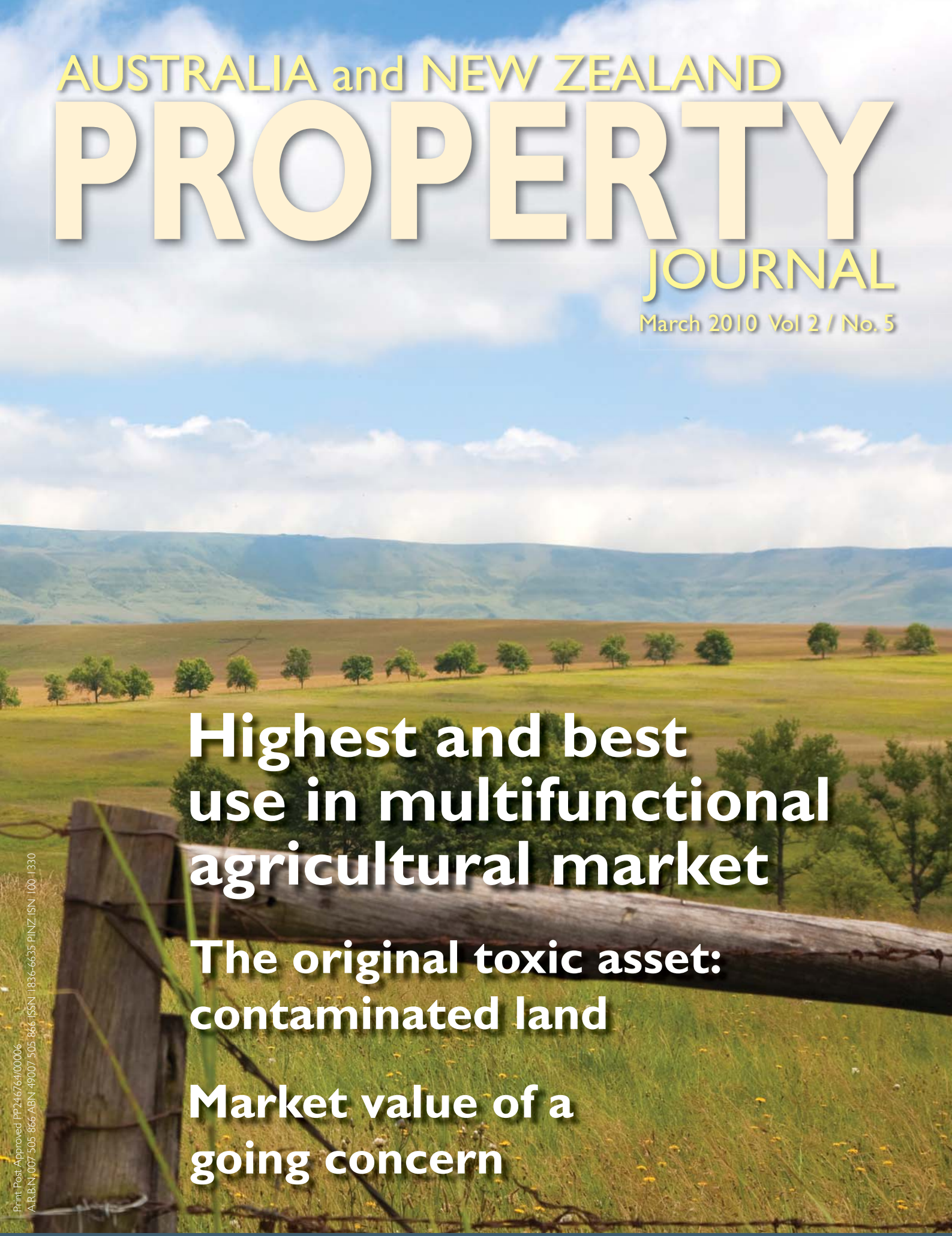

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Highest and best use in multifunctional agricultural market

The original toxic asset: contaminated land

Market value of a going concern

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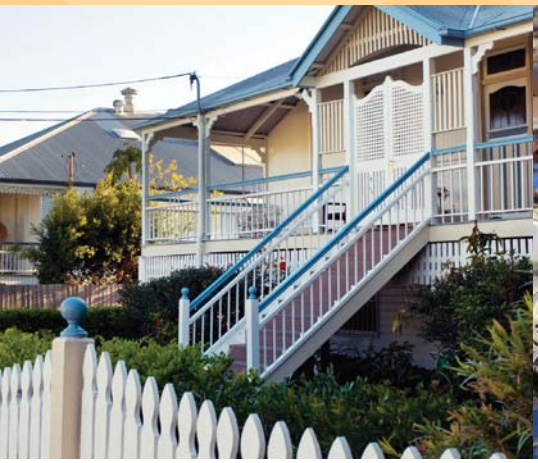

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API NATIONAL PRESIDENT'S REPORT

David Moore
API National President

In October of 1972 a member wrote to the Journal concerned with why "professions associated with land and buildings haven't raised a storm of protest against the introduction of the metric system".

The writer was grappling with the thought of "a brick, instead of having the dimensions of 9 inches x 3 inches, will be 22.86 centimetres x 7.62 centimetres." And the ramifications of that in regard to "buildings" and the thought of "conversion" in relation to ratings and tax was more than the writer could bear.

The letter drew significant debate as ensuing journals have documented but the point overlooked by our learned colleagues is that "change" is inevitable and essential to ensure professions like those related to "property" remain at the leading edge of innovative reform.`

For those who remember those years, it was a complex period but we overcame adversity just as we are doing today.

As I complete my year as National President, I do so proudly with the knowledge that the Institute has embraced significant change in the last 12 months amid extraordinary market influencers both here and abroad. It may seem a world away from the introduction of the metric system but not dissimilar to the impact when technological advancement is being made.

The Australian Property Institute invested in new technology software during 2009 to improve and broaden member services. These changes have started to become visible for members in recent months. A new branding and website will also soon be released and hence the membership technology will continue to grow as a medium for easy and ready access to a new range of information. All API Divisions are participating in this "quantum leap" that will truly enhance the perception and reality of our Institute as an integrated national organisation.

As always, change is presenting challenges that are being encountered by staff and members. Some patience is required as your National Office and Divisional staff actively engage with this dynamic technology that will see the Australian Property Institute provide much enhanced membership communication, information and services.

The joint Australian Property Institute and Property Institute of New Zealand International Conference is being held in Perth, 21-23 April. A diverse and informative program has been developed. All details are at www.ipcperth2010.com. You are encouraged to book now and I look forward to seeing you there at the event.

Of further significance are the latest developments with the capped liability scheme. On advice from the Professional Standards Council, members who undertake the valuation of real property in Australia will have to do so under a new internal structure of the Institute that satisfies the Council's definition of an "occupational association". Members will be asked to vote on the establishment of a new structure at the Institute's annual general meeting in May. In the lead up to this important meeting, members will be sent information providing background information and detailing the benefits of the required structure for the Capped Liability Scheme.

As the Journal goes to print, your National Council and Divisional Presidents are meeting for a Strategic Planning Review day to explore and respond to the results of the recent member survey. It is apparent that there is a desire to enhance the public profile of the Australian Property Institute, enhance existing member services and grow membership. It is the Board's responsibility to appropriately consider the feedback and create a template for the future benefit of the organisation.

The phase of change being experienced within Australian Property Institute reflects the broad changes that have occurred in business and specifically the property industry. During my Presidency your National and Divisional Councils have embraced this change for the Institute to remain relevant into the future. Recent and emerging technology changes in the Institute may feel like its "metric conversion" again. I am reminded that, as happened with metric conversion, the time arrived which is often difficult to pinpoint but where we can question "How did we get by without it?"

It has been both an honour and pleasure to have served as National President. In closing I would like to acknowledge the following:

- The desire of National Councillors to progress the Institute and their willingness to make an enormous contribution towards that;
- Our National Director Grant Warner who is charged with the enormous task of steering the implementation of change throughout the Institute;
- All Australian Property Institute staff who continue to support and promote our Institute; and
- The tireless work carried out by the many members who have given freely of their time and expertise on the many Committees and Task Forces that are the strength of this magnificent institution.

Best wishes to you all and thank you for the opportunity to serve.

David Moore
President
Australian Property Institute

PINZ PRESIDENT'S REPORT

Ian Campbell
PINZ President

I am pleased to be able to report to you current activities undertaken from the beginning of this year.

As you may be aware, current economic data still points towards a slow but fragile improvement in market conditions, with further improvement expected during 2010. However for those who may be aware of discussion around tax reform will be concerned to hear of the potential targeting upon the property sector. A recent report designed to broaden the current tax base for future tax reform has been presented to central Government for consideration. The recommendations which include taxing property ownership would, if adopted, severely impact upon present values and future investment in our sector.

As a background, the Victoria University of Wellington Tax Working Group released its report to Government in January this year. The report recommended sweeping changes to current taxation policy that collectively, seeks to impart a broader, fairer and sustainable tax system than what is currently in place. Being one of many reports concerning New Zealand's future planned deficits, the Tax Working Group report has recommended aligning and reducing top personal, company and trust tax rates. This would in part be funded by a potential increase in GST to 15%. However, in order to preserve the current tax revenue level received by the crown, the report then recommends applying a capital gains tax and introducing a broad low rate land tax on all land ownership. The report also recommended removing tax depreciation for buildings and removing current depreciation loadings for new plant and equipment.

