changing demographics mean there are fewer agents, but they are working more efficiently. The population is becoming more mobile as people move from working in factories to the service, electronics and technology industries. We are seeing this in New Zealand" said Mr Gillman.

"Fewer people are buying houses and people are living longer. All these factors are having an impact on the real estate industry."

"Technology is playing an ever more important role in marketing real estate, including television and video, as well as cell phones and laptop computers. The Internet is a useful tool.

As people become more technology-based, real estate agencies will have to keep up with the play.

A trend in America is agencies which work specifically for the buyer, rather than solely for the vendor.

Mr Gillman feels that "advances developed overseas are beginning to have a global significance, rather than being restricted to local markets"

Christchurch Press 25/1/96

Global Property Markets

Implications for NZ Valuers

by SW Hamilton

Dr Stanley W Hamilton is an Associate Professor of Urban Land Economics, Faculty of Commerce & Business Administration, University of British Columbia. He has had extensive teaching and research experience in the areas of real estate analysis and valuation.

He has served as an External Examiner for the University ofSingapore, and has been instrumental in helping to establish a number of new educational prorgramns at the University of Business and Economics in Beijing.

Dr Hamilton's current research interests include real property price indexes, the role of real estate in portfolios, real estate valuation and pension management. He is the author of several books monographs and articles relating to real estate markets, real estate valuation and financing.

There can be no doubt the world economy has experienced massive structural changes in the past decade and the trend is likely to continue, albeit at a slower pace, into the next century. During this same period we have witnessed major social and political changes as nations divide and separate, from new partnerships and coalitions, and generally move towards market based economies. The traditional economic powers - North America, Western Europe, Japan, Australia and New Zealand all face new competition from the increasing number of newly industrialised countries. Clearly shiftin economic power is in progress and this shift will continue.

Approximately one-half the population of the world is enjoying significant rates of economic growth: China, with approximately 20% of the population, is experiencing 8%-12% per annum economic growth. The economy of India, with a population of over 865 million, is growing at approximately 7% per annum. Similar attractive rates of economic growth are being experienced in Thailand, Malaysia, Brazil, Chile and Mexico. Obviously the notion of an economic slowdown is much more pronounced in the traditional economic powers, not the emerging industrialised countries. This is further evidence of the global restructuring which is occurring.

There appears to be four general themes which have important implications for real estate markets and for valuers. They are:

- The globalization of financial markets
- New competition
- International debt discipline
- Securitization and the growth of derivatives

GLOBALIZATION OF MARKETS

Improved communication and transportation systems have made it possible to foster the global economy. This is particularly true where significant advances in communication and computer technology makes it possible to run "24 hour" markets for stocks, bonds, currencies, options and commodities. One example of this is the Singapore International Monetary Exchange (SIMEX) - Chicago Mercantile Exchange (CME) linkage allowing investors to take positions on one exchange and liquidate on the other, literally a 24 hour exchange (Goldberg, 1992). Financial markets are increasingly inter-connected as global financial transactions now exceed world trade volume by a significant multiple. In the financial community, physical marketplaces (or trading floors) are now obsolete, giving way to the "electronic marketplace", the "virtual marketplace". Technology now makes it possible to run the 24 hour market, and to do so efficiently.

PRESENTATION TO THE SEVENTH CONFERENCE OF HEADS OF COMMONWEALTH VALUATION AGENCIES. CHRISTCHURCH, NEW ZEALAND, FEBRUARY 11-16, 1996.

Transport and communication

This globalization of markets has not been limited to financial markets. Improved transportation, coupled with improved communication, makes it possible to control inventories and goods in transit such that the market for goods is now more global than ever. We are rapidly approaching the point where the warehouse of the future is the hull of a ship, the belly of a jet or the back of a semi-trailer. Similarly the market for services is increasingly global as transportation and communication makes it possible to efficiently provide services across borders.

> *`the warehouse of the fiuture is the hull of a ship, the belly of a jet or the hack of a setni-trailer"*

The internationalisation of financial markets would also suggest that investment portfolios are becoming increasingly homogenised. The globalization of financial markets is expected to result in improvements in the efficiency of these markets, particularly through the improved information flows, hence reduced information asymmetry.

On the other hand, this globalization of financial markets is not without some potential flaws. The 1987 market crash, and the more recent financial problems to occur to Baring PLC, suggest that problems in one market may quickly spread beyond the domestic boundaries to other markets. Similarly, the increased reliance on computerised trading may well represent a source of destabilisation in the marketplace.

Real Estate

Real estate has been a major part of the globalization of markets. While international investment in real estate is not new, the nature and scale of recent international real estate transactions is significantly different from past trends. For example, Gibson cites three categories of foreign real estate investments which were common as early as the 1950s. He identifies the primary class of foreign real property investments as those which were used directly in the industrial and commercial activities of the foreign firm. He identifies the second largest class of foreign real estate investment as being properties held by foreign land development companies. the third category, and the most contentious, was the residential and recreational properties held by foreigners (Gibson, 1976). There was only minor mention of the real estate investment by foreign institutions. It now seems so ironic that Gibson's comments were made at a seminar focusing on ways to restrict foreign investments in domestic property markets. Today the prime international investor represents significant pools of capital, either private or public. The explosive growth in investments by Japanese investors in real estate in North America and Europe, and the equally explosive dis-investment, are clear indications that prime investment grade real estate now ranks with the other important internationally traded assets.

> *"Real estate has been a major pa rt of the globalization of markets*

Why the increased interest in foreign Real Estate?

Edinton (1995) offers some thoughts on this question. He suggests the Japanese investors were attracted to foreign real estate because of their ability to borrow extensive funds from Japanese banks when the interest rate in Japan was amongst the lowest in the world. This cheap funding, coupled with a scarcity of local lands, promoted the dramatic increase in foreign property investments. However this only explains why Japanese firms were investing, not why they invested in real estate, and real estate primarily in North America. Part of the explanation for the growth in interest in foreign real estate, not just Japanese investors, but for all investors, rests with the contemporary research which points to the diversification benefits of real estate. The results of the contemporary research clearly indicate that real estate offers important diversification benefits within a mixed (real and financial) asset portfolio, and that there are also important opportunities to diversify across real estate markets (Hudson-Wilson and Wurtzebach (1994)). This type of portfolio research, while common in financial assets, is only recently being undertaken (post 1980) in real estate markets. The increasing availability of time series data for real estate returns (such as the Russell Property Indexes) is the essential element which makes this research possible.

Research in North America, the United Kingdom, Hong Kong and Australia all appear to share four common conclusions:

1. Returns on real estate investments appear to fall somewhere between the returns on stocks and bonds. While the details vary across markets and time, the evidence supports this general conclusion regarding real estate returns.
2. The co-movement returns on real estate have with returns on stocks is either low or negative, making real estate a useful portfolio component.
3. Real estate is a good hedge against inflation. Returns on real estate assets are positively correlated with domestic inflation rates.
4. Diversification within a real estate portfolio, either by property type or property location, can produce some important portfolio benefits, but not of the scale possible by combining real estate and financial assets.

It is the second and third points which add to the appeal of real estate as a potential addition to portfolios of assets. Modern portfolio theory builds on the concept of a "mean-variance efficient portfolio" in which individual asset classes with less than perfect co-movement are combined to produce a portfolio with lower volatility without sacrificing returns. It is the last point which makes real estate diversification across locations (and nations) an appealing option.

The development of improved information relating to real estate return series is a vital step towards making this asset class a more likely candidate for the international investor. The development of real estate performance indexes, such as the Russell Property Indexes, in many of the leading national markets has been a major factor in stimulating investor interest in this asset class. While these indexes are by no means perfect, they do represent an important step towards equalising the data available for real and financial assets. It is ironic that the major forces behind the development of these real estate performance indexes have been from non-real estate areas.

The Exchange Rate

A digression may be in order at this point. Much has been made about the concerns for hedging currency risk in international investments. Just how does currency risk affect returns on real estate? To answer this we turn to the concept of "purchasing power parity". One reason real estate is an attractive investment is that it provides a hedge against inflation. There is also a relationship between the value of a currency (the exchange rate) and the rate of inflation. The notion of purchasing power parity maintains that the price of tradeable goods should be the same in any two countries when expressed in a common currency. Hence if inflation becomes a serious problem in a particular country, one would expect their exchange rate to be devalued accordingly. However, real estate values would increase with this inflation and offset the impact of the devaluation in the currency. On the other hand, an investment in bonds may be less attractive since bond prices are not expected to adjust to changes in unexpected inflation. Therefore currency devaluation would impact negatively on bond yields, all else being equal.

New Competition

One of the major impacts of the globalization of markets is the creation of new competition, not just in the manufacturing areas, but more recently in the financial and service sectors of the economy. In the past decade we have witnessed the shifting of manufacturing as producers seek lower labour costs. This is by no means a new trend, but what is different this time is the fact that there is a significant transfer of modern technology to labour rich nations. As a consequence, many developing nations can now compete, and do so much quicker, with the developed nations, using imported technology and cheap local labour.

The transfer of modern technology also implies that the quality of the output produced in the lower cost labour markets will compete with the output from the more developed nations: the automobile or television made in Korea is of a quality comparable to those made in the USA. Hence we find more competition and more quality competition than in the past.

What we witness is a shrinking of the economic space as travel and communication costs continue to fall significantly. Additional costs to transport the raw materials to the lower labour cost markets and the finished products to the consuming nations are more than covered by the lower labour costs in the manufacturing sector. One of the consequences of this shrinking international marketplace is that the owners of capital can expect to do well, but labour will do poorly. Why would this be the case? It is now possible (and profitable) to move the manufacturing to the lowest labour cost areas, thereby eliminating any excess earnings to the local labour pool.

We are also witnessing one other change of consequence. Many of the emerging nations have promoted a high level of education within their work force. Asa consequence, the developed nations can no longer count on capitalising on their superior education. Modern technology has helped the emerging nations in this regard as they can now access quality education through modern technology and are less dependent on sending a few select students to a foreign university or college.

"Real estate is viewed as one of the best Hedges against inflation

One further consequence of the more global world market is the fact that the providers of services are more mobile. As a consequence, local experts now find themselves in competition with experts from other countries. Witness the number of North American law firms and consulting firms which have recently opened offices in the Republic of China. Not only is the level of competition higher, the nature of the competition now changes. Experts coming from other countries bring different methodologies and skills to the table. Consumers of these professional services can now select teams of experts which provide the necessary skills and, more often than not, do so in the same dialect.

International debt management discipline

During this past decade there have been significant shifts in the demand forcapital. Initially many of the developed nations were living beyond their means and generating increasingly large public debts. In many cases these deficits could not be financed internally and the nations had to resort to importing significant capital. the spiralling nation debts in North America, Mexico, and many western European countries, and even New Zealand, is evidence of the over-consumption of wealth by these nations.

In the past, many of these nations financed their expanding debt with loans from their central banks (printing money and creating inflation in the process). However, as more of a nation's debt is held externally, the international market becomes increasingly concerned with the mounting debt loads. The idea of hitting the "debt wall" becomes a reality as international sources of capital turn away.

The international pools of capital have left little doubt that they are prepared to discipline the debtor nations. The pressures applied to New Zealand and Mexico are but two examples of how the international community will take charge of a local economy. Canada is facing much the same dilemma as the international suppliers of capital downgrade Canada's national and provincial debt. Similar problems face a number of developed nations in Western Europe.

What implications does this new international discipline on debt accumulation have for real estate markets? Real estate is viewed as one of the best hedges against inflation. To the extent that nations decrease their reliance on borrowing from their central banks (ie less inflation), real estate will become relatively less attractive and investors may exhibit a preference for other asset classes.

Securitization and the growth of derivatives

The decade of the 1990s will be remembered as the decade of the "derivatives". The significance of the growth of these derivative securities is illustrated by the fact that trading in Treasury Bond derivatives by the Chicago Board of Trade increased from 10,000 trades per month in 1977 to over 4 million per month in 1993 (Forrestal, 1993). As the name suggests, derivatives are instruments that are linked to, or derived from, an underlying asset. These derivatives include instruments that are linked to, or derived from, an underlying asset. These derivatives include futures contracts, options, and swaps. While variations of these derivatives have been around for many decades, it was only during the 1980s that they experienced a significant growth.

It seems that almost every asset was subject to some efforts to create derivatives and real estate has been no exception. The value of these derivatives, or paper assets whose value is dependent upon some other underlying assets, can sometimes account for more than the value of the underlying asset.

"k s seeeemmss quite clear that the traditionally trained valuer does not have the breadth of knowledge to a-o-rk in the complex 1110 de171 f nancial world

Advantages of Derivatives

These derivatives offer a number of advantages, including making the underlying asset more affordable to small investors. For example, buying the Dow Jones Index via a derivative is much more manageable than buying each of the individual stocks. In the case of real estate, buying a derivative instrument involves far lower transaction costs than buying the underlying real estate. This would add to the appeal of real estate as an asset class.

Futures contracts

A futures contract is one of the oldest and most common forms of derivatives. This is a contract that binds each party to buy (the "long" position) or sell (the "short position") a certain asset at a specified time and (futures) price. Although less well developed than in financial markets, futures contracts are used in real estate markets. For example, a tenant commits to lease space in a building yet to be constructed, or a buyer agrees to purchase a new condominium once it is constructed.

Options

Options represent another form of derivatives. These are contracts which provide a right, but not an obligation, to buy (the "call option") or to sell (the "put option") a particular asset within or at a specified time and at a specified price (the "exercise price"). Options are used, albeit less frequently, in real estate markets, particularly in land assembly and the pre-development phase. However, there is no evidence to suggest an active real estate options market will be created in the near future.

Swaps

The most contemporary form of derivatives are the swaps. Swaps are an exchange of cash flows between two parties for a specified time period. One of the earliest forms of swaps was the exchange of interest payments based on a floating rate for interest payments based on a fixed rate, or the exchange of contracts in one currency for another. The IBM-World Bank currency swap in 1982 appeared to mark the beginning of an active swap market in North America (Abkin, 1993).

Swaps have not yet become common in real estate markets, but there appears to be a growing interest in using them since they have much to offer. Real estate is a particularly illiquid asset and selling (or buying real estate) to re-balance a portfolio balancing can be both costly and time consuming. If it were possible to swap a portion of a real estate portfolio for a specified time then re-balancing would be both more timely and cost effective. In addition, a more active swap market would make it possible for an investor to arrange a swap of returns on some financial asset in exchange for the returns on a real estate portfolio, thereby acquiring the benefits of owning real estate without the normal transaction costs and delays. Such a possibility now exists as financial intermediaries are starting to offer swap returns based on some real property index, (such as the Russell Property Indexes) for returns on a portfolio of financial assets such as treasury bills.

The potential use of swaps for real estate assets has another important implication. Many investors are reluctant to sell their real estate holdings because they generate property management fees. With the use of swaps, an owner of real estate can sell the real estate returns, but maintain the management function (and fees), simultaneously offering a greater degree of control over the actual (as opposed to contractual) real estate returns.

IMPLICATIONS FOR REAL ESTATE MARKETS AND VALUATION

What are the implications of these themes for real estate markets, and for valuation in particular? Several implications come immediately to mind, but three issues seem to stand out as immediate challenges to the appraisal profession. These include:

- Need for a "new language" for valuers,
- Need to understand the "new" tools for investment management,
- New emphasis on cost effectiveness.