Evidence suggests that the absence of a form of capital gains tax in New Zealand has, over time, encouraged ownership in capital appreciating assets, particularly property. Since the 1990s a trend towards residential property investment has occurred. Transferring net rental losses like loss attributing qualifying companies (LAQC) has contributed to a loss in tax revenue. For instance, in 2008 the loss in tax revenue amounted to $150 million. When quantifying the scale of residential investment property alone, statistics indicate a national investment at around $213 billion, nearly five times the size of the NZX. Accordingly the Crown will view residential property investment as a very large pool with the potential of harvesting additional tax revenue.

The Government has since indicated deferring any introduction of Capital Gains Tax and Land Tax but will focus on stemming tax rental losses and tax depreciation. Accordingly, as an Institute we are anxious to ensure that there is enough time to debate these changes and for our members and the public to consider the impacts. What is concerning is the impact upon current and future residential property supply and investment. Accordingly any announcements prior to this year's budget in May will be closely monitored.

I was delighted to be able to host a nine-person delegation from the Ministry of Finance of Vietnam lead by the Vice-Minister Mr Tran Van Hieu in January with other senior institute members, our Chief Executive David Clark and Valuer-General Neil Sullivan. We were pleased that the Ministry of Finance was able to spend two days reviewing how we currently manage and implement valuation standards within New Zealand including valuer training, registration, land rating and public works compensation.

With this year's joint API/PINZ 2010 conference to be held in Perth on 21 to 23 April, the International Property Conference will provide those members who will be attending, some global content to what will be one of the highpoints for this year. The Perth organising committee led by API President David Moore (WA Division) assisted by conference organisers EECW, have procured an exceptional line up of speakers, tours and events. I understand that a number of our New Zealand members will be attending this year with some competitive air fares promoted by Air New Zealand. If you are able to attend this year in Perth you will not be disappointed and I look forward to seeing you there.

Of interest to all members this year we will be promoting over 100 years of Valuation in New Zealand including the centennial of the Real Estate Valuers Association of Auckland founded in 1910. The Auckland association later amalgamated with other valuer based associations to eventually form the New Zealand Institute of Valuers in 1938. With the support of our organising committee chaired by life member Iain Gribble, this year will mark a period of education and promotion of over 100 years of valuation. As a national event, one of the aims is to heighten awareness and benefits in using a registered valuer. Current plans will include celebrating the 2010 milestone through a number of national and local events. Members are also invited to use the distinctive 100 year logo on all communications. A signature event will be held on 17 & 18 June 2010.

Finally with all branch AGMs and reappointment of committees now occurring, on behalf of the Board, we extend our thanks to all who have contributed their time last year and to those who again offer their time for branch activities. As this is a commemorative year for valuation in New Zealand as well as 10 years since formation of our Institute, please join with me in celebrating what we have achieved together. Thank you for your support.

Should any reader wish to seek further information on any matter contained in this article, then please make contact with National Office or contact any one of the independent professional members of the Property Institute of New Zealand using the institute's website at **www.property.org.nz**.

Ian Campbell
President
Property Institute
of New Zealand

Highest and best use decision-making in a multifunctional agricultural land market

Abstract

The transition in the use of agricultural land as primarily a factor of production towards a multifunctional environment where alternative uses of agricultural land, such as for lifestyle purposes are evident, complicates agricultural land valuations. Competing end users have different interpretations of the factors that determine value. The continued use of familiar conventional farming attributes when valuing farms where lifestyle motivations are present, and the omission of less measurable characteristics, implies that the market sales comparison method cannot be executed accurately.

This paper takes a closer look at the choice of "highest and best use" (HBU) in agricultural land valuation practice in the presence of alternative land uses. This is done through a critical overview of the relevant valuation literature, with specific reference to the concepts of HBU and market value and problems associated with the application of these terms within the valuation context. The need for deferring the decision of a HBU, together with the use of a multiple perspective approach to inform the choice of a HBU are discussed as ways to deal with uncertainties and complexities associated with the valuation of agricultural land where alternative uses are present. Additional and improved information in valuation reports, complemented with comprehensive analysis will also assist in better decision-making by the users of these reports.

Introduction

Traditionally agricultural land was predominantly valued for its productive capacity. Accordingly, in their application of the market sales comparison approach to agricultural land, valuers supposed farmers to be the "typical" buyers of such properties and relied on a set of attributes related to agricultural production as the primary determinants of an agricultural property's highest and best use (HBU) and market value. These characteristics were measurable and related to the property's income-generating capacity.

The rural land market has been undergoing complex supply and demand driven changes – there has been a transition in the use of agricultural land primarily for production towards a multifunctional environment where alternative uses of land, such as for lifestyle purposes, are evident (Brandt and Vejre, 2004:11, Holmes, 2006:142, Roberson, 1997:114, Mundy and Kinnard, 1998:207, Maybery *et al.*, 2005:59, Green *et al.*, 2005:1). These buyers often focus on a wider range of attributes not necessarily related to the production attributes of the land for income purposes, but associated more with satisfaction derived from the property, such as the appreciation of aesthetic beauty, game viewing and outdoor recreation activities (Hendy, 1998:145, Painter, 2004:112, Holmes, 2006:142, 158, Maybery *et al.*, 2005:59-60, Pope, 1985:81-85, Prag, 1995a:5, 12).

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For this reason the multifunctional nature of agricultural land suggests a proliferation of uses, from which the HBU with respective characteristics need to be identified. These range from consumptive uses to amenity uses, with a spectrum of other uses in between. In this multifunctional agricultural landscape, the value of land does not only represent its agricultural potential, but other values as well. This creates a measurement problem for agricultural land valuers, as the characteristics valued by lifestyle buyers are more intangible and subjective, making agricultural land valuations more complex and uncertain.

Multiple uses of land and the characteristics associated with each use blur the choice of a HBU and typical buyer. Valuers feel more comfortable using familiar and factual information in the determination of market value than focusing on subjective human mental processes, even though market value is the product of these mental processes. This is aggravated by time and fee constraints for conducting valuations. The continued use of familiar conventional farming attributes by valuers when valuing farms where lifestyle motivations are present, and the omission of less measurable characteristics, implies that the market sales comparison method cannot be executed accurately.

Herein lays a fundamental theoretical issue – the choice of a specific HBU implies certain characteristics that complement this chosen HBU. The transition from an agricultural land market that was predominantly production-oriented towards a multifunctional landscape with numerous alternative uses complicates the valuation process as uncertainty regarding the motives of buyers and the use of specific properties increase. The presence of alternative uses makes agricultural land valuations more demanding, as it implies different interpretations of the same farm, emphasising different attributes of the property and priorities of buyers, instead of the obvious choice of farming as the HBU (by default) and the concomitant use of typical characteristics related to agricultural production. Every use application has its own "set" of value-bearing characteristics, which vary for different types of uses.

The choice of one use as the highest and best is embedded in the valuation principle that a property can have only one market value at a specific point in time. This is problematic in a multifunctional environment with competing end users which have different interpretations of the factors that determine value. For this reason the choice of the HBU on agricultural properties that maximises satisfaction or utility is challenging. The term "highest and best use" has been the subject of much criticism in valuation literature, as it can be applied as the use that maximises income (production purposes) *or* uniquely personal satisfactions. Several problems with the current situation necessitate the need for a different approach in the valuation of farms bought for lifestyle purposes. Valuation theory states that valuers need to assess buyer motivations and be able to think like "typical" buyers.

Valuers' familiarity with agricultural production as the HBU of farms and their unfamiliarity with other types of buyers obstructs thorough investigations into alternative uses of land before the decision of a specific HBU is made.

Literature overview

The market sales comparison (direct comparison) method is universally accepted as the most appropriate method to determine the market value of properties, because it reflects actual market behaviour and incorporates influences of both sides of the market (buyers and sellers) (Boykin and Ring, 1993:146, Jonker, 1984:79, Ellenberger, 1983:85-85, The South African Property Education Trust, 2004:35). The income capitalisation method is still commonly used in the valuation of income-generating components of farming businesses, such as guest houses and restaurants (Guiling *et al*., 2007:4). It has also been proposed as at least a supplementary method to determine the value of rural properties that are profit-based (Eves, 2005). This method is, however, inadequate for farm valuations where non-agricultural factors, such as lifestyle motivations, are dominant.

The market sales comparison method is based on the principle that a buyer will not pay more for a specific property than the price (which is a proxy for value) for which s/he can obtain a comparable substitute property that will fulfill the same objective (American Institute of Real Estate Appraisers, 1987:312, Sando, 1973:222, Vandell, 1982:256, The South African Property Education Trust, 2004:30-32, 35, Boykin, 2001:73, American Institute of Real Estate Appraisers, 1992:367, Ellenberger, 2007:7-1).

The concepts of HBU and market value form the basis of the market sales comparison method. Valuers must first and foremost decide on the HBU of the subject property. The use envisaged for a property

determines its value. This, in turn, is influenced by the characteristics of the property (Ellenberger, 1983:29, Smith, 2004:42, Reynolds and Regalato, 2002:82, Ellenberger, 2007:7-7). For this reason the HBU of a property is critical, as it guides the valuer through the valuation processes by identifying a specific use for a property, which provides direction on the choice of reasonable comparable properties with similar uses, characteristics and benefits for evidence of market value (Roberson, 1997:118, Lennhoff and Parli, 2004:45, Sando, 1973:222). It also implies a selection of certain value-bearing attributes of the property as perceived by the "typical buyer" (Ling and Archer, 2005:190).

Earlier definitions of HBU and market value, with their associated problems

In general the HBU is defined as that use of vacant land or an improved property that is reasonably likely and legal and is physically, legally and financially possible, which can be properly supported and results in the highest land value (Lennhoff and Parli, 2004:46, American Institute of Real Estate Appraisers, 1987:42, Lennhoff and Elgie, 1995:275, Thair, 1988:190-191). Market value is the highest price estimated in terms of money which a property will bring if exposed for sale in the open market allowing reasonable time to find a purchaser who buys with knowledge of all uses to which it is adapted and for which it is capable of being used (Albritton, 1980, American Institute of Real Estate Appraisers and Society of real estate appraisers, 1981). These concepts have their roots in traditional classical economics, where humans are perceived as rational economic beings who attempt to maximise their utility or income (Grissom, 1983:50).

Over the years the definitions of HBU and market value have been subjected to various revisions because of criticisms of these terms being poorly constructed, confusing, vague and contradictory (Grissom and Crocker, 1994:86, Wolverton, 2004:318); Lennholf, 2004:48; Thair, 1988:193; Vandell, 1982:257).

... the characteristics valued by lifestyle buyers are more intangible and subjective, making agricultural land valuations more complex and uncertain.

The theoretical assumptions of perfect competition and complete information, underpinned by rational human thought, eroded the base of traditional market value theory (Ratcliff, 1972b, Reenstierna, 1985:116, Ratcliff, 1975:486, Grissom, 1983:50-51, Fraser, 1991:35, Campbell, 1969:631). There are seldom many similar transactions from which market value can easily be calculated, the thought processes of buyers and sellers cannot simply be replicated, while limited knowledge makes it difficult for involved parties to make well informed decisions (Kummerow, 2002:407-408, Fraser, 1991:37). Valuations based on a single maximisation criterion are an oversimplification of reality that do not resemble actual decision-making processes (Whipple, 1962:181-183).

At the same time the market value definition assumes a perfect market from which a single "true" value could easily and accurately be determined, while people are depicted as rational beings who make optimal decisions (Reenstierna, 1985:126, Fraser, 1991:37, Collins, 1965:541-542, Ross, 1969:952). It creates the perception that market value can accurately and confidently be determined without any uncertainty or market imperfections. In reality these decisions are complex and subjective, and often not made by relying on a single maximisation criterion based on economic considerations alone, as HBU suggests, but comes about as an interaction of many factors, of which profit makes out only one part (Grissom, 1985:218, Dotzour *et al*., 1990:27, 29). These assumptions are highly theoretical and unrealistic, which make them difficult to apply in practice (Huck, 1965:196). Despite persistent criticism and efforts to create more user-friendly definitions, these continued to be highly theoretical, impractical and unrealistic (Lennhoff and Parli, 2004:45, Dotzour *et al*., 1990:17).

In time the emphasis of HBU shifted from being the use that provides the highest net income over a period of time, to the use resulting in the highest present land value (Ellenberger, 1983:74, Grissom, 1983:51, Rabianski, 2007). These were, however, not necessarily the same (Huck, 1965:195, Webb, 1980:58). Profit relates to the income-generating capacity of the land (production oriented), while satisfaction relates to the use or enjoyment derived from a property (Huck, 1965:191). This gave the definition of HBU a binary approach where both the highest income and/or highest satisfaction could be investigated (Thair, 1988:198).

Involved parties have many motivations for buying agricultural land, which can range from wanting to maximise profit to wanting to maximise satisfaction, which is a less tangible non-economic use (Adams and Mundy, 1991:41, Pope, 1985:81, 85,

Thair, 1988:191). However, each different use has a specific set of value attributes related to it. Valuation of a property from each of these angles would result in different values (productive or consumptive) and valuers would need to establish the comparable features of each. Valuation theory, however, dictates that a property can have only one market value at a specific point in time (Holstein, 2003:37). This matches the Law of One Price (LOOP) used in theories of international trade (Chen and Lee, 2008:123, Goodwin *et al*., 1990:682). However, the LOOP only holds for homogeneous goods, although no two parcels of land can ever be identical (Spreen *et al*., 2007:408).

Most probable selling price and most probable use

While earlier definitions of market value concentrated on it as the *highest* price which a property could sell for in the open market, later definitions forwarded in the 1960s proposed that market value should be the *most probable selling price* of such a property (MPP) (Miles, 1980:540, Babe, 1969:637, Grissom and Crocker, 1994:94). The market value of a property would then be the most probable selling price in the market, instead of the highest price that can be achieved (Grissom, 1983:50, 55, Smith, 1986).

As with market value, the term HBU could be replaced with *most probable use* (MPU), which represents the most likely use among alternatives. HBU focuses on the maximum and optimum use, while MPU looks at most likely use within a range of possible uses (Grissom and Crocker, 1994:86, Abson, 1989, Wilson, 1995), which will not necessarily be the optimal or maximum use, because of market imperfections in the land market (Roberson, 1997:116-117, Thair, 1988:195). The MPU implies the existence of alternative uses with different markets and probable buyers, thereby creating room for multiple and diverging perspectives regarding the best use of a property and thereby also acknowledging the uncertainty surrounding the choice of a single "best" use in valuations (Grissom and Crocker, 1994:87). It provides flexibility in valuations by stressing that the use of a property is determined by a range of factors, including non-economic ones, which could complicate decision making (Thair, 1988:196).

A range of values could statistically be equated to a distribution of potential selling prices, which implies the use of measures of central tendency, such as the mean, mode and modus. The mean relates to the expected price, the mode correlates with the most probable price and the median is the middle price (50 per cent probability that the value is higher or lower than this price) (Colwell, 1979:58). Similarly, the MPU can accommodate multiple uses by treating each use as a separate valuation "stream", until a decision on the use with the highest possibility of being realised is made (Thair, 1988:190, 192). It also allows for the valuation of special purpose properties, which sometimes need to be analysed on the basis of two highest and best uses, such as the continuation of the existing HBU and the conversion to an alternative HBU (American Institute of Real Estate Appraisers, 1992:293). In this way more information is provided on different uses and special cases such as multi-purpose and interim-use properties.

MPU does not assume that the use that yields the highest income is necessarily the use that yields the greatest value. It focuses on the highest land value to be realised in money or amenity terms and emphasises the most likely and possible use for the most probable buyer (Grissom, 1983:52, Thair, 1988:191, Kummerow, 2002:407).

The use of statistics has advantages and disadvantages. Even though statistical analysis provides essential and additional information in valuations, it does not provide a quick solution for valuation problems and a focus on human behaviour, as well as buyer, seller and property characteristics remains important (Reenstierna, 1985:118). Arguments have arisen that valuers are first and foremost valuers, not statisticians and that there is no substitute for a valuer's experience and judgment to choose comparable sales and estimate market value (Ratcliff, 1972a:486, Reynolds, 1995:85).

Acquiring data for rigorous statistical analysis is a cumbersome, expensive and timely process that few valuers can afford if they want to be competitive, while utilisation of statistics assumes that valuers have sufficient knowledge of the subject to undertake such analyses (Smith, 1995:83). Large samples are needed to allow for valuations based on confidence intervals (Holstein, 2003:37, Colwell, 1979:54, Smith, 1995:82, Reynolds, 1995:85). In reality, however, sales data are limited and often insufficient to draw meaningful statistical conclusions (Reynolds, 1995:83). In addition, sales data are seldom normally distributed and distribution measures cannot be used (Reenstierna, 1985:124, Reynolds, 1995:83, The South African Property Education Trust, 2004:91, Isakson, 2001:428). At the same time, the transactions involving special cases are difficult to include in statistical inference (Reenstierna, 1985:125, Kummerow, 2002:411). Small, diverse markets (such

as the agricultural land market) are not well suited to statistical analysis, because probabilities are difficult to estimate, ranges are large and high levels of uncertainty abound (Kummerow, 2002:409-411, Holstein, 2003:40, Thair, 1988:194-196, Isakson, 2001:424).

Another problem with the use of statistics is that it implies that market value is one value within a possible range of random variables, which is evenly distributed if often repeated (The South African Property Education Trust, 2004:83, Reynolds, 1995:82). No repetition occurs in valuation: a valuer is asked to provide one value (although, if a large number of valuers estimated the value of the same property, a normal distribution for the property's value would arise) (Reynolds, 1995:82-83).

The most important contribution of the MPP and MPU is their recognition of complexity and uncertainty surrounding the choice of a single land use and market value (Whipple, 1990:17, 24, Boyd, 1992:87). In contrast to the traditional definition of market value that suggests that there is one "true" value that could be determined as a point estimate, the MPP and MPU admit that more than one price and use is possible, but that a valuer is estimating the use and price that would *most likely* be attained in the open market (Reenstierna, 1985:116, Colwell, 1979:54, Smith, 1995, Thair, 1988:192, Ratcliff, 1975:486).

The choice of an HBU in a multifunctional agricultural land market

There are a number of ways to deal with the choice of a HBU and associated uncertainties in a multifunctional agricultural land market. These are discussed below.