"New language" for valuers

It is becoming quite obvious that the real estate valuer, can no longer use their isolated, and often outdated, "language of business". Increasingly more of the real estate transactions are being controlled by major private investors or institutional investors, generally managed by experts trained in finance, not real estate. These investors have a language of their own and the real estate service sector, the brokers and valuers, must adjust to these new requirements. The "overall capitalisation rate" is now the dividend yield", the income method of valuation is simply a specific application of present value analysis, and fundamental risk analysis replaces the `neighbourhood analysis". However, to suggest the problem is as simple as learning some new "buzz words" is misleading. What is needed is for the real estate experts to develop a new way of looking at real estate assets.

These international investors bring backgrounds which reflect their understanding of financial markets, markets which are much more perfect and efficient than the real estate markets. These investors are accustomed to having timely market information on sales and yields. The idea of working with imperfect esti-

"It is becoming Quite obvious that the real estate value!; can no longer use their isolated, and often outdated, "language of business "

mates of value (appraisals) is essentially new to these investors, and as a consequence they are increasingly challenging the work of the valuation profession, and seeking alternative solutions. The recent recession which has plagued the real estate markets in North America, the UK and much of Western Europe has intensified the questioning of the real estate appraisers. The major Savings & Loans problems in the USA focused attention on the inadequacies of many of the appraisal reports. Similar losses have occurred in Canada and the UK as lenders assume control of properties used as collateral for loans in default. This decline in real estate values during the recent economic recession has resulted in extensive scrutiny of the valuation profession. A number of high profile law suits (and many more less public legal actions) has helped focus attention on some of the concerns about the valuation profession. Unfortunately too many of the professional appraisal bodies have elected to respond by adding more rigour to the process of valuation rather than changing the fundamentals. The amendments to the Valuation Guidelines of the Royal Institution of chartered Surveyors (their "Red Book" and "White Book") are but one example of the type of response from the appraisal professions.

It seems quite clear that the traditionally trained valuer does not have the breadth of knowledge to work in the complex modern financial world. Most appraisers have only limited expertise in statistical analyses (an important element in modern finance theory), they are unfamiliar with the concepts of modern portfolio construction and they have limited understanding of the markets for financial assets. The consumers of these professional real estate services are "voting with their feet" as they increasingly rely upon the advice of non-traditional real estate expertise. One need look no further than the number of major real estate transactions completed in North America which do not involve the use of traditional appraisal or real estate brokerage services. Clearly there is a need for some careful re-evaluation of the education and training of our real estate experts.

Need to understand the "new" tools for investment management

The globalization of assets implies that risk adjusted returns must be the same across markets. In the case of real estate assets, the income flows are generated locally, but the expected risk adjusted rates of return are set internationally. Consider the simple income method of valuation:

$$\text{Value} = \frac{\text{NOI}}{\text{I}}$$

where "NOI" is the net operating income and "I" is the overall capitalisation rate. Since rents and operating expenses are determined locally, it follows that NOI is set locally. However, the expected risk adjusted yield, i%, is set in the global market. This implies there will remain a need for expertise relating to local markets. At the same time, new expertise is required to understand the forces which determine the risk adjusted expected yields (1%) which play such a large part in the determination of property values.

Traditional valuers have demonstrated the expertise to analyse local markets, but they have been slow in adopting modern techniques for forecasting future rental and expense patterns. There remains too much emphasis on the concept of "stabilised NOI". Recent concerns relating to prop erty valuations in North America cite poor lease analyses as a major source of error in the appraised values. Appraisers not only failed to make any reasonable forecasts of future rents, they failed to even account for contractual rent changes built into existing leases. These standards are no longer acceptable.

Perhaps the area where traditional appraisers have the greatest weakness is in their understanding of the forces determining the expected risk yield on real estate (and other assets). A review of the common educational programmes for valuers indicates an almost complete lack of fundamentals in this important area.

Appraisers will also face some new challenges in their work. Real estate is increasingly being bought and sold as part of packaged deals: syndications and portfolios are now more commonly traded, not just the underlying individual properties. As a consequence, appraisers are finding fewer observations of "free and clear title" transactions on which to base their analyses. Analysts will now find it necessary to "unbundle" these observed sales prices in order to undertake their fundamental analysis. This requires a new set of skills not common to the training of the traditional valuer, skills in assessing portfolio risk and returns, skills in the construction of portfolios of assets, both financial and real.

These issues will soon extend to 'packaged sales' which combine traditional real estate assets with some forms of derivatives, again necessitating the unbundling of information. This will call for some basic knowledge of the valuation of these derivatives, and how they alter risk, hence expected returns on real estate and other assets. Something as simple as extracting the value of a government or private guarantee on the payment of rents or capital values are now a common dimension of international deals. These cannot be ignored in valuing the underlying asset as they play a major role in determining the expected yields.

Emphasis on cost control

In the increasingly competitive world, investors are constantly seeking ways to control or reduce costs, and costs in the real estate market are no exception. It has long been realised that transaction costs for real estate are high relative to other assets, hence any potential savings are of even greater significance. Pressures are mounting to reduce "deadweight" transaction costs (the legal fees, brokerage fees and appraisal fees associated with investment in real assets).

The concern for controlling appraisal costs is intensified as real estate portfolio managers are required to report total returns on a more timely basis. For example, managers of real estate mutual funds are frequently required by law to report quarterly returns, including unrealised capital returns. This requires regular appraisals on the portfolio, a cost item which managers seek to minimise. Efforts to reduce the costs of data collection and analysis have already produced some significant savings, especially in the residential areas where computerised appraisals are now not only possible, but a reality. Traditional appraisers have resisted the computerised valuations, in large part because it affects their base income. The standard argument is that the traditionally prepared estimates of value will be more accurate than the computerised appraisals (a questionable position).

However, this is not the central issue. What matters is which approach is more cost effective, after adjusting for potential errors. The traditional appraiser may be more accurate in a particular case, but the lower cost computerised valuation, coupled with some liability insurance, may be the more cost effective overall solution, especially in aportfolio context.

"Financial and real assets are iiicreasi/i,'l v rlndcr the control of managers trained infields Other thalireal estate''

While the main cost savings gains appear to be in mass residential appraisals, there are clearly opportunities to effect savings in the assembly and management of data for non-residential valuations. Clients are demanding more for their dollar and the traditional valuers must seek ways to economise, or face the prospect of seeing their domain of expertise shrink in the near future. Appraisers cannot afford to rely on existing regulatory support which provides formonopolistic orquasi-monopolist powers. They do not have the political clout to keep such powers in the face of potential efficiency gains.

CONCLUSIONS

The globalization of the world markets, and in particular the globalization of financial markets, will forever change the way real estate valuers do their business. Financial and real assets are increasingly under the control of managers trained in fields other than real estate. The traditional "fee simple" real estate deal has given way to packaging. syndication and portfolio consideration. The managers of these assets speak a different language, and are demanding that the real estate valuers adopt their language and modes of operation. These managers are challenging the traditional tools of valuation and demanding improvements (one may say modernisation) of these traditional appraisal tools. We see an increasing amount of the traditional valuation work being done by non-traditional valuers, experts in financial assets, not real assets. Unless the traditional appraisers upgrade their skills, they will find the demand for their services decreasing and they will become more isolated as residential appraisers. This will provide little comfort as the residential market demands lower and lower cost valuations, turning increasingly to computerised models which, while perhaps less accurate in the specific, are more than satisfactory on the bigger scheme of things. A lender granting *a 75%* loan-to-value ratio can accept some minor valuations errors if it implies a significant savings in front end valuation fees. Butthe early evidence suggests the lender may not have to accept any decrease m qual4 y relying upon the computerised valuations.

At the very least, the market will demand traditional appraisers use some of the modern statistical and sampling tools to focus their expertise on the serious, not the common, issues. We see auditors now using sampling methods to conduct important audits. Appraisers can be expected to explore how comparable tools can generate equivalent cost saving in real estate valuations.

Growth in international real estate investments brings both opportunities and challenges to the real estate experts. We can reasonably expect international investment in real estate to continue a strong growth pattern. This internationalisation of real estate brings demands for lower cost, higher quality services. This will not be unique to the real estate markets, it is just occurring later than in other markets. Banking, financial brokerage, legal and financial service sectors have all felt the pressures to produce more with less. Now it is time for the real estate service sector to experience these pressures. This will intensify demands for improved education programs for valuers, programs which provide both different, and more demanding requirements.

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Readers may like to see researched articles in the Journal on other topics. If so phone, fax or write to The Editor

Coping with Competition

Some ideas on marketing

by Stephen G Williams, MAI

Stephen G Williams is a Fellow of the Royal Institution of Chartered Surveyors (FPICS) in the United Kingdom, he has been appraising in Europe and the United States for almost 30 years, He is vice chair of the Appraiser Qualifications Board (AQB) of The Appraisal Foundation.

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The author is an Englishman writing for an American appraisal journal. Valuers worldwide are experiencing similar problems which have arisen out of international deregulation and economic changes. The author's approach to cause, effect and solution is just as relevant to New Zealand as it is to the UK or the USA. (Ed)

Hit by a gradual slowing of appraisal business and trapped in a downward vortex of saggin g fees, appraisers have been giving serious consideration to the subject of marketing their services; however, many simply do not know where to begin.

Those who rush out to find current texts on the library or bookstore shelves will find no- shortage of "how-to" literature. But after studying the theory, brainstorming with colleagues, and even seeking professional advice, most find themselves confused. Which aspects of marketing will effectively produce measurable new business, and how can they justify focusing scarce resources on business development that may or may not produce results?

Appraisers agonize about *why* they need to turn their attention to marketing, *who* they should target, *what* services they should offer, andhowthey should conduct themselves. By seeking answers to these four seemingly simple questions, some clarity can be brought to this elusive topic, and tenets can be established for successful marketing.

WHY?

The United States may be the only country in the world where a significant segment of the market for appraisal services is directly mandated by federal legislation. While this may initially have been a great shot in the arm, the appraisal profession has realized retrospectively that the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) is a double-edged sword. Not only did it spawn the classic economic scenario of excess profits breeding ruinous competition, but it lulled appraisers into believing that because appraisal services were mandated, there was little need to market them. We based our existence as a profession on the fact that the client had to have an appraisal-it was written into law.

Under competitive pressure to prune their appraisal budgets and streamline their loan processing lenders have successfully lobbied for regulatory relief. As aresult, many in the appraisal profession feel that their "right" to work has suddenly been compromised. Appraisers wring their hands in despair at the elevated de minimis levels and direct their energies toward fighting for these "rights."

In reality, the days of the mandate appear for the moment to be over. Today, appraisers operate in a competitive environment where market forces rather than federal and state legislators establish the supply and demand (and therefore the price) for appraisal services. If appraisers meet this challenge only by hoping that another financial downturn will bring tightened regulation, they are doomed.

Need to demonstrate the benefits of appraisal services

Under these circumstances, the need to market "quality" appraisal services to price-sensitive clients by demonstrating the cost benefit of appraiser skills is obvious. (The nature of these services is examined later in this article under the *what* heading.) Appraisers must dispel the notion that an appraisal is a mandated evil for which the client grudgingly pays as little as possible. Appraisal must be portrayed as a service that, if competent and timely, brings a benefit to a client that far outweighs the fee. With the help of a good appraisal, a banker is able to make a sound loan. An investor uses the advice to quantify risk and project yield, a developer has the tools to measure the feasibility of a project, an asset manager gets advice that makes him or her a wise decision maker, and an attorney is able to rely on expert testimony. It is these direct benefits and indirect repercussions that determine, from a client's viewpoint, whether appraisal service is cost effective. If these benefits are successfully communicated, clients feel good about us and we generate repeat business.

"Today, appraisers operate in a competitive environment where market forces rather than federal and state legislators establish the supply and demand (and therefore the price) for appraisal services.„

Compare this scenario with the long-term financial implications of a "poor" appraisal or one that is not cost effective in which, for example, an appraiser has missed some current comparable evidence, is weak in the technical analysis, errs in the interpretation of data, or simply misses a crucial delivery deadline. As in the financial crises of the late 1980s, aggregate loss exposure for a client can be in the ranee of millions of dollars. In this context, in light of the relatively minimal differentials between high and low appraisal fee quotes, the long-term financial implications of poor work (frequently characteristic of a low-fee appraisal) may be catastrophic. Expressed more graphically, I overheard an appraiser advising a major portfolio investor on the need for a good appraisal with *regular niarkeling is an absolutely essential facet of doiiig fastness in today's economy.*

the words, "Don'tput your Rolls Royce through the automatic carwash."

The keyto communicating this message is effective individual and collective marketing. The marketing effort must be focused and sustained, and if necessary, supplemented by orchestration from a larger professional organization. It is not something that fills slow work periods, either in the appraisal office or at an organizational level. Even during peak production periods, marketing duties must take priority, for to neglect them is to almost guarantee a prolonged slow period while gearing up again after delivering the last assignment.

If appraisers understand this *why,* they will realize that regular marketing is an absolutely essential facet of doing business in today's economy.

WHO?

Targeting client groups

Most firms maintain or can quickly assemble a list of major clients. While this represents a primary source of marketing information, it is not in itself enough to form the foundation of a successful marketing program. For effective client-specific communication, the list must be arrayed into two target groups: existing clients and prospective clients.

Existing clients

One school of marketing thought' claims that as much as 90% of all new business will come from existing clients. If these are sustained, maintained, and expanded, an appraiser might have more new business than he or she can possibly handle.

The great advantage of existing clients is that, even though they may have been dormant over the preceding months or even years, resurrecting their business will not require a prolonged courtship and honeymoon. This can be very cost effective for all concerned. Time needed for "ice-breaking" introductory meetings, "power" lunches, and the exchange of company literature is minimized. With an existing client, this energy can be channelled toward a more direct approach. Instead of suggesting a purely social lunch meeting you might, for example, offer some helpful insight into a property type or a market in which you know the client has an interest. You might even respond to specific questions about a potential assignment you know your existing client is considering. Research such topics and fax some insight or data with the comment, "Thought you may not have seen this information, which may be helpful in your deliberations." Later, when ordering an appraisal on this or another project, the client will remember your gesture.

Instead of suggesting a purely social lunch meeting you might, for example, of e some helpful insight into a property type or a market in which you know the client has an interest. 7J

One of the most encouraging aspects of existing clients is that colleagues can support you in your efforts, not by new marketing but merely by doing old business "better." The shift to total quality management (TQM)Z of the late 1980s epitomized this strategy. The new acronym only emphasized what we already *knew-delight* the clients with your quality and timeliness, and they will be beating down your door for your services.

But beware of treating these existing relationships as easy pickings. Serving existing clients entails ongoing regular communication. By all means dust off lists of existing clients to whom a call is overdue, go back through your billings to see who last year's big spenders with your company were, make "after sales service" calls on recent jobs, and make "informational" calls to advise your clients of any innovative changes in your service. But above all, constantly please existing clients by a sustained high quality of work. Do no more than you do already-but do it better.

Prospects

There will never be any lack of prospective clients. Half an hour's brainstorming will reveal that the real problem is not insufficient quantity but insufficient quality. By quality clients, I mean the effective decision makers who actually have a willingness and capacity to decide to use your services.

In seeking quality, beware if your first call to a new client gets an overenthusiastic response. Chances are that the client is either a gatekeeper trying to divert you from the real decision maker, or someone trying to sell to you. An example of this phenomenon is the local "after-hours business" meeting, where not a soul may be interested in purchasingyourservices, but all are intent on selling you *theirs.*

Identify your true prospects-the effective latent demand for your services. A myriad of preprinted lists, directories, on-line data, and more recently, compact disks (CDs) are available to speed you in this task. But be conscious of the need to be selective and flexible in revising these lists to reflect constant changes in business. Today's prospective client may disappear tomorrow; tomorrow's may not yet be in existence. The difficulty of marketing professional services to new clients is the time needed to establish a relationship.

A single telephone call is not enough. There is very little impulse buying among professionals. Building a business relationship requires mutual trust built up over time, and the only way to create such trust is outside of the business environment, away from any hint of sales talk.

By all means go to lunch or to the gym, meet for coffee, or suggest a round of golf. But for long-lasting results try working together on the PTA, planning the neighbourhood bake sale, or ringing the Salvation Army kettle bell in freezing rain. These are the real relationship builders.

The more deeply rooted the relationship the more able it will be to withstand the ever more frequent business revolutions that hit us like Kansas twisters. They will certainly survive the "Ms. Smith no longer works here" let-down call. For if she doesn't work "here" she does work "there" and will be transferring your relationship to the new company. "Oh yes, we worked together at the neighbourhood bake sale last summer," she will be telling her new boss.

You, meanwhile, are forming new relationships at her former company. "Well, if Ms. Smith is no longer there, perhaps her successor, Mr. Jones, would like to attend our free seminar." You have turned the potential single client loss into a double hit.

This only scratches the surface of *who.* Once you understand the scope of the question, answers will come readily to mind. Today, for instance, one CD may list over I I million businesses across the country. Someone on that list is awaiting your call to start a long-standing business relationship. The real issue is finding the needle in the CD haystack.

WHAT?

Defining the service

What are the services you provide? The response, "appraising," is one-dimensional in a three-dimensional market. The single dimension of merely concluding a value at the end of a three-week research and writing period will serve appraisers poorly in a market that demands more.

Create a demand for your whole repertoire of appraisal and analytical skills by presenting them in the context of their invaluable contribution to solving the issues of today's changing real estate markets. Identify a diverse list of appraisal-based services you can provide to today's lenders, investors, developers, attorneys, and owners. Once you strip the question down to what formats and services aclientreally wants (and *Unifonn Standards of Professional Appraisal Practice* [USPAP] permit), you discover that there is life after federally mandated narrative appraisals.

In any format, today's appraisal should be marketed as a living document forming the very foundation for decision making. Where else is a client going to get such a detailed investigation of his or her property and its market'? It does not have to be a document that the lender throws into a file and the client never sees.

In my own firm's menu of services, the detailed description of what the client can expect from the full commercial narrative, for example, is supplemented by the advice that "It is a comprehensive document providing the level of detail necessary for processing the initial lending or investment in the property and describing all aspects of the land and improvements as well as clearly defining the interests appraised and concluding their market value." I stop short of telling my clients not to lend without it but that is my message.

Similar "window-dressing" can supplement descriptions of all services offered. In other words, the *what* is amplified in your marketing literature by a clear statement of an appraisal's purpose, uses, and advantages.

Other examples of diversifying your services within the appraisal process include bringing a client's attention to such findings as discrepancies in the title documents or leases, observed deterioration in major structural components, or a physical boundary encroachment of which the client was unaware. While you will not be able, under the Competency Provision of the USPAP, to take a detailed position on these issues, you are providing a valuable service by alerting the client to them.

You may be asked to make different assumptions and conclude alternative "investment" values based on a variety of assumed parameters. Assuming compliance with the USPAP, all of the finely honed skills that go into an appraisal-the research, the analysis. the documentary support, the market knowledge, and the technical expertise-may deserve a more expansive and lfexible marketing label than mere "appraising." Be creative in defining and communicating your skills.

The importance of communicating skills cannot be overemphasized. Effective communication is still an elusive goal for most of us. Good letter writers will tell you that, as they write, they carry a mental picture of the recipient's reaction to each word or phrase. Their words can elicit the whole gamut of emotions joy, anger, sorrow, or envy. Similarly, a good conversationalist will convey emotions in words, expressions, and body or hand language. A good phone manner will plant emotions in the listener from afar, just as an artist or musician emotes through his or her medium, so there is a basic art to presenting yourself through the medium of your craft; in this case, appraising and related services. But above all, be a good listener. Only by first listening to and understanding the real issues will your marketing response be relevant, articulate, and successful.

cc today's appraisal should be marketed as a living document forming the very foundation for decision snaking

Listen to each client individually. It has been said that it does not matter so much what your services actually are as what a client perceives them to be.' Each client will have different needs and expectations. Each will react differently to your initial presentation. Therefore, with a one-dimensional or "catch-all" approach you will miss the boat. But one word of caution in your search for a creative approach to each client. While it is up to you, as the communicator, to influence perceptions, beware of making promises you can't keep. Your final work product must not disappoint. In all of your communications, present a positive demeanour. In talking with other appraisers about business development, I am often overwhelmed by their negativity. What should be a positive outlook is engulfed by the negative. I hear professionals begging for business on the pretext that "appraisers are down on their luck." Vocalized this translates into two currently endemic complaints: "The bankers don't like us" or, increasingly more common, "FIRREA has killed the profession." My response is: Don't wait for this "luck" to change. It is unrealistic, and somewhat churlish, to pin your professional hopes on a tightening of federal regulations in response to another financial downturn. Instead, seek new horizons, talk up your skills, and above all be responsive to change.

Adjunct services

In addition to the basic range of appraisal services, appraisers can make available to clients a wide diversity of adjunct services using not only basic appraisal knowledge, but also ancillary skills. While appraisers must remind clients that in any discussion involving an opinion of value, the USPAPrequires appraisers to avoid misunderstandings caused by misleading or confusing information, there are as many permutations of adjunct services as there are prospective clients.

For example, what if your bank client asks how he or she can teach loan officers to understand an appraisal? Your initial reluctance to teach loan processors to prepare their own internal evaluations will be far outweighed by the opportunity for educational outsourcing. While an appraiser may lose some work opportunities in the short term, the relationship established by such an assignment can pay off handsomely in the long term.

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Another way of presenting the same services but with added appeal is to offer an expedited service. I remember when the concept of "express" service entered my world. I was working a vacation job in a photo processing lab, when someone rushed in with a competitor's ad, crying, "Look, Joe's Photo down the street is offering 48 hour film developing." The boss was skeptical. "No one can beat our one-week mail-in service or our five-day pick-up and delivery," he retorted complacently. Just one year later I learned that the business had closed and my former boss was checking fast-photo orders in a parking lot kiosk. One-hour photo developing had come along and stabbed him in the back-and all because he had ignored the first signs of a rapid industry change.

As you research other possibilities of the *what*, a word of caution. Don't try too many innovative services; you will quickly become overextended. There is not enough time in the day to effectively offer everything to everybody. Be selective and do what you do best. There is nothing worse than a diluted or "restricted" service for an overly broad range of offerings. We have all at one time or another arrived at the railroad station to find the "restricted service" sign up, and known we would be spending the best part of the morning in a railroad tunnel.

I remember one winter's day regretting not heeding a "restricted service" notice when catching a train from New York to Buffalo. When I realized I had to disembark at Rochester and be bussed the last fifty miles, I vowed never again to travel by train. Your appraisal services may suffer a similar fate if you fail to provide the "full" service.

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Specialized services

At the other extreme, the most focused appraisal services are the specialities. Many, but not all, have become specialists by accident. They do one or two assignments on a single property type, get interested, become experts, and the result is a speciality.

Specialities do not have to be all-consuming. There is room to be a specialist in one area and still have skills left to be a generalist in others. This is as true for an individual as for a large practice, where different individuals can shoulder different specialities to create a viable team of experts.

The list of the whatis elastic. It is not my intention to spell out all of the answers; merely to invite earnest consideration of the question. Consulting, financial valuations, property acquisition advice, investment analysis, tax advisory work, public sector assignments, litigation support, electronic data services, and relocation work are just a few services an appraiser can offer. The possibilities are endless. Divide the question into property types, client groupings, and even time periods. Be mindful too that services in demand today are subject to change; even as you are preparing today's marketing plan, acknowledge the need for regular revision and possibly major changes.

HOW?

Overcoming the fear

Professionals generally dislike marketing their services. The traditional "salesman" image is a bad fit. It somehow evokes a "peddler" image-loud clothes, a slick demeanour, and pushy pressure tactics. Such car lot tactics, we tell ourselves, are obviously an instant "turn-off"to a professional's clients. Why would we lower ourselves to this?

But are we using this as an excuse to "lie low?" This distaste for aggressive marketing is bred, in most of us, by fear-the fear of the 90% rejection ratio that is the bedfellow of cold calling. Not having a workable way of deciding who to target: and who to avoid, we retreat behind our telephones and make calls only to those we already know will respect us and not reject us.

If instead of retreating, appraisers overcome these fears and enter the "big bad" world of marketing, they will find that professional services can be as legitimately, yet subtly, marketed as any traditional product. Any concerns should be dispelled by the successes achieved in this field by such professionals as attorneys, doctors, architects, and engineers. Once he or she sees that successful marketing does not tarnish a professional demeanour, marketing (or more accurately, establishing business relationships) can be the most enjoyable part of any appraiser's working day.

The *how* is perhaps the steepest obstacle for most of us. This is the question that never goes away but to which we never find the one solution we can implement and evaluate. There is no one proven solution; it is a moving target. If there were an easy answer, the "how-to" authors would be out of business.

Two pivotal frustrations are how to get through to the right people, and how to measure whether the marketing dollar has been effectively used to achieve measurable results. Results may seem impossible to quantify.

I have just completed, for example, a year-long "courtship" with a local bank. This has involved lunches, golf games, and even a chance to serve on a Boy Scout committee with the CEO. I have made good friendships but no appraisal business has been forthcoming. My accountant questions the return on this particular marketing expense. But I am persevering into year two with the understanding that some portion of every marketing budget, even those of the corporate giants, must be allowed to take a scattershot approach and that eventually my patience will be repaid.

Assemble the "team"

The first step to answering thehowdilemma is usually a controlled brainstorm. Get your appraisal colleagues together. Expand the search to your social groups, your Sunday school class, and your Rotary club. Even the most unlikely sources can offer an opinion or uncover a source of new business; your team can be "everyman." Even nonbusiness a

groups understand marketing, simply from being personally bombarded by sales talk every minute of the day. All of us can distinguish successful marketing concepts simply from being exposed to them.

Concepts

Divide the discussion into concepts and actual ideas. By a concept I mean the marketing vehicle-usually a group of related ideas such as media marketing, a letter campaign, brochure materials, newsletters, a planned program of meetings, inhouse seminars and presentations, an orchestrated follow-up to past services, a "how am I doing" questionnaire, company-sponsored events, or free ancillary services to regular clients (e.g., online data, hotline access, promotional materials).

Each of these concepts may provide enough material to be delegated to separate individuals or work groups within your organization. Even if you are a small group or a sole practitioner you can still activate a variety of marketing ideas; the pace of progress will just seem slower. Establish priorities on a time line and make sure colleagues share successes and failures on a regular basis.

Remember the need for focus and the danger of trying to be all things to all people. Within each concept, assemble specific ideas. Each idea is a miniproject. Put a budget against each project; see it through. It is so easy to spend valuable time on an idea only to have it languish, partially completed because of lack of time or, more commonly, waning interest. If an idea dissipates before completion, debrief as to why and try to avoid further unconsummated follies.

Once you get the ideas flowing, you will understand the huge scope of this how topic. One appraisal group with which I worked accumulated over 100 workable concepts and found that the only way to effectively array them was an alphabetical list (I still keep my own version of this list as a reference for fresh ideas). From this they were able to prioritize concepts worth pursuing to meet their current goals and pinpoint concepts to be abandoned.

CONCLUSION

If you feel confused by the myriad of topics touched on in the answers to my four questions, let me conclude with a number of essential reminders-the primary "do's and don'ts" for successful marketing.

Beware of gatekeepers. There is a legion of nondecision makers out there, whose common denominator is a voracious appetite for your time. They will eat your lunches, take your data, get mileage from your reputation, and you will never get an assignment from them because it is not in their power to engage you.

"Mileage gained from a quality assignment is woiih ten times the mileage from all ujl'oil rrnarliering.

Maintain your focus and be wise in the use of your scarce resources. The scarcest resource is your time. Divide it equitably between marketing and production. You can't have one without the other.

After considering the whole gamut of ideas and gimmicks, your best marketing tool is your own good work. It will have a shelf life far longer than your marketin g literature. Therefore, present it well, with equal parts of form and substance. Then deliver within your promise-in the format and time frame expected by the client. Exceed expectations by all means but don't give away the store with your excesses. Finally, follow up to ensure you are in line for the next assignment. Mileage gained from a quality assignment is worth ten times the mileage from all of your marketing.

If you are amenable to change, hold regular but brief "SWOT" (i.e., strengths, weaknesses, opportunities, and threats) meetings, no matter how large or small your business. In addition to your own knowledge and client relationships, your appraisal colleagues are your front-line troops and are a valuable source of new ideas. Acknowledge that *they* may be closer to clients with whom they are working than you currently are. For example, don't take the bank CEO to lunch and ignore the loan officer who, through your colleagues, is a prolific source of business. Keep the positive concepts and discard the negative and the obsolete concepts. Finally, your road map for finding the answers in this four-question marketing approach is goal setting. Relate all of your marketing decisions to a primary mission, broken down, preferably against a time line, into goals. Constantly and honestly re-evaluate your results in the context of change. If you think you have achieved excellence, it will elude you. You will be defeated by that mortal enemy of success-complacency.

"DO'S AND DON'TS" FOR SUCCESSFUL MARKETING

- Beware of gatekeepers
- Maintain your focus
- Yourbestmarketingtoolisyour own good work
- Follow up
- "SWOT" (i.e., strengths, weaknesses, opportunities, and threats)
- Your appraisal colleagues are your front-line troops
- Keep the positive concepts and discard the negative
- Set goals
- Re-evaluate your results in the context of change

1 Advantage Training, Inc.; Orlando, Florida. Workshop, March 1993.

2. Edward W. Deming: *Our* ot'*Crisi.s.* Cambridge. Mass. MIT Press 1982.

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ImproveYour Report Writing Skills

A key to success

by Patricia Langridge

Patricia Langridge has already conducted successful CPD seminars on report writing at a number of North Island centres and readers will quickly appreciate the skills, style and understanding she offers her participants.

She is author of "Move into Management" and was, fortwo years a columnistfor MORE magazine.

As Principal of RESULTS Human Resource Consultancy, Patricia helps clients throughout New Zealand to communicate, interact and train others more effectively.

Any branches, practices or readers wishing to contact Patricia may do so by phone or fax to (09) 521 9312.

Language is a tool to communicate information, ideas and feelings. The more precise the tool, the more effectively we communicate.

In a recent survey of 182 senior professionals in science and industry the main complaint about written work was 'generally foggy language'. Lack of clarity, it seems, is the most widespread problem in business and professional writing.