Postponing the decision of an HBU

Valuation practices require an early choice of the HBU for a property in order to guide the valuation process: a valuer must first and foremost decide on the HBU, and most of the valuation work is done after this decision has been made. With transitional properties where the HBU is not clear-cut, the opposite *modus operandi* might be more beneficial: to postpone the decision of the HBU until an investigation of the market has been done and more information has been gathered, after which the valuer would be better equipped to determine with which "lenses" to look at a property and choose the HBU. This corresponds with the approach forwarded in complexity theory, which states that when dealing with complex issues, decision making (i.e. choice of HBU) must be delayed until more information is collected.

The use of multiple perspectives

The decision of an HBU on agricultural land where alternative uses are possible involves uncertainty and valuers need to make this decision with limited information at their disposal (Ribeiro *et al.*, 1995:183). For this reason, the ability to view the farm and its attributes from different perspectives (e.g. production and lifestyle perspectives) and acquisition of more information regarding farm trends, attributes valued by buyers and types of buyers in the market will assist valuers in

making informed decisions regarding an HBU (Hall *et al*., 2005:279).

In a complex system characterised by uncertainty, where components interact with each other to create an outcome that cannot be separated into its respective parts, the use of multiple perspectives becomes relevant to provide unique insight from different angles, which cannot be obtained in isolation (Linstone and Mitroff, 1994:108). Instead of choosing an HBU for agricultural property, where alternative uses are present early in the valuation process, valuers should admit that these valuations are complex, with increased uncertainty, necessitating in-depth analysis of agricultural properties and meaningful investigations of alternative use options in order to provide clients with the best possible information (Vasquez *et al*., 2002:70).

Because of their heterogeneous nature, rural properties need a wide-ranging HBU analysis. If the choice of the HBU for a property is postponed until more information on buyer behaviour and preferences, as well as property characteristics are available and different perspectives are investigated, a more informed decision can be made.

The provision of relevant additional information

The compound nature of rural land is an indication that valuers need to gather more information and do more research on alternative uses to understand markets better (Jonker, 1984:125, Ellenberger, 1983:91, Woods, 1969:598-600). A substantial amount of valuation literature is dedicated to the improvement of valuations by the inclusion of more and better information to provide insight into the thought processes of buyers and sellers through in-depth research and analysis (Holstein, 2003:37, Swenson, 2005:28).

... the use of multiple perspectives becomes relevant to provide unique insight from different angles, which cannot be obtained in isolation ...

More complex valuations, such as in a multifunctional land market where alternative uses for agricultural properties are present, need to be researched better for accuracy (Mazengarb, 1942:228, McAloon, 1986:313). For this reason valuers have to broaden their investigations to reflect actual market conditions (Boyd, 1992:85, Connolly, 1993:486, Coombs, 1956:115) and even outliers need to be mentioned if occurring under open market conditions (Fraser, 1991:36). Valuers provide an informed opinion of market value which must be substantiated and transparent (Albritton, 1980:205, Ratcliff, 1972a:524-525, Vandell, 1982:266). Informative and comprehendible valuation reports assist clients in understanding the market better and improve their decision making, while increasing the reliability and accuracy of valuations (Reenstierna, 1985:115).

The use of graphs to indicate several uses and the probabilities of each being realised has been suggested to improve

the quality of valuation reports and provide more information to the client on the different use options of a property in an easily understandable manner (Boyd, 1992, Boyd, 1990). However, this is data-intensive and valuers need to know the types of buyers and probability of a certain use being realised. This could arguably be done for residential property, but would be extremely difficult to do for agricultural properties. Valuers could also include an estimate of the accuracy of their valuations (Miles, 1980:540, Hill, 1990:234-235, 240).

Spending more time on research could have cost implications for valuers who already face time and fee constraints. The benefit of additional information by improving the product for clients to enhance decision making, however, outweighs the cost of collecting this additional information, and valuers are obliged to provide as much information in their valuation reports as possible (Vandell, 1988:349). Valuations remain opinions of the market value of properties and valuers' experience and judgment play important roles. The provision of more information would lead to better understanding of their opinion of market value (Falconer, 1971:613).

Conclusion

This paper looks at the decision of an HBU in multifunctional agricultural land markets. The presence of alternative uses complicates the valuation process, as the presence of two (or more) competing end users blurs the decision of an HBU. This complexity creates uncertainty and makes valuations of such properties more demanding.

The concepts of HBU and market value form the basis of the market sales comparison method. The literature regarding HBU and market value bears testimony to the struggle valuers have in practically applying the concepts of HBU and market value. These concepts have been criticised as being too theoretical and unrealistic. The fundamental criticism against definitions of HBU and market value stems from their neo-classical assumptions of operating within a perfectly competitive market with perfect information and rational decision-making. Over the years the definition of HBU has changed from being the use that is most profitable (corresponding with the highest net income generated on the property), to the use that provides the highest present land value. The terms most probable use and most probable selling price alluded to the presence of alternative land uses by depicting the HBU as the most likely use among alternatives. However, valuation theory states that there can only be one market value for a property at a specific point in time, which provides valuers of agricultural properties in a multifunctional land market with very little manoeuvring space. These concepts have been defined and redefined, but provide little guidance as to the way properties with alternative uses should be valued.

An agricultural property where the HBU is uncertain due to the presence of alternative uses represents a complex system and should be investigated from different dimensions, levels and perspectives in order to gain insight into the forces at work. At the same time the customary *modus operandi* of choosing an HBU early on in the valuation process should be postponed until more information is gathered in order to make an informed decision. The valuation of agricultural properties where alternative uses are present necessitates in-depth analysis of alternative use options. This will increase accuracy and provide essential additional information for clients of valuation reports for improved decision-making. ■

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The original toxic asset: contaminated land

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Amidst all the talk of toxic loans, toxic debt and toxic assets during the global financial crisis, it can be easy to overlook the original toxic asset – contaminated land. Gentrification and the increasing redevelopment of former industrial sites for commercial and residential uses means a greater likelihood of finding hazardous substances in the soil and groundwater. This in turn has been caused by inadequate procedures for the manufacture, use and disposal of chemicals on these sites. Not only could the presence of these hazardous substances prevent the land from being redeveloped for more sensitive uses, but they can cause serious environmental and health problems.

This article provides a concise overview of Australian contaminated land-related legislation focussing on recent amendments to the New South Wales Contaminated Land Management Act *1997 (CLM Act). Because many states have adopted legislation or incorporated provisions into existing legislation that is similar to the New South Wales regime, it is foreseeable that the amendments or the intent of the amendments to the CLM Act will be adopted by other jurisdictions.*

Contaminated land legislation in Australia

Each state has its own legislation on liability for contaminated land, usually including:

- Offences for contaminating or polluting land
- Regulatory authority to require remediation of contaminated land
- Indicative responsibility for contamination of land and for recovery of costs for remediation of land required by a regulatory authority
- Requirement to notify the regulatory authority of pollution incidents or contaminated land.

The legislation operates in conjunction with common law duties (e.g. negligence, nuisance and under contract law) and other statutory requirements (e.g. under the *Trade Practices Act*) that may affect dealings with contaminated land.

In NSW liability and obligations for contaminated land mainly stem from the *Protection of the Environment Operations Act* 1997 and the CLM Act, which until the recent amendments provided:

1. It is an offence to pollute land or water unless it is in accordance with a licence (e.g. an environment protection licence for a waste facility)
2. The EPA can issue investigation and remediation orders if land is

so contaminated that it presents a 'significant risk of harm'

3. The EPA can issue orders on 'appropriate persons' who are, in order, the person principally responsible for the contamination, the owner or the notional owner (e.g. a mortgagee in possession)
4. Persons issued with orders could seek the costs of compliance from those deemed responsible for the contamination under the Act, and
5. Land owners or persons causing contamination have a duty to report contamination as soon as they become aware that the contamination presents a significant risk of harm.

In Western Australia, the duty to report contamination is similar to that in NSW, except that auditors also have a duty to report if they have been engaged for the purposes of the Act (*Contaminated Sites Act* 2003). Landowners also have a duty to advise incoming owners, lessees and mortgagees of sites classified as contaminated or remediated with restricted uses or if a notice has been issued by the regulatory authority. The persons deemed to be responsible for contamination is very similar to NSW.

In Victoria, occupiers of land have the primary responsibility for contamination (*Environment Protection Act* 1970). Occupiers that carry out industrial or commercial undertakings are deemed to have caused the contamination unless they can prove the contamination was unrelated to those undertakings. There is a legislative ability for an innocent occupier to recover costs from the actual polluter, although in practice this can be difficult. Owners of land can be liable to pay the costs of remediation in their capacity as owner in some limited circumstances. Because owners are also likely to be occupiers of their

land at some stage (e.g. at the end of a tenancy) they may also become liable for contamination as occupiers. There is no express legislative duty upon any person, other than environmental auditors carrying out a statutory audit, to report contamination of land or a pollution incident. Operators of sites which are the subject of an environmental licence may be required by a condition of that licence to report a breach of a licence (including exceeding emission limits).

In Queensland, the *Environment Protection Act* 1994 provides that owners and occupiers have a duty to report contamination of which they are aware, or if the land is being used for 'notifiable activities' listed in the Act. Notification normally leads to the land being listed on either the environmental management register or contaminated land register. Owners and occupiers must notify incoming owners and occupiers if a site is registered or subject to notices from the EPA on contamination or remediation of the site. Failing to do so could lead to the agreement being terminated and any monies paid under the contract returned.

Owners of contaminated land in Queensland are normally only liable to conduct site investigations or remediation pursuant to an EPA notice, where the land was contaminated and registered as contaminated before the owner bought the site. If an owner seeks to redevelop land, they are often obliged, as a condition of approval, to remediate the land prior to its redevelopment.

In the ACT, the duty to notify and responsibility for contamination is similar to the CLM Act.

In South Australia, orders for remediation of contaminated land under the *Environment Protection Act* 2005 can be issued to the person responsible or, if impractical, the owner (in certain circumstances). The occupier can be deemed to be responsible if its activities caused or contributed to the contamination. Former owners and occupiers might avoid liability if there was a change in ownership that took into account liability for remediation.

Key CLM Act amendments

Amendments to the CLM Act came into force on 1 July 2009 and the major changes are discussed below.

Greater duty to notify the EPA

Thanks to a new constructive knowledge provision, there is now a greater onus, or a stricter test, on landowners, occupiers or former occupiers, to notify contamination of land.

The duty is on owners of contaminated land (whether it was contaminated before or during the ownership) and persons who have caused contamination to notify the EPA of the contamination if:

- The contaminant has or is likely to migrate beyond the property , and the level of contaminant on neighbouring land is higher (and will continue to be) than the levels specified in the regulations or guidelines, **or**
- The level of contaminant is higher than levels specified for the current or approved use of the land, and persons have been or could be exposed to it.

Persons are required to notify the EPA as soon practicable after they become aware of or **ought reasonably to have been aware** of the contamination, taking into account the person's experience, qualifications, their ability to seek advice and the circumstances of the contamination. Closing one's eyes to the potential contamination is not enough.

The Guidelines on the Duty to Report Contamination (which came into effect on 1 December 2009) state that a review of site activities and history, and a site inspection should be undertaken in order to assess whether the contamination should be reported. The results of the preliminary investigation will determine whether a more detailed investigation is required. The Guidelines include a checklist and scenarios where the duty to notify is intended to apply or not apply. For example, a person is expected to seek advice on the level of contamination and the duty to notify if the site:

- Is currently used for commercial, industrial or open recreational purposes
- Allows public access
- Is uncovered, with access to soil and/or fill materials
- contains large areas filled with materials of unknown origin, and is adjacent or close to a sensitive receptor (such as land used for residential purposes).

It is particularly important for occupiers, landowners and persons responsible for contamination to make sure that they comply with the duty to notify or risk penalties of up to $165,000.

Increased EPA powers

Previously the EPA's powers under the CLM Act were only triggered when it formed the view that the land was so contaminated that it presented a significant risk of harm. This threshold test has changed and the EPA's powers have broadened.

The 'significant risk of harm' test (a form of which continues to be used in the ACT) has been replaced by the EPA's power to declare land 'significantly contaminated', meaning

the contamination is significant enough to warrant regulation. The new power is accompanied by detailed Guidelines for assessing the level of harm posed by the contamination. In many ways it is similar to the old criteria except that the EPA has greater flexibility to step in and regulate contaminated land where the risk of harm is lower but public interest in EPA regulation of the site is high.

Once the EPA determines the land is significantly contaminated it will publish a declaration in the *NSW Government Gazette*, and notify at least the owner, local council and occupier. Previously the EPA could declare land as an investigation or remediation area (a similar concept exists in WA) as a warning on the title. Now there is one type of declaration – significantly contaminated – this could be a greater blight on lands that might previously have been declared only as an investigation area as distinct from a remediation area. Submissions on the declaration cannot be made nor is there a positive obligation on the EPA to remove or revoke the declaration once the land has been remediated which could make the stain of the declaration hard to remove.

Now, the EPA can:

- Issue *preliminary investigation orders* to require persons to investigate whether the land is contaminated with a specified substance, and provide that information to the EPA. Essentially, the EPA is asking the land owner or occupier to make the enquiries that the EPA might have otherwise done to determine the significance of, or threat posed by, contamination on the property. Orders can be issued on, and in no particular order to, the person the EPA suspects is responsible, the owner, the notional owner, the person whose activities were likely to generate, consume or be converted into the specified substance, or a public authority.
- Issue *management orders*, covering issues previously encompassed by investigation and remediation orders, as well as such things as a requirement to prepare or comply with a plan of management prepared by a third party, make progress reports to the EPA, have specified actions audited by an accredited site auditor, to advertise and conduct public meetings, and inform the EPA of changes of ownership. Once the land ceases to be significantly contaminated, the management orders are deemed to cease to have effect (section 14(8)) but the EPA has discretion to revoke the management order. This process does not provide certainty on the removal of an apparent blight on an asset.
- Issue *clean up notices* or *prevention notices* under the POEO Act despite an approved voluntary management proposal.
- Take other reasonable steps to investigate or manage contaminated land or threats of harm from contaminated land, whether or not it believes the land is significantly contaminated.

Persons are required to notify the EPA as soon practicable after they become aware of or ought reasonably to have been aware of the contamination ...

Order of responsibility

The order of responsibility has changed so that the first entity to be targeted is the person responsible (not just principally responsible) for the contamination. Therefore, persons who share responsibility are likely to be targeted, and the EPA is now more likely to issue notices to several persons on the same parcel of contaminated land.

Occupiers are clearly more likely to be the subject of orders under the amendments, because the Act provides that an owner or occupier is responsible for the contamination where they knew or ought to have known that their activities would cause contamination and they failed to take reasonable steps to prevent it. This is similar to existing provisions in Victoria and South Australia for former or current occupiers of contaminated land.

Essentially the intention is to make persons who failed to act or prevent contamination from occurring just as liable as those who caused the contamination. The owner or occupier in this situation is responsible for proving they did not cause the contamination or took all reasonable steps to prevent it.

The amendments mean that the EPA need not get involved in arguments between current and former occupiers or between owner and occupier about responsibility for or liability for contamination. The EPA will issue the orders on one or more of the entities and those entities will have to seek compensation from the other occupiers or the owner to the extent they weren't responsible for the contamination the subject of the order.

Voluntary management proposals

Under the CLM Act, parties could enter into voluntary investigation or

remediation proposals which would, if approved by the EPA, give them assurance that they would not be the subject of a future order from the EPA.

The amended Act replaces these with voluntary management proposals (VMP) and gives the EPA greater powers to issue orders on persons, even if they have entered into a voluntary management proposal, and unilaterally withdraw approval. An order can still be issued for example if the VMP was not carried out, or if it relates to a matter not adequately addressed by the VMP, or if approval was based on false or misleading information. Whereas in South Australia parties to approved agreements by the EPA are protected from being issued with orders in the future.

Key messages

The amendments to the CLM Act in New South Wales highlight some of the key issues to be aware of with literally 'toxic' assets and may be a precursor to amendments to legislation in other states:

- Landowners, occupiers and/or persons responsible for contamination, in most states have a statutory duty to report contamination. In NSW, even if a person wasn't aware of the contamination, they are taken to have been aware in certain circumstances and there may be a positive duty to investigate contamination. In light of the NSW amendments NSW landowners, or occupiers of current or former contaminated land, must review their statutory duty to notify.
- Prior to the purchase, occupation or acceptance as security for a loan, of land enquiries should be made about the site's history of use, its location and any prior assessments of contamination. It may also be appropriate to ask the vendor about past convictions or orders for environmental offences, business activities, environmental management systems. Borrowers should be asked if they have contaminated land in the past, are complying with environmental laws and whether public authorities have begun to investigate contamination on the land. Depending on the responses, the purchaser may want to seek specialist advice on the contamination risks.
- In some states, contractual arrangements between parties on liability for contamination do not prevent regulatory authorities from issuing orders, rather they only deal with the recovery of costs. Enquiries should be made into attempts to transfer liability for contamination in previous contractual arrangements.
- Prior to occupying a site the new tenant, owner or occupier should obtain a contamination report to help attribute responsibility for new or subsequent contamination.
- Landlords and occupiers must take sufficient and reasonable measures to prevent contamination such as by implementing environmental management plans and securing the site.
- It is better to take positive action to remediate contamination before a regulatory authority makes declarations and/or issues orders. Regulatory action and declaration can act as a permanent blight on the land affecting its value and resale potential. ■

Market value of property, plant and equipment as part of a going concern business

Roy Farthing

Roy Farthing is a Partner, Valuation and Business Modelling, at Ernst & Young. He is currently a member of the National Professional Board of the API, Chair of the Australian Valuation and Property Standards Board and a member of the International Valuation Professional Board.

The following article provides some background to the development and release of the Exposure Draft *Guidance note – Market value of property, plant & equipment as part of a going concern business*.

The original need for some sort of guidance was identified following a court case (*Symex Holdings Ltd v Commissioner of State Revenue* [2007] VSC 159). This was a stamp duty matter which was heard by the Supreme Court of Victoria and concerned the valuation of plant and equipment for stamp duty purposes under s.63(3) of the *Stamps Act* 1958.