Whatever happened to the vigorous concise writing advocated by William Strunk as long ago as 1919 in his hallmark work *The Elements of Style?* High technology and information overload have made difficult words and long-windedness a luxury no-one can afford. Strunk was generally unheard when I was at school and few are applying his lessons on writing with precision today.

Every word must count. Never use ten words when you can say it in two. Never use a longer word where a shorter one will do.

How do I know that yesterday's students are suffering from the overuse of long and unnecessary words?

I march my pen relentlessly through words like `utilise', `terminate' and `commence' and reject meaningless phrases tacked on simply because everyone's using them.

"Never use ten words *when you can say it in two."*

I prefer my programme participants not to `maximise their potentialities' even 'in the foreseeable future' and enjoy the shock waves from bringing back into their overinflated vocabularies little gems like `get' and `do'.

Mature business writers are often understandably still in the grip of the `waffle complex', in younger people it should not be happening.

The chip has speeded up the reduction revolution, current business practice demands it. When are our schools going to follow?

What are we doing about it?

JARGON

Another problem, especially in our high-tech age, is the thoughtless use of jargon. It has its place as industry shorthand among colleagues in the same field but should not be used to confuse or impress the lay person. Write to express not to impress.

"Write to expre,ss not to impress,"

The purpose of communication is to convey a message which is received, understood and acted upon. If your message fails to reach your audience communication has not taken place. Remember the reader. The secret of writing for results is simply to put yourself in the reader's place.

The professional who continues to write about `maximised output with minimised input' increases the chances of missing the mark while decreasing the chances of getting ahead in business.

The *New Zealand Institute of Valuers* is recognising that written communication is an important area of need by employing a professional writer with ten years experience in running business writing programmes. The aim is to make this programme an Institute one incorporating relevant material and exercises and considering the needs of professionals working in the property field.

I have had a long association with Valuers including some years spent running report writing programmes for Valuation New Zealand's Northern Region. If you decide to organise a business writing programme in your area what am I going to do for you? In general any training lifts motivation and morale but let's look at the benefits that a well-run writing programme will provide. It may be that you already write clearly and economically communicating with a clear aim and an informed and understanding attitude towards the reader's needs. In this case 'Congratulations!' My programme will offer you confidence that you are on the right track, reinforcement of the principles and the encouragement to influence your less fortunate colleagues.

If, however, your written communication needs updating, paring down to the essentials and you know you could be reaching your clients more effectively then organise a programme in your branch or practice. Those attending will come away knowing how to:

- focus on a clear and specific aim
- write the way they speak
- economise with words
- avoid jargon
- use appropriate tone
- plan and format longer documents

PROGRAMME PRINCIPLES

Today's business writing style is more direct, concise and personal than in the past. Written language also aims to be flexible and appropriate. Why these changes?

The reasons are:

- the pressures of time and the information explosion
- technology with its use of basic, simple language
- legislation and the requirements of plain English
- a competitive business climate
- the need to create relationships with our clients
- human rights issues and cultural awareness

It's important to adopt a style that follows these guidelines but your writing style will vary according to the aim of the document, the reader's needs and your practice's culture and image.

PROGRAMME OUTLINE

Business and Report Writing is best presented in two half days. The first, which I call Writing for Results, covers planning and preparation, words without waffle and style without strain. The second half day, Readable Reports, provides a systematic way of planning and outlining longer documents as well as a format to follow. The last exercise is a group reworking of reports which have been provided by participants beforehand. Reading these gives me clear insight into the writing personality and practice of every one attending.

Writing should not be as difficult an activity as people seem to make of it. I often say to my clients `If I phoned and asked you to tell me about your current project you would fill me in five minutes or less. And it would be easy! But what if I asked you to send me a short report on the same subject?'

For some the whole exercise would take three weeks and several drafts, a ridiculous waste of time and money to the practice. As two writers on time, Turla and Hawkins, put it: 'Let your purpose for doing the task determine how much time you spend doing it.' This particular project should take no more than an hour and the end result should be clear, readable, accurate, concise and well-presented.

I don't meet many people who are equal to the task but imagine the time, hassles and energy saved if you could easily put words to paper that met your outcome and your reader's needs. It's a skill well worth developing and essential to the public relations profile of your company. After all if all I ever receive from your organisation is one piece of correspondence my opinion of how you will handle my business will depend on that letter or report. Ignore your writing personality at your peril!

cc 191,10re ti'oui writing personality at your lord.'

Today's effective business writer communicates with a clear aim and an informed and understanding attitude towards the reader's needs. The points to be covered are carefully planned and the tone is appropriate for the outcome. No words are wasted and the style, presentation and design convey a practice that is professional, up-to-date, efficient and approachable.

Readers want to read your words because of the interesting ideas presented and the life and vigour of the personality behind the pen. That writer could be you-direct, specific and persuasive, someone who wins with words and gets results by creating rapport through writing.

Young Professional Valuer of the Year 1996

Members are reminded that the New Zealand Institute of Valuers seeks nominations of suitable candidates for the Young Professional Valuer of the Year bythe 30th November each year. Members are encouraged to identify potential nominees and where appropriate to advise their employers of the award. Information kits are available from the General Secretary.

ELIGIBILITY CRITERIA:

dominations are limited to Members of Affiliates aged 30 years or less who have achieved outstanding significance within any one or more of the following criteria:

professional participation within the NZIV
original research
original authorship

and

- outstanding technical and/or professional excellence

or

- significant contribution to the community that brings credit to the Profession.

Initial selection will beat Branch level with final selection made bythe National Award Panel. There will be one national award each year and this will only be conferred if the candidate is worthy of it.

PREVIOUS AWARDEES

1993 Marcus Jackson B.Sc., B.P.A. - Otago

1994 Leonie Freeman M.Com (V.P.M) Hons -- Auckland

Plant & Machinery Values

An Engineer's Perspective

by Colin Francis
M.I.P.M.V.

Colin Francis is the principal of Francis Valuation Service in Christchurch. He has considerable experience in the valuation of a number of major engineering projects in Australia, Asia, New Zealand and the Pacific.

He has qualifications in both marine and mechanical engineering and is a member of the Institute of Plant and Machinery Valuers.

When is the most economical time to replace plant and machinery ? Knowing the right answer to this question is the difference between making a profit or making a loss, yet too often there is not enough reliable information on which to base a decision.

A planned equipment replacement program is important to prevent the unnecessary expense of keeping plant and machinery after it has passed the point of economical operation. It can prevent the loss of investment caused by replacing plant and equipment before, or after it reaches the point of maximum return.

Pinpointing the best time to replace a piece of plant or machinery is a difficult task. With costs constantly rising, and having to compete in a very competitive market place the manufacturer or business cannot afford to gamble on a matter which significantly affects its ability to earn a profit. In any manufacturing operation there are high production applications which require either a new, near new or recently rebuilt machine. These applications require top machines in excellent operating condition in order to maintain profits and remain competitive.

Some owners install a new machine when the present machinery requires a major overhaul, or perhaps when a second overhaul is required. Others wait until they have extra capital, or when starting a new contract. While all these methods are used, none of them provide a sound financial or economic basis for a replacement decision.

In order to determine the most economical replacement time, accurate records of maintenance, repair costs and downtime must be kept for each machine. The purchaser must then consider finance costs, possible future price increases, and the effects of inflation.

As an example, we will use a machine with an initial purchase price of $30,000 that is worked a total of 1,500 hours per year. Five cost factors will influence the cumulative cost per hour and each will be considered separately.

- Depreciation and Replacement Costs
- Investment Costs
- Maintenance and Repair Costs
- Downtime Costs
- Obsolescence Costs

Total cumulative costs divided by total cumulative plant hours for a given period, equals cumulative cost per hour.

" Whether cumulative cast per]ncxc'hirre her'orm '.ti ptr gres.�ively higher, or lower withi added rnoehine hours is the key to the most economical replacement tine.

The following example is not intended to tell you how long to keep a piece of plant or machinery, but is used to point out the effects of these five factors and their influence on making the decision to replace the item of plant. Considering these factors can offer substantial savings for the business.

Throughout this analysis it is important to remember that both costs and hours are cumulative. For example, if the cumulative cost per hour is $5.04 in the fourth year, this does not mean that only the hours accumulated in the fourth have cost $5.04 per hour. It means that all hours accumulated during the first, second, third and fourth year have cost $5.04 per hour. The cumulative basis is the key to this analysis.

PRESENTED TO THE IPMV SOUTHERN BRANCH SEMINAR 30 SEPTEMBER 1995

Depreciation and Replacement Costs

Depreciation cost is the out of pocket cost due to the decline in actual value of a machine because of usage and age. It is simply the difference between the initial price paid for a machine and the price obtained for that machine when sold or traded.

Depreciation has become an increasingly important factor in recent years because true depreciation costs for plant and machinery are increasing, with a greater proportion of depreciation occurring within the first five years. This has been a result of rapid new product development by most manufacturers and changes which increase machinery productivity. Depreciation rate is also dependent upon type of machine, manufacturer, location, service, and parts availability.

Replacement cost is a result of the rising price of new machinery and the purchasing power of the dollar. An examination of the wholesale price index of manufacturing plant and machinery from 1980 to 1989, shows that there has been an increase of 30 points, or a 29 % increase within a 10 year period, an average price increase of about 3% per year *(Figure 1).*

Assuming future price increases will continue at the rate of 3 % per year, one can see what will happen to these indexes in terms of 1990 prices. From these figures it is possible to project the cost of replacing the $30,000 machine used in this example *(Figure 2).*

Figure 1

WHOLESALE PRICE INDEX MANUFACTURING PLANT AND MACHINERY

(1977/78 = 100)

Year	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Index	105.8	107.5	107.8	109.6	112.1	115.3	118.9	123.2	129.6	136.0

Figure 2

PROJECTED PRICE INDEX

(1990 = 100)

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Index	100	103	106	109	112	115	118	121	124	127

These two factors will influence the cost of replacing the machine: First, the value of the machine owned is decreasing (depreciation) and second, the cost of replacing the machine is increasing (replacement cost) This can best be shown by *figure 3* which considers the effect of both costs *(Figure 3).*

Figure 4

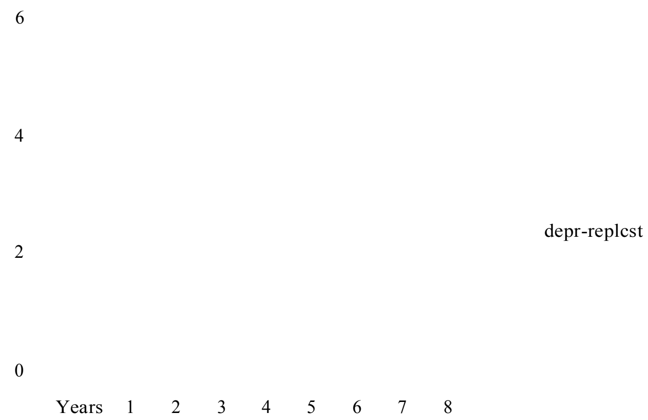
DEPRECIATION AND REPLACEMENT COSTS

Year		2		4	5	6	7	8
Reinstatement Cost ($)	30,900	31,850	32,780	33,770	34,780	35,820	36,900	38.000
Trade-in Percentage	77%	65%	55%	45%	40%	35%	32%	30%
Trade-in Value ($)	23,100	19,500	16,500	13,500	12,000	10,500	9,600	9,000
Loss on Reinstatement ($)	7,800	12,350	16,280	20,270	22,780	25,320	27,300	29,000
Cumulative Running Hours	1,500	3,000	4,500	6,000	7,500	9,000	10,500	12,000
Total Cost/Running Hour ($)	5.20	4.11	3.62	3.38	3.04	2.81	2.60	2.42

The importance of depreciation and replacement costs is also shown in *Figures 4 & 5.* While the loss on replacement is increasing each year, the hours the machine has worked are also increasing, which results in a yearly decrease in depreciation and replacement cost. If this was the only factor in a replacement program an owner might retain the machine indefinitely, but there are other factors to be considered.

Figure 5

Depreciation and Replacement Costs $30,000
Machine Working 1,500 Hours Per Year



Investment Costs

Figure 6

INVESTMENT COSTS

Year	1	2	3	4	5	6	7	8
Investment start of the year	30,000	23,000	19,500	16,500	13,500	12,000	10,500	9.600
Yearly depreciation	6,900	3.600	3,000	3,000	1,000	1,500	900	600
End of year investment	23,100	19,500	16,500	13.500	12,000	10,500	9,600	9,000
Average yearly investment	26,550	21,300	15,000	15,000	12,500	1 1	,250	1 0,050 9,300
Investment cost @ 10%	2,655	2.130	1,800	1,500	1,250	1, 1	25	1 7005930
Cumulative investment cost	2,655	4,785	6,585	8,085	9,335	10,460	11465	12,395
Cumulative job hours	1,500	3,000	4,500	6,000	7,500	9,000	10,500	12,000
Investment cost/cumulative hour	1.77	1.66	1.46	1.35	1 .24	1 .16	1.09	1.03

Investment costs favour retaining the machine

The capital investment required for the purchase or replacement of plant and machinery increases every year, with rising prices and the trend toward bigger, more productive machines.

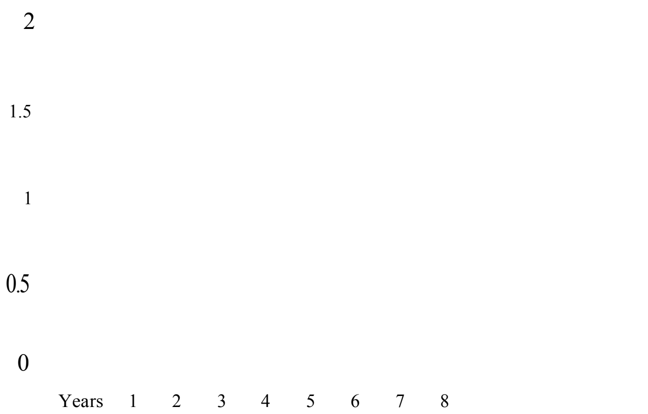
Whether this machinery is purchased for cash, by instalment contract, rental to purchase, or leased, there is some type of interest charge, finance expense, insurance and tax which must be charged against each unit in order to determine the true costs in an orderly replacement program.

If a unit is rented, or purchased on an instalment contract, most of the interest is a result of the charges for financing the transaction. However on cash purchases, the interest charged against a machine is that which would be earned if the same amount were invested at (say) a 6% return.

In order to keep the example in a simple form, it can be assumed the combined cost of interest, insurance and taxes equal 10% of the average yearly investment for a given year. These figures are general. Each plant and machinery purchaser must use the type of charges which are incurred in a particular operation.

Figure 7

Investment Costs



Note in figures 6 & 7that the investment costs per cumulative hour decrease as the machine grows older, favouring retaining the machine indefinitely.