In this case a valuation of specialised plant & equipment came under criticism by the judge. The value of the plant & equipment had been determined using a depreciated replacement cost (cost) approach and was reported subject to a test of adequate profitability. Other evidence made it clear that the value of the business as a whole did not support the valuation of the plant & equipment. Whilst the valuation of the plant & equipment was consistent with existing guidance provided by the International Valuation Standards Council (IVSC) and API the court observed that a qualified opinion of value (i.e. reported subject to a test of adequate profitability) did not provide an appropriate measure of market value having regard to the facts and circumstances of the case.

The Australian Valuation & Property Standards Board (AV&PSB) therefore set about preparing some guidance designed to help valuers in these situations. As the working party started to explore this issue, it became apparent that the circumstances were not unique to any one valuation purpose – the court case was about stamp duty – but the matters in play arise every time a valuer is asked to value property, plant & equipment as part of a going concern business. Valuations may be required for a variety of purposes including financial reporting, tax, stamp duty and financing.

Whilst the IVSC provides some guidance in respect of valuations for financial reporting purposes, there is no standard or guidance note that covers the valuation of property, plant & equipment as part of a going concern business more generally. Further the IVSC provides no guidance in respect of how to measure various forms of obsolescence. It was therefore agreed that the AV&PSB would develop a guidance note that covered valuations of property, plant & equipment as part of a going concern business with particular emphasis on identifying and measuring obsolescence.

Whilst it is not intended that this (or any other) guidance note should be an exhaustive "how to" manual, this guidance note explores the various forms of obsolescence that can impact on the value of an asset as well as some of the methods that can be applied to identify and quantify obsolescence. Members who practise in this area should already be familiar with many of these concepts. However, we always recommend that people who wish to practise in any area read and consult widely. There are

various published texts on the matter that provide greater detail and worked examples.

In summary however, the guidance note is intended to help members make the connection between the value of specialised assets and the value of the business enterprise within which they operate. The two are inextricably linked and valuers who ignore this connection may do so at some risk.

By their very nature, specialised assets are rarely, if ever sold, except as part of the business in occupation. Assets that possess a high value as part of a going concern business may have little or no value when removed from that business setting.

As the exposure draft states, IVGN8 requires that:

"where the value of a specialised asset is estimated by the depreciated replacement cost method, a statement should be made that it is subject to a test of adequate potential profitability in relation to the whole of the assets held by a for-profit entity or cash generating unit."

This requirement is a direct acknowledgement of that inextricable link between the value of specialised assets and the value of the business enterprise within which they operate. The Exposure Draft is intended to help valuers address that test of adequate profitability by identifying and quantifying all forms of obsolescence that may have an impact on value.

In this regard the valuer should consider three forms of obsolescence:

1. Physical deterioration.
2. Functional obsolescence (sometimes called technological obsolescence).
3. Economic obsolescence (sometimes called external obsolescence).

It could be (and clearly sometimes is) argued that a properly constructed valuation using the cost approach should address all forms of obsolescence, however the traditional approach has been to address physical deterioration and possibly functional obsolescence but to leave economic obsolescence (the test of adequate profitability) to the directors of the company.

This is because property and plant & equipment valuers either do not have access to the information, or have felt they do not have the skills, necessary to address this aspect. However, in certain circumstances, such as the case noted above, it is clear that a valuation that does not address all forms of obsolescence can be considered inadequate.

Clearly valuers will either need to up-skill themselves or (consistent with the API code of ethics) decline an engagement where they do not possess the necessary skills. It is also recognised that there will continue to be many situations where it is acceptable to report values that have been determined using a cost approach subject to a test of adequate profitability. The facts and circumstances of each case will dictate the appropriate approach but valuers certainly need to have a far greater awareness of the interaction between specialised assets and the business enterprise in which they operate.

The resultant document is now issued as an Exposure Draft and is also available on the API National website **www.api.org.au** in the News/Information section.

The API would appreciate your feedback regarding the Exposure Draft. Please forward any comments to the API Professional Standards Manager, Tony McNamara via email **tmcnamara@api.org.au** by close of business 1 June 2010. ■

Market Value of property, plant and equipment as part of a going concern business (Exposure Draft) 1 March 2010

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1 Introduction

1.1 Purpose

The purpose of this Guidance Note is to provide information, commentary, opinion, advice and recommendations to Members producing valuations of property, plant and equipment when required to determine the market value of such assets as part of a going concern business. These guidance notes cover various situations to assist Members in undertaking such valuations.

It is also intended this Guidance Note will assist users of valuation reports to understand the basis upon which valuations of property, plant and equipment are undertaken in these circumstances.

This Guidance Note is not intended to repeat information already covered in Practice Standards and other Guidance Notes. Practice Standards and other Guidance Notes which should be read in conjunction with this Guidance Note include:

- IVS 1 Market Value Basis of Valuation
- IVS 2 Valuation Bases Other Than Market Value
- IVA 1 Valuation for Financial Reporting
- AVGN 1 Valuations for use in Australian Financial Reports
- NZVGN 1 Valuations for use in New Zealand Financial Reports
- IVA 2 Valuation for Lending Purposes
- IVGN 1 Real Property Valuation
- IVGN 3 Valuation of Plant and Equipment
- IVGN 4 Valuation of Intangible Assets
- IVGN 8 Depreciated Replacement Cost
- IVGN 9 Discounted Cash Flow Analysis for Market and Non-Market Based Valuations

1.2 Status of guidance notes

Guidance notes are intended to embody recognised 'good practice' and therefore may (although this should not be assumed) provide some professional support if properly applied. While they are not mandatory, it is likely that they will serve as a comparative measure of the level of performance of a Member. They are an integral part of the Valuation and Property Standards Manual.

1.3 Scope of this guidance note

The scope of this guidance note is for any situation where a valuation of property, plant and equipment as part of a going concern business is required.

The Market Value of such assets as part of a going concern business assumes that the assets would be sold as part of a going concern or continuing business.

Often these assets are specialised operational assets, the value of which cannot be readily assessed by reference to market prices.

Non-operational, surplus assets that will not continue to be used as part of the going concern business (e.g. assets which are approaching or at the end of their economic life) should be valued based on their market value assuming they will be sold separate from the going concern business. Such a value may be higher or lower than the value as part of the going concern business depending upon the specific circumstances, but should reflect the highest and best use of the assets assuming they will no longer be used as part of the going concern business. This may include alternative use value in the case of real estate. In respect of plant & equipment such a value should assume that the assets will be sold for removal (commonly referred to as net realisable value).

... the sales comparison approach, cost approach and income approach are all considered appropriate methods of valuation depending on the nature of the assets and the information available.

1.4 Assets included

Because valuations of property, plant and equipment as part of a going concern business presuppose a sale of those assets in their existing use to an operator who would continue to use the assets as part of that business enterprise, the valuations, (depending upon how they are assessed) will usually include all assets used in that business enterprise. This may include real property and plant and equipment (i.e. tangible assets) as well as intangible assets (e.g. business licenses, patents, patterns, designs, intellectual property, goodwill, etc).

Where the income approach has been used to assess the market value of assets as part of a going concern business, Members should be conscious that the values assessed may include tangible and intangible assets. An apportionment of value to the various asset classes may be required (particularly in the case of valuations for mortgage security purposes).

2. Test of adequate potential profitability/service potential

IVGN8 requires that:

> *"Where the value of a specialised asset is estimated by the depreciated replacement cost method, a statement should be made that it is subject to a test of adequate potential profitability in relation to the whole of the assets held by a for-profit entity or cash generating unit."*
>
> *"For not-for-profit public sector entities, the reference to a test of adequate profitability is replaced by a test of adequate service potential."*

This qualification is important as it is intended to alert the reader of the valuation to the fact that the valuation assumes and is dependent upon (i.e. subject to) the reporting entity being profitable (i.e. having adequate potential profitability) or in the case of not for profit entities, continuing to provide the service for which the asset is used (i.e. service potential).

Valuations that assume continuation of the going concern business or service should not be construed as representing the market value of those assets in the event that the going concern business or service ceases to exist.

In assessing market value under the cost approach, the test of adequate potential profitability (or service potential) has traditionally been seen as the responsibility of the entity's directors or auditors.

However, to the extent that it is within their skills and knowledge, and the necessary information is available, Members may complete the test of adequate potential profitability (or service potential) rather than reporting a value subject to that test being completed by others.

It should be noted that existing guidance in respect of the test of adequate profitability is restricted to valuations for financial reporting purposes completed using the cost approach. The test of adequate profitability is effectively used as a means to identify the potential existence of economic obsolescence. However, economic obsolescence is a matter that may need to be considered in any valuation that has been completed using the cost approach.

It should be noted therefore that if a Member does not include the qualification that the valuation is subject to the test of adequate profitability (or service potential), the valuation may be construed as reflecting all forms of obsolescence (including economic obsolescence) and hence representing an unqualified opinion of market value.

A valuation that properly considers and reflects profitability or service potential as described in this guidance note will result in an unqualified opinion of market value. By implication therefore a valuation that does not consider and reflect profitability or service potential must be presented as a qualified opinion of market value.

3. Highest and best use

In undertaking market valuations of property, plant and equipment as part of a going concern business Members should consider whether the current use of those assets represents their highest and best use.

If an asset potentially has a higher and better use, Members may need to assess and report the value of the asset for its alternative use, but in doing so should also consider the costs that may be incurred in changing use or decommissioning the asset as well as the potential impact on the future use and therefore value of other interdependent assets.

ANZVGN2 Valuations for Mortgage and Loan Security Purposes requires that where assets have a lower value for alternative uses the Member should report both values.

4. Valuation methods

In assessing valuations of property, plant and equipment as part of a going concern business, the sales comparison approach, cost approach and income approach are all considered appropriate methods of valuation depending on the nature of the assets and the information available.

4.1 Sales comparison approach

It is generally difficult to find and analyse sales of specialised property, plant and equipment. Such assets are usually sold as part of the going concern business along with all its other tangible and intangible assets and liabilities or as part of a group or portfolio of assets and as a result apportionment of the business acquisition price may not be available or reliable.

Where comparable sales evidence exists for real property being transacted as part of a going concern business, the sales comparison approach can be used to determine the value to an owner occupier. The value of the property for its alternative use or value with vacant possession may be different.

The implication for Members is that comparable sales of properties sold for redevelopment or with vacant possession may not provide a true indication of the value of a property for use as part of a going concern business.

In some cases the value as part of a going concern business may be lower than the property's value for its highest and best use. IVS 1, 2 & 3 require valuations to be assessed on a highest and best use basis, but Members should consider possible costs that may be incurred in changing the use of the asset as well as the potential impact on the use and therefore value of other inter-dependent assets.

For plant and equipment this may mean assessing the value of individual assets or production units on a comparable sales basis and weighting that value for installation and any enhancements/ modifications.

This means the Member will use a combined approach to value: the comparables sales approach (where comparable sales can be found) and the cost approach for the installation component that brings those assets into use within the business.

In applying the cost approach to the installation component of an asset's value, Members should take into account any obsolescence in order to determine the depreciation to be applied to the installation cost component.

The comparables sales should be adjusted to reflect any variations from the subject asset.

Members should also have regard to the market place by understanding the context of each sale and should be aware of asking prices for equivalent assets in developing a complete understanding of the market place.

4.2 Cost approach

The cost approach is the most commonly used valuation method to determine the value of specialised assets. Under the cost approach the current replacement cost is calculated and then any loss in value caused by physical deterioration and functional and economic obsolescence is deducted to arrive at the market value of the asset.

4.2.1 Forms of obsolescence

The Member should consider three forms of obsolescence:

1. Physical deterioration. This is the loss in value resulting from the consumption of the useful life or service potential of the asset caused by wear and tear, deterioration, exposure to various elements, physical stresses, and similar factors.
   a. It should be noted that the consumption of the useful life or service potential of an asset may be constant over the life of an asset and on other occasions this may occur more quickly at the beginning or at the end of the asset's life. This can result from variations in the intensity of use to which the asset is subjected at different stages of its life. These variations in the consumption of useful life or service potential of an asset will likely be reflected by variations in the level of maintenance costs.
   b. The useful life of an asset may be expressed in terms of years of service but may also be expressed in terms of units of production. When assessing remaining useful life Members should have regard to the condition of the asset at the time of assessment which may alter the total life of the asset as compared to its expected life when new.
2. Functional (sometimes called technological) obsolescence is the loss in value resulting from inefficiencies in the subject asset compared to a more efficient or less costly asset. Such excess operating costs and/or excess capital costs can be used to measure the extent of functional obsolescence.
3. Economic obsolescence (sometimes called external obsolescence) is the loss in value caused by factors which are external to the asset itself. Such factors often relate to the economics of the industry in which the business operates or the business in which it is employed. New legislation (or fear/risks of it) may also contribute to economic obsolescence.
   a. Economic obsolescence may result from over capacity. The replacement cost of a plant that has a capacity equal to need may be significantly lower than the reproduction cost of the plant as installed. The extent of economic obsolescence in these circumstances can be measured by comparing the reproduction cost of the subject assets to the replacement cost of the assets required to meet the expected demand. If the plant's capacity is limited by an asset within the plant rather than by external factors then the obsolescence may be regarded as technological (i.e. functional) and may be curable.
   b. Economic obsolescence can also be a result of other external factors such as increased raw material costs or reduced product sales/value. These factors may be specific to a particular location or more generally experienced throughout an industry sector.
   c. It is important when investigating the impact of economic obsolescence that Members understand and consider the connection with the profitability of the business. This might be evident from the acquisition price (in a business transaction scenario), or reported business value. To the extent that a contemporaneous transaction involving the sale of the going concern business indicates a lower value than that of the property, plant and equipment used by that going concern business, this may provide an indication of economic obsolescence.
   d. Economic obsolescence may also be observed for some assets (predominantly real estate) by considering whether the going concern business could afford to pay a market rent for the assets and still return a profit.

Having regard to the various forms of obsolescence discussed above, Members should be wary of using depreciation tables which only reflect physical deterioration or methods which purport to represent all forms of obsolescence in one calculation without having regard to the circumstances and use of each asset.

In the case of new businesses, the sum of the market value of the assets may indicate the business is yet to achieve a profitability which provides an appropriate return on the assets employed and capital outlay. For valuations for financial reporting, these issues are part of the test of adequate potential profitability/service potential (refer IVGN No.8).

Observation and analysis of sales of comparable businesses may be helpful in determining whether the subject business can support the assessed values of the tangible assets.

It is recognised that Members may not possess the appropriate skills or have access to the information necessary to determine the value of a business as a going concern however it is prudent to investigate factors that may indicate economic obsolescence and discuss these with the client prior to drawing a conclusion


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as to the value of the assets. For instance it would be prudent for Members to inform themselves of the details of relevant discoverable information (such as a recent sale of the going concern business that owns the assets) which might alert the Member to the possible existence of economic obsolescence.

Members should be careful to individually assess all forms of obsolescence for each asset as different assets within the same business may be impacted differently by obsolescence.

Valuations determined having regard to all three forms of obsolescence under the cost approach will result in an unqualified opinion of market value of the asset.

In applying the cost approach to real property, the Member should assess the market value of the land and add the value of the improvements after assessing all forms of obsolescence. Where the property has a higher value for alternative uses, the added value of the improvements may need to be reduced by applying a higher economic obsolescence factor, so as to not over value the property.

4.2.2 Guidance on the identification and quantification of obsolescence

Specialised assets are typically owner occupied. Such assets are rarely leased and therefore, it is difficult to identify market rental income or income capitalisation rates from the market.

Whilst these assets are typically used to produce income, the income that is produced is consolidated in the overall business enterprise income and as such is produced by a combination of real estate, plant and equipment, and intangible assets functioning together as an integrated going concern business.

It is often difficult therefore to separate this business enterprise income into the particular components that represent income in respect of the individual tangible assets.

Specialised assets do not sell regularly in the secondary market and as a result it is difficult to identify and analyse comparable sale transactions.

Transactions involving the sale of specialised assets are relatively infrequent and when they do occur, the property, plant and equipment are sold as part of a going concern business. In such situations, the individual values attributable to the property, plant and equipment are typically not disclosed to the marketplace.

For these reasons, the cost approach is commonly used to value specialised assets. The identification and quantification of all forms of obsolescence is a fundamental procedure in a cost approach valuation.

The quantification of functional and economic obsolescence is however often challenging for the following reasons:

- It is difficult to visually identify the existence and effects of functional and economic obsolescence.
- The data needed to quantify some forms of obsolescence are often only available from the owner of the assets and therefore independent verification may be difficult.
- With regard to economic obsolescence, the causes of the obsolescence are, by definition, factors that are external to the subject asset.
- The identification and quantification of some forms of obsolescence is often comparative in nature and therefore requires data in respect of both the subject asset and comparable assets.

Functional and economic obsolescence may be identified from reviewing financial documents or operational reports but may also be identified from comparison with and knowledge of comparable assets.

With regard to economic obsolescence, it will most likely be necessary to analyse asset-specific financial data in order to identify the causes of obsolescence.

Negative movements in gross margin can also be an indicator of economic obsolescence. The gross margin is represented by the difference between a plant's revenues and its cost of raw materials. These inputs can be measured using units of production. The current year's gross margin can be compared to previous years.

Functional obsolescence

Common examples of functional obsolescence include:

- Excess operating/maintenance costs
- Excess capital costs.

Examples of excess operating costs include:

- The subject asset may require 10 operators while a comparative asset only requires five.
- The subject asset may produce ten units per period while a comparable asset produces twenty units per period.
- The subject asset may produce more scrap/waste material than a comparative asset.

In each case the present value of the excess operating costs in terms of labour, efficiency or raw materials is used to arrive at a measure of functional obsolescence.

An example of excess capital costs is where the subject asset is considered to be over-engineered for its required function. This can arise where methods (and costs) of construction or materials of construction have improved (reduced) since the subject asset was originally put into service.

Functional obsolescence can be quantified and captured by:

- Reducing value by an amount equal to the present value of the excess operating costs embodied in the subject asset(s)
- Reducing value by an amount equal to the excess capital cost embodied in the subject asset(s)
- Reducing value by an amount equal to the estimated capital costs to cure the functional deficiency embodied in the subject asset(s).

Specialised assets do not sell regularly in the secondary market and as a result it is difficult to identify and analyse comparable sale transactions.

Economic obsolescence

Economic obsolescence relates to a decrease in the value of an asset due to influences that are external to the subject asset and occurs when the asset owner can no longer earn an appropriate rate of return on the ownership/operation of the subject asset, (i.e. the asset does not meet the test of adequate potential profitability).