Maintenance and Repair Costs

Figure 8

MAINTENANCE AND REPAIR COSTS

Items .	Years	1	2	3	4	5	6	7	8
Availability		97%	94%	92%	90%	88%a	86%	83%	80%
Maintenance & repair cost		1,050	1	,950	2,700	3,300	4,050	4,650	5,700 6,600
Cumulative R&M costs		1,050	3,000	5,700	9,000	13,050	17,700	23,400	30,000
Cumulative job hours		1.50	3,000	4,500	6,000	7,500	9,000	10,500	12,000
R&M costs per cum hour		0.70	1,00	1.27	1.50	1.74	1.97	2.23	2.50

Maintenance and repair costs favour trading the machine

The largest single item of operating expense for heavy rotating plant and machinery is the cost of maintenance and repairs. Over eight years, an amount equal to 100% of the purchase price could be spent to maintain it. Under severe conditions, this amount can be reached in three or four years. Since the example is based on averages of hundreds of units, the repair costs increase evenly. The costs for an individual operation may show an irregular pattern. This is a result of major overhauls or extensive repairs such as track overhauls on earthmoving machinery, or engines and transmissions etc. which cause unusually high costs in the year in which they occur. For this reason it is important that machine owners keep accurate cost records on an individual machine basis.

In spite of actual costs varying greatly from year to year, there is some correlation between maintenance costs and downtime. Using availability figures based on averages of many machines, it is possible to prorate the downtime and maintenance costs accordingly. However each equipment owner must rely only upon their own maintenance records in computing actual hourly costs.

As the figures show, if the costs of maintenance and repair were the only factors to be considered, one might well conclude that machines should be traded every year to avoid the increasing costs and downtime.

Downtime Costs

As the productive capacity of a machine increases, the cost of lost time due to machine breakdown also increases. With the trend toward faster, more productive machines, it is imperative that today's manufacturers consider downtime as an operating expense.

While the design goal for most equipment manufacturers would be about 95% availability, normal usage will result in increased downtime as a machine gets older. Since downtime can vary according to make, age and preventive maintenance of each

Figure 10

DOWNTIME COSTS

,Items	Years	1	2	3	4	5	6	7	8
Availability		97%	94%	92%	90%	88%	86%	83%	80%
Hours to be regained		45	90	120	150	180	210	255	300
Cost per hour		6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Downtime cost		270	540	720	900	1,080	1,260	1,530	1,800
Cumulative downtime costs		270	810	1,530	2,430	3,520	4,770	6,300	8,100
Cumulative job hours		1,500	3,000	4,500	6,000	7,500	9,000	10,500	12,000
Downtime costs/cum hour		0.18	0.27	0.34	0.41	0.47	0.53	0.60	0.68

Downtime costs favour trading the machine

Figure 11

Downtime Costs

0.8

0.6

0.4

Drnmecost

0.2

0

Years 1 2 3 4 5 6 7 8

Downtime costs favour trading the machine.

machine, each business should keep its own records in computing down time expense.

As overhead expense is such a variable factor among various size businesses a fixed overhead charge for downtime delays is not shown. Instead, the downtime cost in *Figure 10* is the approximate owning and operating cost of a comparable machine used to keep the job on schedule. This method is extremely conservative, and the cumulative down cost per hour is computed on this basis.

Obsolescence Costs

While the model designation of a machine may be retained by a manufacturer for many years, the productive capacity of that machine may be increased many times during that period. Machines produced even five years ago are no match for today's more powerful and more productive models.

Over the years the productive capacity of many types of machines has increased, and in some cases, can now economically do jobs which previously were an economic impossibility. While the production potential is growing in some cases by an average of 5% per year, the increases do not necessarily follow a smooth curve, but may rise sharply with the introduction of a new model.

Present equipment manufacturers do not seem to have a set pattern for introducing new models, but past history indicates that a new model in a particular line is generally introduced on an average of every two or three years. Based upon an average increase in production potential of 5% per year, most new models have the ability to produce 10 to 15% more than their predecessors. Staying on the conservative side, let's assume a new model

Figure 12

OBSOLESCENCE COSTS

Items	Years	2		4			7	8
Obsolescence factor	0	0	0	154-c	15%	*15*	30'-(;	30%
Hours to equal a new machine	0	0	0	225	225	225	450	450
Cost per hour	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Yearly cost of obsolescence	0	0	0	1,350	1,350	1,350	2,700	2,700
Cumulative obsolescence cost	0	0	0	1,350	2,700	4,050	6,750	9,450
Cumulative job hours	1,500	3,000	4,500	6,000	7,500	9,000	*1 0,500*	12,000
Obsolescence Cost per hour	0	0	0	0.23	0.36	0.45	0.68	0.700

Obsolence costs favour trading the machine.

Figure 13

Obsolence Costs

1.0

0.8

0.6

0.4

Obsolcost

0.2

0

Years 1 2 3 4 5 6 7 8

every three years and a 15% increase in productive capacity . This means that the operator who works 1,500 hours per year must operate an additional 225 hours (15% of 1,500) or a total of 1,725 to give him the same production which a new machine achieves in 1,500 hours. The additional hours of operation required to match the new machine production will be considered obsolescence costs

The adverse effects of obsolete equipment are more important today than ever before. Manufacturers are spending record sums on research and development, and these efforts result in an ever increasing rate of product development and improvement. The rising costs of obsolescence are seen in *Figure 13*. There again, the conclusion is a simple one if only considering the effect of productivity or obsolescence : Trade your machine every time a new model is introduced.

Summary

In analysing this example, some factors favoured retaining a machine while other factors favoured trading. As a review, the following conclusions were reached in considering each factor.

Obviously, there is never a situation in which these factors occur independently of each other. All of them exert their influence at the same time, and their total effect points to the most economical time to replace a machine.

	Factor	Conclusion
1.	Depreciation and replacement costs	Retain the machine
2.	Investment costs	Retain the machine
3.	Maintenance and repair costs	Trade the machine
4.	Downtime costs	Trade the machine
5.	Obsolescence costs	Trade the machine

Figures 14 and 15 contain a summation of all previous data. They reveal that for the condition assumed in the example, this $30,000 unit should be traded at the end of the third year. IT DOES NOT MEAN THAT EVERY OWNER SHOULD TRADE EVERY MACHINE EVERY THREE YEARS. In many cases two years would be more economical, while in other cases conditions exist where the period may extend beyond three years.

Figure 14

CUMULATIVE COSTS PER HOUR

Factor Years	1	2	3					
Depreciation & replacement costs	5.20	4.11	3.62	3.38	3.04	2.81	2.60	2.42
Investment costs	1.77	1.66	1	.46	1.35	1.24	1.16	1.09 1.03
R&M costs	0.70	1.00	1.27	1.50	1.74	1.97	2.23	2.50
Downtime costs	0.18	0.27	0.34	0.41	0.47	0.53	0.60	0.68
Obsolescence costs	0	0	0	0.23	0.36	0.45	0.64	0.79
Total cumulative cost/hour	7.85	6.98	6.69	6.87	6.85	6.92	7.16	7.37

General operating expenses per unit (other than maintenance costs) are not included in the equipment cost factors because they have no particular effect on the final results. This is because operating costs per unit of work are about the same for both new and old machines. For example, a new higher horsepower engine will consume more fuel than its lower powered predecessor, but older units will use more oil, grease, hydraulic oil etc. If increased operating costs, particularly increased fuel consumption, appear to be a significant factor, then they should be considered along with the other factors in this analysis.

It should be kept in mind that the totals in the summary are not owning and operating costs. The addition of operating expenses plus the cost of the operators wages will increase each cumulative yearly total.

Whether considering new or used equipment for replacement the important point to consider is that in every equipment user's operation, there is one ideal time to replace any profit producing capital investment. Only by applying the effects of all influencing factors can a proper decision be reached.

Technology Forum

Technology Forum is a regular feature of the NZ Valuers' Journal. Its aim is to report on computer technology as it evolves with particular emphasis on information systems, property sales and database issues, telecommunication, computer hardware and software developments. It will also endeavour to cover technological developments in the building, mapping and other similar land based industries.

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Any subscribers encountering technology related problems or seeking advice on computer issues are encouraged to use the Mail Bag for appropriate discussion and comment. In addition to answering queries direct the letter may be published (anonymously if preferred) in order to share problems, answers and outcomes within the subscription membership. Prospective authors in this field, practitioners with technology problems or ideas and anyone with computer skills willing to assist should feel free to contact:

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What's happened to Valpak?

by E.T. Fitzgerald F.N.Z.I.V.

By the time this article is published Headway Systems Ltd will have already provided several electronic & microfiche sales updates to subscribers in New Zealand. Ted Fitzgerald outlines the background and purpose of Headway Systems Ltd.

Computer hardware and software has advanced tremendously, and become much more affordable. The result is that both industry and the professions are better able to harness its productivity. The property professions are no exception. Good computer applications provide operational efficiency, and give clients a better quality service.

The development of successful software requires considerable investment. In many cases this is beyond the prudent investment level of single practicing firms. A group of valuation/property consultancy firms, recognised the merit of a combined initiative and formed Headway Systems in 1995. The NZ Institute of Valuers also recognised the merit of such an initiative. The outcome resulted in Headway Systems being restructured to become jointly owned by NZIV (50%), and PT (for Property Technology) Investments Ltd (the valuation/property consultancy group) (50%). Headway Systems Ltd operates as a separate business unit from offices recently established in Christchurch. It is governed by its own Board of Directors. As a result of this joint arrangement Headway acquired from the Institute various well established technology interests, while the industry shareholders have provided fresh capital to establish Headway on a sound financial basis and to fund further systems development. The existing software, and new software products being developed, will be available to all practising property professionals.

Ted Fitzgerald is the Managing Directorof Headway Systems Ltd, which now operates the sales data and ValpakTM software systems previously provided by the NZ Institute of Valuers. Ted Fitzgerald was the driving force behind the development of the sales data and Valpak-2TM software for the Institute. He is a Fellow of the Institute of Valuers and was awarded its JM Harcourt Award in 1990 recognising his significant contribution to the development and deployment of computer technology throughout the valuing profession. He is an experienced valuer and property consultant. In late 1995 he redeployed his time to Headway Systems Ltd which plans to again develop significant new software specifically for property professionals.

"Like it or not, we too must fully embrace and deploy the power of computers as a modern professitnal tool.

APPLICATIONS IN CONTEXT

Software

Office applications fall under 3 main categories; word processing, spreadsheet modeling, and database information systems. Specialist applications are typically variant applications from these functions, or combinations of them.

Better Cheaper Technology

Over recent years, particularly the last two, enormous advances have been made in the capability of PC computer hardware all at affordable prices. Many of the available office application software packages have benefited from major upgrades. One example was the evolutionary development of WindowsTM 3.11, then Windows for WorkgroupsTM, and more recently Windows- '95TM. Popular packages such as Microsoft WordTM (wordprocessor), ExcelTM (spreadsheet), AccessTM (database), have also evolved and upgraded.

"Computerisation is real, global, and transcending ever} walk of life, but its effectiveness in the end still depends on the capabilit ' o respective application software. "

Headways recent survey of data subscribers illustrated a wide range of office application software in use. Other systems have enjoyed a strong following but the recently released Microsoft Office `95TM (Windows) and their application software upgrades to match are arguably the most spectacular advance with a very wide market acceptance. MicrosoftTM with enormous R & D applied resources, and a worldwide market, seem likely to dominat'ethe core office software market. No doubt other software companies will continue to be in there also.

It seems certain that computerisation is real, global, and transcending every walk of life, but its effectiveness in the end still depends on the capability of respective application software.

It is now clear that modern word-processing and spreadsheet software is able to be readily setup and maintained at individual offices. Such software systems are more than adequate to meet the word processing and spread-sheeting needs of property professional offices providing personnel are appropriately trained.

Almost weekly, new technical advances are heralded with publicity and hype ineluding the Internet, the so called 'Information Highway'. The Internet has great potential and will ultimately revolutionise information communication. But let's keep our feet on the ground. At this stage Headway is more interested in building good information management systems rather than speeding down a `Highway' without specific form or destination.

Let's recognise that the technical advances with computerisation are also bringing great advances in communication which will be very significant to our professional lives. Headway is making every endeavour to position itself to capitalise on the advances in communication at the opportune time.

Database

The `information systems' (database) category is a different proposition. While database software exists `off the shelf' it still requires considerable development to structure a useful robust information system. Such developmentmay be within the grasp of a few of the larger organisations, but it is particularly demanding of development resources (time and funding). It requires constant support and evolution to ensure the system objectives are met. The ValpakTM sales System is a good example of a property sales information database (in Valpak's case integrating a centralised data subscription service matched to the Valpak-2TM user data management software). It continues to operate very satisfactorily at its present level, but requires modernisation if the full benefits of present computer power are to be realised..

Most are struggling tofind the 'on-ramp' rather than coping with, or deriving benefits from, the Internet super highway!"

Property professional offices (whether management, valuation or real estate marketing) rely extensively on information. Information (knowledge) is the lifeblood which enables professionals to apply their skill and judgment. Such information must be reliable, timely, relevant, and most importantlyreadily accessible. There is nothing new in this but computerisation of well designed and well maintained information systems enormously improves the accessibility and immediacy of information. This then enables users to improve the delivery of services in a competitive market. The market reality is that professional services are contestable. Other professions who compete in the property services market are also well aware of the beneficial power of computerisation. Like it or not, we must fully embrace and deploy the power of computers as a modern professional tool.

It is in this information systems area that Headway Systems Ltd identifies its primary mission. The success of the Valpak-2TM project well demonstrates the merit of a combined `industry' initiative for such developments.

UTILISING COMPUTER TECHNOLOGY

A further interesting response in Headways survey was that most offices would consider upgrading their computer systems if the application software merited it. This is particularly important as the cost barriers to upgrading have been greatly reduced, and look likely to continue to reduce. The usefulness of computer systems is ultimately determined by software capability rather than computer hardware capability, though modern effective software demands highercomputer processor capacities in CPU speed, RAM memory, and disk storage capacity. Happily all of these hardware aspects are now very affordable even to smaller offices. Products which Headway has on its drawing boards will work well on computer hardware now available at a reasonable cost. In many cases such hardware is already in use.

The Valpak-2TM sales system was developed for the NZIV about 1988/89 when the IBM AT (80286chip, 640k- 1 mb RAM, 50-60mb hard disk) was the hot new standard and the AT computer capability was utilised largely to its reliable operating limits by Valpak-2TM. It has proven itself as a robust reliable programme which has been enormously successful. It continues to be widely used and efficiently operates on 386, 486, and now Pentium computers. Headway Systems will continue to maintain and support the Valpak-2TM system, but will also be developing successor software which will provide further data capture benefits utilising higher486 & Pentium capabilities.

Headway Systems' policy is to invest in continual product development. At the time of writing Headway Systems are working on three development projects:

Subscriber

An important core activity of Headway is the twice monthly sales subscription service.

We are well through the redevelopment of the central sales data distribution system software which is now established on new higher capacity computer equipment in readiness of further developments. This system distributes the data according to each subscriber's specific requirements. The data is then archived to a history database which Headway holds for client database support purposes, and for extraction of specific history data when required.

" 1hedevclopntent of software is hest achieved on an evoltttionarv basis, rather tlrart. a revolutiorrarv busts.

Targeted Data

We are investigating the option of transferring update data to subscribers `on line' via modem. We are also looking at the ability to specify data export to subscribers for targeted geographic areas smaller than entire territorial authorities; also by categories where specific supplementary data is required.

Printout Options

An upgrade to Valpak-2TM is high on Headways agenda. It will include an improved range of printer choices.

Plans are also on the drawing boards for other new products .

Office Management Programmes

We are currently considering the development and release of a Debtors/Matter (Job) management programme especially written for Valuation/Property Consultancy Offices. The focus of this programme revolves around Clients (Debtors), Matters (Instructions), and Staff. Apart from all the regular Debtor functions a key benefit of this package will be its ability to manage and record individual matters from the time instructions are received through to the time of completion and billing. It offers excellent practice management reporting options. Many aspects of this programme (running under MS DOSTM and as a DOS programme within WindowsTM v3.11, Windows for WorkgroupsTM, and Windows '95TH) are already accomplished but some aspects are being further refined. We are keen to hear from practices interested in this Debtor/ Matter Management software so we can take on board any fresh ideas and programme them into this useful package.

Property Information

Another major project is the development of an new comprehensive database software programme for Valuation/Property Consultancy Offices. It will have the capacity to receive sales data updates (as for ValpakTM), and also record rental/lease information, as well as ad hoc property information. It will also have a capability to record `own valuation' data all indexed to specific properties. This programme will allow a much greater depth of data to be recorded and retrieved, including analysis details. Headways recent subscriber survey shows a large number of sites run Windows of one version or another, or have equipment capable of running WindowsTM, or indicate interest in upgrading computer equipment if the software package merits it. It therefore seems logical to develop this new comprehensive database software for WindowsTM

The development of software is best achieved on an evolutionary basis, rather than a revolutionary basis. Headway System's mission is to generate system advancements, and to fully support its products and services. Headway Systems actively welcomes ideas and will make every endeavour to incorporate worthwhile ideas into its software.

Headways Contact address is: Headway Systems Ltd, PO Box 71, Christchurch Phone 03 379 1900, Fax 03 379 0116

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"SURFING THE INTERNET?"

by Leonie Freeman of Crest Consultancy

Internet Yes it's everywhere. It's discussed at length by all sorts of people. It's in the media because it's being used for pornography. It's even being used to build bombs. But it does have much greater significance than this.

Let's look not so much at the technical aspects of the Internet, but at its existing and potential use! From a business perspective, in my opinion there are three main uses of the Internet:

COMMUNICATION:

Main communication options at the present time are the phone, fax, and mail. The Internet very simply is a global network in which anyone anywhere in the world can, with a modem from their computer, dial up and access the Internet. This global network also allows for very cheap and efficient communication, called electronic mail or e-mail.

For-example, once you have an Internet link with an Internet provider established (costs are approximately $50 to setup and between $15-50 thereafter), you could send for example a five page letter anywhere in New Zealand for approximately 2-3 cents. To send this letter overseas would cost in the vicinity of 8 cents. E-mail addresses are slowly creeping onto peoples business cards, but I believe in time an email address will become as standard as a fax number is at present.

ADVERTISING

A Home Pa ge is the term which refers to somebody's Internet location and tends to display information of potential interest.

Any information you desire can appear on your home page and can include information about your company, what you do, useful information to the public, who are your partners and employees and anything else. This is available for anyone to access from either within New Zealand or overseas.

You can even conduct on-line sales by user interaction. If for example you sell publications or other material, a selection list could appear on your home page. The user then has the ability to make an order. One useful accessory to advertising using the Internet and the development of your home page, is information can be provided on how many people actually access your home page, and where they are looking from i.e overseas or within New Zealand. This enables you to determine the effectiveness of your advertising.

INFORMATION

Do you want to look for properties advertised for sale in Australia or Israel, what about the state of the retail market in Hong Kong or the office market in London? Are you planning a holiday in Europe and you want to rent an apartment in France or are you looking for further articles on a specialist area you are involved with?

There are many libraries, research institutes, local and central government and national and international organisations connected to the Internet which hold information in the public arena.

It's all there, growing continuously and available to anyone wishing to access it. You just have to find it. This searching through the web of data is called surfing the net and is something in which you can spend a large amount of time doing but is amazing what you can find.

It does highlight perhaps the biggest disadvantage of the Internet - and that is the actual finding of information - it changes at such a rapid rate, and there is no central system of finding what you are looking for. It's like looking through the Yellow Pages without a directory.

Substantial work has been undertaken by companies to setup searching mechanisms so for instance if you type in property or real estate, it will link you to a huge array of property related sources. But it isn't necessarily all the available material.

So where is it all sitting at the present time? The Internet is the here and now. All factors discussed above are able to be used and accessed today. In the past Internet has been the domain of the computer boffins and an interested few, but in my opinion an e-mail address will become standard practice within 1- 2 years. In addition, 1996 will see a change in the property arena from interesting "surfing" for property information predominantly overseas, to being able to access a much wider range of local based property and other useful information.

So, no don't put your head back in the sand, and say it's something I don't need to know about. Venture into your local library - many have Internet access, or in some cities there are even Cyberspace Cafes where you can have a coffee and "surf the Net" at the same time. Keep a watchful eye - and remember you too could become one of those "Internet surfies".

The Mid-Rent Approach to Determining Rental Rate

by Tom Marks

The author is a Practicing Registered Valuerwho was SeniorLecturer in Valuation at Lincoln College from 1969 to 1986. He is now employed as Consultant by Ernst & Young, Christchurch. TomholdstheDip. V.F.M. &B.Ag.Com, having majored in Production and Econometries. He acknowledges the input of his teaching colleague Ralph Frizzell, FNZIV.

A common approach to setting contract rents is the application of a rental rate to a rental value. A normal valuation process determines the rental value-similar to any other market-related valuation. The determination of the rental rate, however, generally suffers from a lack of quality specific market evidence and can be significantly complicated by a difference in lease terms.

Valuers have long recognised that contract rents set for longer rent review terms should initially be set at a higher rate than for shorter terms. Simply, as rental values tend to increase gradually, the contract rent that is a fair return in the initial year of the term can seriously disadvantage the lessor as their asset's rental value inflates over time.

A mid-rent initially sets a contract rent above the fair annual return. The lessee is compensated in the longer-term when the contract rent falls below the fair annual rent. Ideally, the net present value of the annual contract rent set will equate with the net present value of notional annual rentals set on inflating rental values, over the review period of the lease.

Analysis of market rental data can establish the difference between rental rates for longer review terms, or the rates may even be based on considered opinion when reliable market data is unavailable.

However, mid-rents can be specifically calculated. The process produces a contract rental for a term which has the same net present value as notional annual rentals set on the inflating annual rental values.

The mid-rent formula is as follows:

Where:

$$R = \frac{{}_{1}\Big[\Big(1_{+iy} \quad (1+i)n\Big]}{(1_{+i}\Big)_{n} \quad 1}$$

R	=	the mid rent rate
I	=	the expected inflation rate over the review term
i	=	the nominal discount rate
n	=	the number of periods for the term

Note: i - I is the real rate of return

This approach to setting rents is one of a number of valuation methods: Ernst & Young considers the main advantage of the mid-rent calculation to be its removal of the subjectivity associated with the assessment of premiums' allowed in rental rates for longer-term leases.

The method is therefore applicable as an aid to rental assessment on onv *lease that does not have the rent assessment method tightly prescribed.*

Example

- a lease term for 7 years on a property with a present rental value of $100,000;
- the forecast rate of inflation in rental value is 3%;
- the required real rate of return is 6%
- rent is paid annually.

Thus:

$$I = 0.03$$
$$i = 0.09$$
$$n = 7$$

The mid rent rate is therefore calculated as:

$$R = \frac{0.09\,\underline{(1.09^7} \quad 1.03^7}{1.09^7-1}$$

$$\therefore R = 0.065015 (6.5015\%)$$

and the annual contract rent for the 7 year term is:

$100,000 x 0.065015 = $6501.49

We now check that the net present value of $6,501.49 per year is the same as the net present value (NPV) of the notional annually reviewed rents at 6% of the rental values, inflated at 3% per year.

The NPV of an annuity paid in arrears is calculated as follows:

$$P = A \frac{(1+t)^n-1}{i(1+i)^n}$$

Where:

$$P = \text{present value}$$
$$i = \text{nominal discount rate}$$
$$n = \text{number of periods in the term}$$

This converts to payments in advance when multiplied by 1+i.

Thus the NPV of the mid-rent in the example lease is:

$$\$6{,}501.49 \quad \frac{(1+i)^n-1}{i(1+i)^n} \quad (1+i)$$

$6,501.49 x 5.485919

$35,667

The NPV of an inflating annuity is given by:

$$P = AI$$

Where:

$$P = \text{present value}$$
$$A_1 = \text{the rental stream for year I}$$
$$i = \text{nominal discount rate}$$
$$I = \text{expected inflation rate}$$
$$n = \text{number of periods in the term}$$

The factor is converted from payments in arrears to payments in advance by multiplying by (1+i).

Thus the NPV of the notional annual rental stream at 6% of the rental values inflating annually at 3% is:

$6,000 x 5.9444 = $35,667

Both rental streams have the same present value and, provided the predictions of inflation are in line with market expectation, the objective will be achieved of a fair allocation of the contract rent stream.

Mid-Rent Approach to Determining Rental Rate

$7,200
$7,000
$6,800
c $6,600
$6,400
$6,200
$6,000
$5,800
$5,600
$5,400

1 2 3 4 5 6

Year

Contract rent
Notional Annual Rent

LEGAL ISSUES

by Deborah A Edmonds, BA. LLB, Partner, Kensington Swan Solicitors

Rights to Mineral Title and Access to the Resource

INTRODUCTION

The present law relating to title and access to minerals in New Zealand has an interesting and complex history. This history has resulted in an often confusing and complex system of mineral ownership and multiple licensing regimes. It is not uncommon, for example, to find that there are at least three owners of the whole estate; the "surface" owner who apparently owns the fee simple title, the Crown who owns certain minerals and another private owner who owns the balance of the minerals. In Great Britain the Crown generally only owns what are called the "royal metals" and those it has nationalised by way of statute. In some parts of Australia, private minerals are the exception. New Zealand however has a mixed ownership pattern depending to some degree on the period in which settlement originally took place.

We now have two parallel legal regimes: one for minerals owned by the Crown minerals and one owned privately. The property interests that arise from these mixed regimes are differently dealt with in terms of property law and are recorded differently on certificates of title issued under the Land Transfer Act 1952. For these reasons it is often difficult for those unfamiliar with the history of minerals legislation to determine what is the legal effect of the various notations found on titles to land. Recent reforms of the mining licensing regimes has resulted in New Zealand having, in practice, four separate licensing regimes depending either on the mineral concerned or the date at which permits were granted. This article briefly describes the history to our present regime and explains the types of mineral interests that are now found on titles and their legal implications.

THE CROWN MINERALS ACT 1991

The 1991 reform of minerals and resource management legislation in New Zealand saw the introduction of the Crown Minerals Act 1991 which was designed to primarily deal with the management and allocation of rights to Crown owned minerals. It repealed and superseded earlier legislation some of which was directed to specific minerals: the Mining Act 1971, theCoal Mines Act 1979 and the Petroleum Act 1936. Each of these earlier regimes dealt with licensing and private minerals in different ways. The Coal Mines Act 1979 for example had required the obtaining of mining licences from the Crown even if the coal was privately owned. The Mining Act generally only licensed Crown owned minerals, but also regulated some aspects private mineral development. The Petroleum Act controlled all aspects of hydrocarbon development since that resource had been nationalised. The Crown Minerals Act however does not cover the grant of rights for privately owned minerals; rights to private minerals are a matter for contractual negotiation between mineral explorers and the mineral owners. If the minerals (which after 1991 include coal and hydrocarbons) to be mined are Crown owned, the prospective miner is obliged to obtain a permit for that particular mineral from the Minister of Energy.

Although the Crown Minerals Act establishes a new regime for Crown minerals it does not replace existing licences granted under the previous legislation. The Act provides instead that, subject to a few qualifications, existing licences continue in force as if the Crown Minerals Act and the Resource Management Act had not been enacted. In other words, the licences under previous regimes continue to operate as if the earlier regimes continued in force. The result is a significant difference in terms of rights and obligations that the different licences and permits confer on the holders and the land owners concerned. An important difference is the rights of access over private land which is discussed later.

As a consequence of the dual regime of mineral ownership, the ownership of minerals will not only affect payment of royalty obligations, but also whether allocation rights are subject to a statutory or a private contractual process, and the extent of the rights of private landowners affected by mining activities. Determining mineral ownership therefore can be a vital issues and depending on the mineral concerned either the Crown or a private owner may be involved in the arrangements i equired to allow mining operations.

ACCESS TO MINERALS

Although the Crown Minerals Act provides for the allocation of permit rights to Crown minerals it does not permit automatic and general rights of access over land to those minerals. The Act makes access to minerals a matter for negotiation between the permit holder and thelandowners and occupiers concerned. This is the case whether the land is privately or Crown owned. In general the Act requires entry onto land to be authorised by an access agreement with the landowner and occupiers. There are some exceptions to the need for access arrangements. If the proposed activities are "minimum impact activates", such as sampling and surveying, an access arrangement is not needed. The permit holder may enter onto the land after giving 10 day's notice to the landowner. In the case of Maori land reasonable efforts must be made to consult with the owners of land before any activity can proceed.

In other cases if access is denied by the landowner and occupiers, the permit holder may have the matter determined by an arbitrator. In the case of petroleum, an access arrangement will automatically be referred to and determined by an arbitrator. In the case of other minerals, the landowner is required to consent to the involvement of an arbitrator. Should the landowner and occupier not consent to this process the Minister of Energy may only intervene where the issue is a matter of national importance. Where access is determined by an arbitrator, an access agreement must be concluded giving the permit holder access on reasonable conditions and allowing for appropriate compensation to the landowners concerned. Access onto Crown land is also subject to negotiation and agreement. In considering whether to agree to access the Minister is obliged to have regard to the relevant statutory regime under which the land is administered and other relevant matters. Certain Crown lands are exempted from the determination of access arrangements by an arbitrator. They are in general terms lands held for conservation purposes. Certain private lands are also exempt from arbitration. They relate to the protection of crops, buildings, improvements or horticulture and smaller allotments of land of 4.05 hectares or less. There are additional protection in respect of Maori land. Maori landowners do have special protection in terms of access.

RIGHTS TO MINERAL TITLE

The origins of our system of land ownership is central to this subject of mineral ownership. It is now generally assumed that by means of the Treaty of Waitangi the Maori tribes of New Zealand ceded sovereignty to the British Crown in return for British citizenship and the guarantee of their lands and other properties. But in 1840 after the signing of the Treaty, and despite the Crown's acquisition of sovereignty over New Zealand, the Crown had no legalsupremacy as the source of title to land: for the theory to become a reality the Maori title or rights to the land had to be extinguished and the land re-granted. Article II of the Treaty, however, conferred a right of pre-emption, that is the sole right to extinguish Maori rights of property, in the Crown, and this was shortly given statutory recognition in the Land Claims Ordinance of 1841. The practical effect of pre-emption combined with the recognition of Maori title to the whole of the country was that all land and resources remained Maori-owned until they had been expressly extinguished (usually purchased) by the Crown.

From the beginning of the colony's history an important Crown activity has been the purchase of Maori land; even after preemption was abolished by the Native Land Act in 1862 the Crown continued to be the major purchaser of Maori land. In addition to the acquisition of Maori land by purchase, the Crown acquired huge tracts of land in the Waikato, Taranaki, Bay of Plenty and Hawkes Bay by means of confiscation under the New Zealand Settlements Act of 1863. Much of the land it purchased, or otherwise acquired from Maori has remained in Crown ownership and is Crown land managed under the Land Act and other Crown lands management statutes (such as the Conservation Act 1987) but large amounts of it have been granted to private individuals.

Unlike the legal position in England where the concept of original Crown grants is a legal fiction, this is certainly not the case in New Zealand, where Crown grants are the primary source of title to land: indeed nearly all titles can be traced to an original grant preceded by Crown extinguishment of the Maori territorial title. Even in the case of land directly purchased by private individuals from Maori after an investigation of title by the Native Land Court the Crown grant was used to complete the alienation to the purchaser.

Resource ownership in New Zealand therefore is closely bound together with the law of Crown grants since nearly all private title to land has derived from a grant of land by the Crown. The most important example is the law of mineral ownership, where in most cases the ownership of minerals is determined by the law in force at the date of the original grant. In the 19th century Crown grants regularly granted the whole of the fee simple estate in the land together with ownership of the minerals, but in the twentieth century the law has reflected a growing state policy of retaining mineral ownership and access rights in the Crown when land was alienated by the Crown.

At common law an owner of the fee simple was prima facie entitled to all that lay above or below the surface and this included minerals on or below the surface. Gold and silver was treated as belonging to the Crown by royal prerogative and consequently this prerogative was treated by the common law as overriding the fee simple rights of landowners; it was not until the Mining Act 1971 that the royal metals were declared by statute to be the property of the Crown. The royal metals could not be alienated by the Crown and did not pass by Crown grant. This was not the case in respect of other minerals which could be passed from Crown ownership with the grant of Crown land. Maori landowners who have derived their title from a grant confirming their prior customary title generally will be the owners of all minerals except those vested generally by State in the Crown

Legislative controls over mining first began with the exploitation of gold being dealt with in the Gold Fields Act 1858. Special legislation was enacted to facilitate mining activities on Crown lands and special mining districts were created. However, once the Crown had alienated land, it lost mineral ownership and the control over the resource and hence the power to foster mineral exploitation. Because of the importance of mineral exploitation last century to the economic growth of the country the state increasingly adopted a policy of reserving minerals from Crown grants and other disposals. This policy developed progressively with different types of reservations being applied by successive legislation to various types of tenure, initially within mining districts, and eventually to tenures and alienations of all Crown land.

Early land legislation allowed the granting of Crown land under mineral leases with the payment of royalties to the relevant government authority. The Land Act 1877 consolidated these provisions allowing the grant of mineral licences over Crown lands, and other licences could be cancelled if minerals were discovered on the land. Later land legislation provided for the resumption of land if it was deemed auriferous or required for mining purposes but it was not until 1892, that disposals of Crown land were made subject of reservations of minerals to the Crown together with a right of ingress. Between 1892 and 1948, subsequent land legislation provided for reservations of minerals with or without rights of access and ingress at the time of the alienation by the then current legislation.

Generally however, outright sales of land by the Crown were not subject to reservation ofminerals until the Land Act 1948 which provided in section 59 for the reservation of all minerals together with rights of way on all disposals of land under that Act. This was replaced by similar reservations of minerals and access rights in the Mining Act 1971 and the Coal Mines Act 1979, both of which are now replaced by section 11 of the Crown Minerals Act 1991.

This section contains the general statutory reservation of minerals and states:

> Every alienation of land from the Crown made on or after the commencement of this Act (whether by way of sale, lease, or otherwise) shall be deemed to be made subject to a reservation in favour of the Crown of every mineral existing in its natural condition in the land.

Reservations in grants are not, however, the only means by which natural resources have come into Crown ownership. The development of collectivist approaches to management of the economy saw a number of partial or complete nationalisations of various resources by statute in the course of the twentieth century. Resources which have been nationalised have included rights of hydro-electric generation (Water-power Act 1903), petroleum and natural gas (Petroleum Act 1937), uranium (Atomic Energy Act 1945), coal (Coal Act 1948, subsequently "denationalised" in 1951), and the right to take geothermal energy (Geothermal Energy Act 1953). The current legislation, the Crown Minerals Act 1991, consolidates in one statute the Crown's ownership of these particular minerals. It states in section 10:

> Notwithstanding anything to the contrary in any Act or in any Crown grant, certificate of title, lease, or other instrument of title, all petroleum, gold, silver, and uranium existing in its natural condition in land (whether or not the land has been alienated from the Crown) shall be the property of the Crown.

Lastly, particular parcels of land or mineral estates have been acquired by the Crown for various designated purposes. Generally this was done under the public works legislation or under various other specific purpose legislation, for example such as the coal mines legislationwhich provided for the establishment of a state coal industry. The Public Works Act 1981 consolidated the law relating to compulsory acquisition and prior to this time rights of compulsory taking was contained in many statutes. Early public works legislation however took different approaches to the acquisition of the sub stratum estate; in some statutes there was a presumption the minerals were acquired with the land in others the presumption was that minerals were not acquired unless the proclamation concerned expressly included them.

Slatey Creek on the West Coast, 1890. Courtesy of Tyree Collection, Alexander Turnbull Library

In summary, the Crown has acquired or retained land and resources in a variety of ways. These were by: acquisition frorq Maori by purchase; confiscation from Maori; retention of various proprietary rights in Crown grants; general nationalisations of resources by statute; and by compulsory acquisition for particular purposes, principally under the Public Works Acts.

Because however minerals were not always reserved by the Crown large quantities of minerals in New Zealand are privately owned. The net effect is a patchwork whereby the Crown has sole ownership of gold and silver and a few other minerals, wherever located, as well as retaining ownership of other minerals in different geographic areas. Because reservation of minerals to the Crown was not universal until the beginning of this century the general pattern is that those areas of New Zealand which were settled earlier have a greater proportion of private mineral ownership.

RESERVATION MEMORIALS ON TITLES

For valuers and lawyers an obvious visual effect of the Crown's retention or taking of minerals is the frequent occurrence of memorials on titles to the effect that the title is "subject to section 8 of the Mining Act 1971" or "subject to section 5 of the Coal Mines Act 197, 9". These reservations, like others in preceding legislation, continue to have legal effect despite the repeal of the enactment that initiated them. However to be certain as to whether minerals are Crown or privately owned, the title has to be searched back to the original title, deed, or Crown grant in order to determine whether the grant of the land was pursuant to legislation which reserved minerals to the Crown. Frequently titles will indicate the section and statute the land was alienated by the Crown. For example, land alienated pursuant to the Land Laws Amendment Act 1912 will include the minerals but land alienated under certain provisions of asimilar statute in 1913 will not. Often titles do not disclose the relevant legislation. Where the Crown has granted land and minerals and subsequently reacquired ownership of the land it did not always reacquire the mineral ownership. This depended on whether the land was acquired under public works legislation, on what terms the acquisition was made and when. As a result of the the ascertaining of who owns the mineral estate (often a very valuable asset) can frequently be a confusing and complex matter and expert legal advice is often of assistance.

In mineral rich areas of New Zealand it also became common for landowners to split out the mineral estate from the fee simple or what is often called the "surface" ownership of land. Separate titles were then frequently issued for the mineral estate. In some cases the mineral estate was further split depending upon the particular mineral resource located to hoped to exist within the land, and separate titles were issued for the fee simple, the coal, and the balance of the minerals. In addition to the private owners there would have existed a fourth mineral owner, the Crown, who owned the royal metals and those minerals which had been nationalised.

Private mineral arrangements are sometimes registered on titles as leases of the mineral, or as easements or even protected by way of caveat. However there is no facility for the "noting" of private mining arrangements that exists in respect of Crown minerals.

THE NOTATION SYSTEM

The Crown Minerals Act has continued the practice of earlier legislation in providing for the notation on land titles of the various dealings under the minerals legislation. The Act provides for the lodging of permits (other than those for petroleum, which typically cover a very large acreage) with the District Land Registrar who then makes a notation on the relevant certificates of titles details of the exploration and mining permits. Access arrangements entered into between permit holders and landowners which have a duration of more then six months must also be lodged with the District Land Registrar who makes a notation on the title of the particulars of the arrangement.

The Act expressly provides that the entries on the register, certificate of title or other instrument of title, of the permit or access arrangement operates only as a notice of theexistence of the permit or access arrangement and does not create any estate or interest under the Land Transfer Act 1952. To put the legal position of permits beyond doubt the Act further provides that permits granted under the Act are "neither real nor personal property" and that access arrangements do not transfer to, or confer on, the permit holder or applicant for a permit an estate or interest in the land to which it relates.

The Act also recognises that due to historical confusion or chance titles often fail to record the fact that a separate mineral estates exist. The Act provides a mechanism for an application to the District Land Registrar to have entered on a certificate of title or other instrument of title for an estate in fee simple, the particulars of the ownership of all or any of the minerals in the land to which the estate in fee simple relates. The Act also charges the District Land Registrar with the duty to ensure all minerals ownership are properly entered on the title whenever a dealing with the minerals or an alienation from the Crown takes place.

CONCLUSION

In conclusion although we now have a new reform of our minerals legislation, past regimes continue to have a major role in defining the rights of past licences which may continue to have force for another thirty or more years. Licences granted under previous regimes continue to operate as if the earlier regimes continued in force and because of the difference in approach to permit rights in the Crown Minerals Act, permits under that Act and licences under earlier regimes have important differences in their rights and obligations. New Zealand now has in practice four separate licensing regimes depending either on the mineral concerned or the date at which permits were granted. New Zealand also has a mixed mineral ownership and effectively two parallel legal regimes: one for minerals owned by the Crown and one for private minerals. The interests that arise from these mixed regimes being dealt with differently in terms of property law and recorded differently on certificates of title issued under the Land Transfer Act 1952. Both of these aspects to minerals law can have a significant implications for the nature and the value of estate included within particular certificates of title. These are matters which valuers should have regard to and where necessary ought to take into account.

Legal Decisions

Goods and services tax - input tax - purchase of farm property with a dwelling - whetherpurchaseroffarm property can claim input tax credits forfull purchase price - whether definition of input tax anticipates apportionment - principle purpose of making taxable supplies Goods and Services Tax Act *1985,* ss2(c), *5(14) and 10(18).*

IN THE COURT OF APPEAL
OF NEW ZEALAND

CA 237/94

BETWEEN THE COMMISSIONER OF INLAND REVENUE
Appellant

AND NEIL WILLIAM COVENEY and CAROLE ALISON COVENEY
Respondents

BETWEEN THE COMMISSIONER OF INLAND REVENUE
Appellant

AND JOHN FRANCIS DOOLEY
Respondent

BETWEEN THE COMMISSIONER OF INLAND REVENUE
Appellant

AND *NANCY PRICILLA SWAIN and JOHN WAYNE ADAMS*
Respondents

Coram: Richardson J
Gault J
Blanchard J

Hearing: 18 May 1995

Counsel: J R Eichelbaum and Mrs Barbara Corbett for Appellant
D E McLay for Respondent

Judgment 25 May 1995

JUDGMENT OF THE COURT DELIVERED BY RICHARDSON J

This appeal from a judgment of Fraser J reported at (1994) 16 NZTC 11,328 concerns the apportionability of consideration paid on the purchase of farm property in arriving at the input tax credit under the Goods & Services Tax Act 1985 where the purchasers are registered but the vendors are not registered persons for gst purposes.

The factual background

The 3 cases before the court are representative of different factual situations but they have common features. Each was a purchase of a farm property. While each farm had a building occupied and used as a dwellinghouse, the dwelling had not been subdivided off. In each case the agreement provided for sale of the property as a single undivided unit and for a single sum. In short, the agreements actually entered into and carried out neither contemplated nor allowed as between the parties for apportionment of either the subject matter or the consideration. That was the position as between the parties to each transaction. For 2 reasons purchasers may decide to make an apportionment for their own purposes. First, under the Stamp & Cheque Duties Act 1971 a dwellinghouse is exempt from conveyance duty and s24(2) explicitly provides for an apportionment to arrive at the value of the dwellinghouse (including curtilage). Second, for financial reporting and income tax purposes farmers traditionally apportion the purchase price between land and buildings. But those practices do not change the legal character of the preceding transaction between vendor and purchaser.

In each case the purchaser claimed an input tax deduction in respect of consideration paid on the purchase. The Commissioner disallowed that part of the deduction referable to the valuation for stamp duty purposes of the house and curtilage. The factual differences were that in one case (Coveney) the portion of the value attributed to the house was less than 50% of the consideration for the purchase of the property and the house was leased out; in the second (Dooley) the position was the same but the house was lived in by the purchaser; and in the third (Swain and Adams) the land was used intensively for their horse training business but the portion of the value attributed to the house was over 50% of the consideration paid for the property. However, it is now common ground that nothing turns on any of these factual differences.

The legislation

Under the Goods & Services Tax Act goods includes all kinds of personal or real property (s2(1)) and the resale of land is a sale of "secondhand goods". The statute imposes a tax on the supply of goods and services. The supply of residential accommodation is exempt. Registered persons collect and account for gst on goods and services supplied by them but are entitled to deduct amounts charged by way of gst on goods and services supplied to them. An input tax credit is also available in some circumstances in respect of secondhand goods even though no gst is payable by the supplier because he or she is not registered for gst purposes. It is this provision (para (c)) and the proviso of the definition of input tax in s2 which is in point in the present case. That definition reads as follows:

> ""Input tax", in relation to a registered person, means
>
> (a) Tax charged under section 8(1) of this Act on the supply of goods and services made to that person:
>
> (b) Tax levied under section 12(1) or section 13(1) of this Act on goods entered for home consumption under the Customs Act 1966 by that person:
>
> (c) Any amount equal to the tax fraction (being the tax fraction applicable at the time of supply within the meaning of section 9 or any other provision of this Act) of the consideration in money for the supply, being a supply by way of sale that is not a taxable supply, to a registered person of any secondhand goods situated in New Zealand -

being in any case goods and services acquired for the principal purpose of making taxable supplies: Provided that where, in relation fo any supply to which paragraph (c) of this definition applies, the supplier and recipient are associated persons, or the supply is not the only matter to which the consideration relates, the consideration in money for that supply shall, for the purposes of this definition, be deemed to be the lesser of the purchase price or the open market value of that supply:"

The second limb of the proviso "or the supply is not the only matter to which the consideration relates" was inserted by s2(2) of the 1989 Amendment Act.

Various provisions of the legislation in their terms contemplate apportionment. Mr Eichelbaum for the Commissioner relies particularly on s5(14) and slO(18). Section 5(14) anticipates that a single supply may be charged for tax in part under s8 (where the 12/2% rate applies) and in part under s I I (where the zero rate applies). Section 5(14) provides:

"For the purposes of this Act, where a supply is charged with tax in part under section 8 of this Act and in part under section 11 of this Act, each such part shall be deemed to be a separate supply."

Section 10 is concerned with taxable supplies and so relates to supplies by registered persons and subs (18) provides:

"Where a taxable supply is northe only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it."

Decision of Fraser J

The argument for the Commissioner in the High Court was that the definition of input tax expressly and by necessary implication contemplates apportionment. Fraser J concluded that the supply was of the farm as a whole. Although the farm comprised land, buildings and a dwelling, none of the items could be dealt with separately and in each case there was a single supply of the property sold, not a multiple supply of its component parts. It followed that the proviso to para (c) did not assist the Commissioner because, if there was only one supply, that was the only matter to which the consideration related. Sections 5(14) and 10 (18) both dealt expressly with taxable supplies where apportionment of one sort was clearly contemplated but a different regime applied to input tax in respect of secondhand goods which did not constitute a taxable supply. The test under the definition of input tax was whether the property had been acquired for the principal purpose of making taxable supplies. That carried with it the recognition that there are, or may be, subsidiary purposes which do not include the making of taxable supplies. Fraser J found, and it is no longer in issue, that the principal purpose of each taxpayer in acquiring the particular property was to make taxable supplies, the principal purpose being to run the property as a business venture.

The Commissioner's arguments on appeal

In its essentials the Commissioner's argument was that, adopting a purposive and workable construction of the legislation reflected in the parallel provisions of s5(14) and s10(18), apportionment was required on the present facts under the input tax definition. Mr Eichelbaum submitted that the facts could properly be analysed in 3 ways, any one of which would justify the Commissioner's apportionment approach:

(1) There were 2 supplies, one of the land used for business purposes and the other of the dwelling and adjacent land.

(2) Without resort to the proviso, para (c) should be read as calling for apportionment: the input tax is referable to the consideration for the supply of secondhand goods in so far as they are acquired for the principal purpose of making taxable supplies.

(3) Applying the proviso, the supply was not the only matter to which the consideration related: expanding the phrase by incorporating the earlier qualifying expression so as to read "the supply of goods acquired for the principal purpose of making supplies is not the only matter to which the consideration relates", the other matter here was the provision of domestic accommodation.

The short answer to the first proposition is that the legal character of the transaction between vendor and purchaser as entered into and carried out was "a supply by way of sale", to use the words of para (c), of a single property for a single consideration. It was that undivided property which was supplied as an entirety by the vendor to the purchaser. From the perspective of the purchaser the acquisition of the property served 2 purposes, that of making taxable supplies and of providing housing accommodation. But that does not change the true character of the supply from the vendor to the purchaser.

In answering the second and third questions it is important to set particular provisions in their statutory context and to accord them a purposive interpretation. But we must give due effect to the scheme and language of the particular provision, here para (c) and the proviso. In that regard s5(14) is against rather than for the Commissioner's proposed reading of the input tax definition provision. It is a deeming provision: each part of a single supply is deemed to be a separate supply. As a possible parallel, s 10(18) is more in point. It uses the same formula as under the proviso "a [taxable] supply is not the only matter to which the consideration relates". Where that test is met s10(18) provides that "the supply is deemed to be for such part of the consideration as properly attributable to it". That has been regarded as allowing apportionment of farm property sales between registered persons. In that situation there is of course symmetry of gst treatment between vendor and purchaser. And the correctness of that practice is not an issue in this case.

Paragraph (c) and the proviso must be read according to their natural and intended meaning. The difficulty facing Mr Eichelbaum's second proposition is that para (c) does not contain any language indicative of or allowing for apportionment. On the contrary the input tax is the "amount equal to the tax fraction ... of the consideration in money for the supply". As under (a) and (b), it is a calculable sum and the yardstick then applicable in each case is whether or not the subject matter of the supply was "acquired for the principal purpose of making taxable supplies". If the principal purchase test is satisfied, the full amount is the applicable input tax. Further, the proviso itself proceeds on the premise that, subject to the operation of the proviso, the full amount is the applicable input tax.

The third proposition is equally unsupportable when tested against the proviso. The proviso applies where, and only where, "the supply is not the only matter to which the consideration relates". To come within the proviso it is necessary to identify a matter, other than the supply in question, to which the consideration relates. Thus, on a sale of land with late settlement, the consideration may contain an interest equivalent component which may fairly be described as a second matter to which the consideration relates. No doubt other examples could be given. The point is that there are circumstances where, giving the words their ordinary and natural meaning, the proviso could have effect. It follows that there is no basis in the scheme and language of para (c) and the proviso for invoking the proviso where the consideration does not relate to any matter other than the supply of secondhand goods which has already satisfied the principal purpose test. There may be sound policy reasons for apportioning the consideration on the sale of farm property and other secondhand goods and whether or not the vendor is a registered person. But for the reasons given we are satisfied that to do so on the present facts would be inconsistent with the scheme and language of the input tax definition. The appeal is dismissed. Although a test case we see no justification for interfering with Fraser J's decision that costs simply follow the event rather than being fixed on a solicitor-client basis as submitted for the respondents. However, a higher than the usual party-party award is appropriate in respect of the appeal given that the Commissioner having lost in the High Court put these respondents to the expense of an appeal and the tax in dispute for all 3 is under $30,000. Costs on the appeal are fixed at $10,000 together with all reasonable disbursements as fixed by the Registrar.

Solicitors:

Crown Law Office, Wellington, for the Appellant

Bell Gully Buddle Weir, Wellington, for the Respondents

Lease - rent review clause - ratchet clause - ratchet clause not expressly included in lease agreement - whether ratchet clause was a provision normally used in lease agreements for similar properties by solicitors practising in district of Auckland District Law Society.

IN THE COURT OF APPEAL OF NEW ZEALAND

CA. 1 93/94

BETWEEN METAL SALES LTD

Appellant

AND WIEBE DIRK ETTEMA AND OTHERS

Respondents

Coram: Gault, J.
McKay, J.
Blanchard, J.

Hearing: 9 June 1995

Counsel: S. C. Dench for Appellant D. K. Wilson for Respondent

Judgment: 9 June 1995

JUDGMENT OF THE COURT DELIVERED BY BLANCHARD, J.

This appeal raises a question about the construction of a rent review provision in an agreement between the parties for a lease of warehouse premises in Mangere, Auckland. The agreement was signed in December 1989 by the appellant as lessee and the respondents as lessors. It provided for a term of eight years, with renewals, at a rental of $85,545 per annum, commencing from 31 March 1990. Certain work had to be carried out on the premises before the commencement date which explains the delay in the commencement of the lease term. The agreement was prepared by a real estate agent using a printed form into which some provisions were typed.

> Opposite a heading "Rent Review Periods" there had been inserted: "Two yearly and such reviews to be based on the current market rentals". But there was also a printed provision as follows:
>
> "3. The landlord agrees to grant and the tenant agrees to accept a lease which will incorporate what is expressly provided for in this agreement and shall also include with any consequential variations the provisions normally used in leases for similar properties by solicitors practising in the Law Society District of Auckland. Any dispute as to what are usual terms shall be determined by an arbitrator appointed by the Auckland District Law Society president or vice president."

The agreement form also had on it a note which was in the following terms, but was expressly stated not to form part of the contract:

> "This is a binding contract. If any party has any doubts legal advice should be sought before signing. A guide as to what are usual terms can be obtained by persuing [sic] the Auckland District Law Society lease form which contains clauses concerning, amongst other things, the obligation of the tenant to maintain the interior, the exterior and the outside areas; common areas; assignment and subletting; exterior sign; compliance with statutes and regulations; alterations and additions."

No form of lease has been executed because of disagreement about whether the respondent lessors were entitled to insist upon the inclusion of a ratchet clause providing that upon any review the rent was not to be less than the rent payable during the immediately preceding period. Nor would the lessee accept a clause under which the lessors would have the sole right to trigger rent reviews. An example of such a provision is found in the decision of this Court in *Australian Mutual Provident Society v National Mutual Life Association of Australasia Ltd [1995] 1 NZLR 581*. We agree that, if a ratchet clause could not be included, nor could a provision of this kind which in practice would have much the same effect of enabling the lessors to avoid a reduction in rent occurring if market rentals fell.

The question is, then, whether as Anderson, J. held in the High Court, the lessors were entitled to insist on a ratchet provision.

The argument for the appellant, which was very carefully and ably put by Mr Dench, was, first, that the heading "Rent Review Periods" and the words found opposite it were plain and unambiguous. They called for a lease under which rent reviews would be based on current market rentals. A ratchet clause was inconsistent with that because under its operation in a time of generally falling rentals this clause might hold the rent under the lease at a level above the current market rental of the premises. Therefore, it is said, the purpose of a ratchet clause is to prevent a market rent from being set by the rent review process in such circumstances. Mr Dench submitted that a ratchet clause is logically the second step in the process whereby a rent is set, the first step being the ascertainment of the market rent. Only at the second step can a comparison be made to determine whether the ratchet clause will alter the reviewed rent provisionally, as he put it, set by the market. In a deflationary market the reviewed rent will be determined, and therefore based upon, the existing or former rent, not on the current market rentals.

The respondents, on the other hand, maintain that the words relating to rent review periods do not exclude the incorporation, pursuant to clause 3 of the agreement, of normally used provisions enabling the lessor to choose whether to initiate a review and including a ratchet in the review mechanism.

In the High Court Anderson, J. in a judgment delivered on 27 June 1994 said that " at least until a few years ago" the term "rent review" meant a provision in a lease for increasing the rent and thereby protecting the lessor against inflation. He thought that:

> "Consistent with the purposeof benefiting a landlord, rent review provisions invariably limited to the landlord the ability to invoke a revision, and commonly provided what became known as a "ratchet clause", that is, a provision which prevented the rent ever declining in consequence of a revision."

He expressed the view that:

> "...the term "rent review", with its connotation of benefit to a lessor, was not equivalent to arentreviewing or revising procedure, the operation of which might result in benefit to either the landlord or the tenant."

With respect to the Judge, we do not think that "rent review" means anything more than a review of rent. It's not to be read as necessarily confined to a review which excludes the possibility of a reduction. If all that the agreement had said was that there were to be rent reviews and there had been no equivalent of clause 3, we would be of the view that the lessors could not ask for inclusion of a ratchet provision. The reviews would simply fix the current market rent assessed in the usual way.

However, the Judge appears not to have made his decision on this point because he proceeded then to examine the question of what could in terms of clause 3 be said to be "provision normally used' for rent reviews.

Before reference can be made to clause 3 it is necessary to consider Mr Dench's submission that what is said about rent reviews in the agreement is plain and unambiguous. It is clear that clause 3 and its incorporation of normal terms must be read subject to the express provisions found elsewhere in the agreement. That is indicated by the stipulations that the lease is to incorporate "what is expressly provided for in this agreement" and that normal provisions are to be included "with any consequential variations".

But when the express provision about rent reviews is examined it is notable that it does not direct that the rent upon review is to be the current market rent. Rather, it says that the reviews are to be based on current market rentals, which is not the same thing and is not inconsistent with a ratchet clause. In our view a rent fixed first by assessing a market level of rent by looking at comparable properties and then by taking the higher of the existing rent or the assessed rent can fairly be said to be fixed by a review process based on the market rent. The review, that is the process, is to be based on market rents. The agreement does not say that the rent fixed as a result is necessarily to be a current market rent.

So we turn, as the Judge did, to the operation of clause 3 by means of which the rent review provision must be fleshed out and to the question of whether a ratchet clause was in December 1989 a provision normally used in leases for similar properties. The Judge heard evidence on this question from two experts, Mr Marshall and Mr Eades, experienced Auckland conveyancers. He found that a ratchet clause was, notwithstanding the adverse effects of the property market of the sharemarket crash two years earlier, a normal provision. He said that the expression "normally used in leases" had connotations of "prevalent acceptance", a characterisation with which we did not understand Mr Dench to differ. Nor do we. In Anderson, J's judgment, based upon the evidence he heard, "the acceptance by tenants of a landlord triggered ratcheted rent revision stipulation in leases was still prevalent in December 1989".

It was for the appellant to demonstrate to us that this was a conclusion not open to the Judge upon the evidence. Both experts had agreed, and our own experiences in practice confirm, that prior to the market crash commercial leases almost invariably included a ratchet provision in their rent review conditions. Both agreed also that by around December 1989 some lessees, having raised objection to such a provision, were successful in negotiating for its removal. As MrDench says, the difference between the experts was as to how prevalent this occurrence was.

Mr Eades, called for the appellant lessee, considered that the inclusion of a ratchet clause had become a matter of negotiation, dependent on the bargaining position of the parties. He thought that a significant proportion of leases negotiated at that time did not contain ratchet clauses, although he could not say what proportion. He gave the opinion that ratchet clauses had ceased to be normal. He based this view in part on a limited sampling of leases negotiated at about the relevant time by his law firm. On the other hand Mr Marshall, while agreeing that ratchet clauses had come under challenge and that some tenants successfully avoided their inclusion, did not consider that this was happening in a significant proportion of cases. He considered that a ratchet clause was still normal. Both experts must have had understandable difficulty in putting their minds back to practices in a changing leasing market some years prior to their testimony in June 1994. The Judge found some assistance in assessing their evidence in a seminar paper which Mr Marshall himself had written for the New Zealand Law Society in May 1990 on the subject "Perusing and Negotiating Commercial Leases". There Mr Marshall had said:

> "The insertion of a ratchet clause is one of the more contentious issues currently exercising the minds of property lawyers. To achieve a fair balance between the parties, a rent review clause should make an allowance for downward movements in the open market rental value. There is no good reason why rent should always go up and never down. New Zealand landlords until recently have been in stronger bargaining positions than tenants and have refused to allow tenants to have protection against deflationary pressures to match the protection landlords receive against inflation.
>
> The ratchet clause has been retained in clause 2.1 (b) of the form [the District Law Society Form] purely by reason of the fact that its deletion could have seriously affected the acceptability of the new form for and by landlords."

The Judge found that the excerpts from the seminar were useful contemporary indicators of practices which were then usual. Certainly the seminar paper suggested that tenants' lawyers should consider challenging ratchet provisions but it seems to go no further than that. The reference to the Auckland District Law Society form is of more than passing interest because not only had it been drafted for the Society by Mr Marshall himself, but it was, of course, referred to in the note which appeared in the agreement to lease where it was suggested, as an assistance to the parties, that the Law Society form might be a guide to what were usual terms. We should not, however, be taken to be saying that the provisions of this form are necessarily usual terms. Obviously in some cases the process of negotiation resulted in deletion of the ratchet. But if, as is the case, a ratchet provision was at the relevant time found in a widely used form prepared by the local Law Society and recommended for use by practitioners, that is a matter to be given some weight. notwithstanding that, because the form was to be marketed to solicitors drawing up leases for lessor clients, it was desirable to include provisions like a ratchet clause which would appeal to them.

Weighing up this evidence the Judge concluded that ratchet clauses were still prevalent in leases negotiated in December 1989 and that accordingly the lessors were entitled to include one in the lease. On this appeal it has not been shown that the Judge was wrong. On the contrary, we think that upon the basis of Mr Marshall's evidence, including the seminar excerpts, his conclusion was a proper one. A departure from an established conveyancing practice was suggested as having become so common that it was ordinary or usual. The Courts are slow to accept such a proposition. Strong evidence of the frequency and degree of departure was needed. Mr Eades was able to do no more than say that a "significant proportion" he could not say how large - of commercial leases omitted a ratchet clause. That is not enough to support the contention that this new practice had become normal or usual.

For these reasons the appeal is dismissed. The respondents are entitled to costs of $3,500 together with reasonable travel and accommodation costs and any other disbursements, as fixed by the Registrar.

Solicitors:

Churton Hart Divers & Wong. Auckland for Appellant

Bell Gully Buddle Weir, Auckland for Respondent

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6. Establish education, admission and categories of membership criteria and provide appropriate pathways to admission.
7. Encourage research and develop viable services of benefit to members.
8. Develop closer association and cooperation with other professional bodies both in New Zealand and overseas.

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