It is acknowledged that economic obsolescence is typically the hardest form of obsolescence to identify and quantify.

Because economic obsolescence is usually a function of external factors that affect an entire going concern business (i.e. all tangible and intangible assets) rather than individual assets, it is sometimes measured using the income approach or by using the income approach to help identify the existence of economic factors that may be having an impact on value.

When the operating level of an asset is significantly lower than its capacity, and this situation is expected to continue for the foreseeable future, this form of economic obsolescence can be measured using the cost approach.

In its simplest form this can be measured by adopting the cost-to-capacity concept. The economic obsolescence penalty can be calculated on a percentage basis by comparing the actual operating level to the rated capacity using the cost-to-capacity concept. The penalty factor is deducted after physical deterioration and functional obsolescence because economic obsolescence is independent of the asset(s).

This is based on the logic that a prudent purchaser will only pay for capacity that can be used profitably.

It should be noted that the cost of assets of different capacities tends to vary exponentially rather than linearly because of economies of scale. In other words, as capacity increases, capital costs also increase, but at a different rate.

Other methods are also possible for quantifying economic obsolescence within the cost approach. Members should determine the facts and circumstances and apply them as appropriate.

4.3 Income approach

In assessing valuations of real property assets as part of a going concern business, capitalisation and discounted cash flow analysis (cash inflows and outflows) may be appropriate methods of valuation.

Whilst direct market evidence of sale prices may not exist for specialised assets, Members may use other market evidence or benchmarks to assess the value of assets as part of a going concern business, either in their entirety or by components.

Examples may include assessment of rents of specialised assets having regard to likely returns required within the market for assets employed within similar industry sectors.

In other cases capitalisation of net profit may be appropriate to assess the value of the entity as a going concern however Members are cautioned that valuations assessed on this basis include both tangible and intangible assets, and an apportionment may be required (refer Section 1.4).

There are few instances where the income approach can be used to value individual plant and equipment assets without also capturing other assets such as intangibles and working capital. The income approach may be able to be utilised for leased plant and equipment assets that generate an income stream or a group of assets that can produce a saleable product.

It is recognised however that it is rarely possible to identify an income stream and allocate it to individual assets. As a result, it is generally very difficult, if not impossible, to assess values for individual assets by reference to the income approach. It is also arguable that any cash flow based valuation will, by default, include more than just the plant and equipment assets. ■

The objective valuation: more things that matter

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This is the last paper in a series of four. The previous papers can be found in the *Australian and New Zealand Property Journal*. The first article (see Vol.2/no.2) examined the concept of fair market value and most probable price. The second article (see Vol.2/3) commenced an examination of objective approaches and techniques using market comparison. The third article (see Vol.2/4) continued with the development of valuation models in the market comparison approach. This fourth article further discusses issues that were raised in the previous two articles, and provides some assistance to the valuer who seeks to implement the objective concepts and techniques outlined in the those articles. Five particular matters are now examined:

1. Scoring schema in quality points valuation model.
2. References section covering the main works dealing with objective valuation techniques and their accessibility.
3. Fundamental principles and headings for valuation reports.
4. Reporting the value conclusion.
5. Regression analysis, including multiple regression analysis (MRA).

1. Scoring schema in quality points model

In the quality points (QP) valuation model the first step, after firstly making any preliminary adjustments to the sales for time and other sale (not property) conditions such as differences in financing terms, will normally be to identify the appropriate unit of comparison and unit of value. This is usually done by choosing that property variable which is the most highly correlated with the sales (adjusted) prices by examination of the relevant r and r^2 values. The final step is then to make adjustment for remaining differences in the Unit values to the subject property.

A. Three basic principles should be applied to any valuation model. Keep the system as simple as possible. The objective is not to build a model that is seen as better if it is more intricate than others. On the contrary, any model should be replicative by other professionals but also one that they would themselves adopt given the same data and problem. So keep it simple, reduce the likelihood of disagreement and maybe even the client will understand the logic.

B. However, the model must portray the differences (and only the differences) in the property attributes, not only between the sales and subject properties, but between the sales properties themselves. Specifically, what are the differentials as perceived by the actual, or failing that, the theoretical buyer?

C. As a general proposition it is prudent to make a lot of small adjustments or discriminations rather than a few large ones. Consider the scientific techniques that deal with variance, where in one case a single adjustment of $100,000 is made and where 10 adjustments of $10,000 are made. The latter provides a smoothing process and avoids catastrophic outcome due to error.

Perhaps a more positive approach, rather than be concerned with how large the differences are, is to consider how close the properties are. This, after all, is the essence of identifying the set of comparable sales. The properties with $10,000 "differences" are the more comparable set than the ones requiring adjustments at the $100,000 level.

In the selection of attributes to score in the QP model the following principles are important.

1. An attribute difference not appropriately represented in the sales should not be used. For example, where all of the sales have a different

zoning to the subject. In such cases the adjustment for zoning would have to be made outside the QP model.

2. The attributes are inherent to the subject property.
3. Economic logic should be used in the allocation of scores.
4. Should scores have the subject in the middle of a range? This is probably not necessary, but it is not desirable for the subject to score at the end of a range by itself (or almost so). While not essential, generally try, at least initially, to move +/- from the centre of the adopted scale. However, interpolation should always be sought and extrapolation avoided – where attributes and scores of the subject are outside the scores of the sales.
5. Do not include attributes where all properties, including the subject, have the same score or value. In such cases this is a constant, not a difference. The valuation process, at this stage, is concerned with difference.

The scoring scale

The aim should be to keep the attributes and scores to as few as possible, but, at the same time the scores must fairly represent the differences between the sales and subject property attributes.

In the previous paper it was stated:

> *It is suggested that the initial scores be based on, 'better' or 'more than', 'typical', 'worse' or 'less than', using a 3-2-1 or 5-3-1 schema. Wherever possible the score descriptions should be unambiguous.*
>
> *Such a simple scheme is easily understood and reduces the likelihood of argument about varying degrees of 'better' or 'worse'. However, users of this technique, both in the USA and Australia report that finer gradings which are more subtle in describing differences sometimes give better results.*

Some further comment is offered.

A. While the initial thinking might be along the lines of 'better' or 'more than', 'typical', 'worse' or' less than', these notions should be replaced by objective criteria wherever possible to make the description positive and clear, and so reduce ambiguity and the opportunity to 'fudge'.

B. Use of zero. Where one of the properties does not have a feature but the others do then 0 can be used. Dilmore, (unpublished monograph) in scoring for the number and type of project amenities and then unit amenities, and using a schema of '11-9-7-5-3-1', 1 represented 'none'. It is not clear why a non-existent attribute would be given a positive and additive score, and in logic, this does not seem appropriate. In the case of a need to score an attribute on a yes/no basis, then consider using the mid-point of the range for 'yes' and a 'no' is given 0.

C. Early work assumed that 5-3-1 (or 5-4-3-2-1) would generally suffice, and, based on experience, this is still regarded as a good starting point, often giving quite adequate results. However, Dilmore has described a variety of ranges, based on experience and for different property types. In his apartment example he used six categories and has suggested a maximum of seven. Dilmore states this maximum is in keeping with general scientific practice, and that psychologists for example, have long since used a maximum of a seven-point rating scale, since attempts to increase the fineness of the analysis appeared to reach a point of diminishing returns. In Dilmore's experience, the same principle seems valid for attribute rankings.

D. Non-linear scaling. If linear works, use it. For example; 1-3-5-7 is a type of linear scale, while 10-12-15-20-26 is slightly non-linear. Use whichever works best but experience suggests that the linear type will generally work satisfactorily.

E. In 1984, Dilmore also advocated that a five-point scale of 26 = excellent, 20 = good, 15 = average, 13 = fair, 10 = poor, provides a better smoothing of differences in some cases where the differences within the attributes are not great.

F. Similarly, Marshall, (in commercial valuation modelling in Melbourne 2008), has found that moving from 5-3-1 to 10-9-8-7 provided a similar opportunity (and much better outcome) to express attribute differences.

G. Negative values are a difficult issue which remains unresolved. If the use of negative values in a scoring schema were contemplated then there is probably a requirement to include '0' say in a -1/0/+1 scale which suggests the middle of the range score has no value.

H. Where an attribute, considered by the valuer to be important, is given a 5% to 0% weighting by 'Solver' in the QP model, this does not mean that the attribute is necessarily unimportant. It probably simply suggests that there is insufficient systematic variation among sale properties for the attribute to **measurably add** to the explanation of variation in price. (Compare this with a weak regression variable and *adjusted* r^2.)

I. Like many phenomena it is possible to delve more deeply into those issues that cannot be as precise as a "yes/no" response. Moving from a 3-2-1 to 5-3-1 was believed to smooth out the score. It would appear that mathematically the opposite occurs. Using different scoring schemas on the same set of

attributes causes changes in output which can present a dilemma for the valuer. If the scores are constructed as relative differences around some sort of mid-point and the same mid-point is used for all attribute scoring schemas then this may lead to consistency and remove distortions. This could lead to a *standardised* scoring schema. However, this should not inhibit the use of different ranges to truly reflect the differences between the properties for any attribute.

J. A *standardised* mid-point might be centred on 1. A 10% difference either way, therefore suggests a 1.1-1-0.9 scale.

This would also allow a 1.1-1-0.9-0.8 scale, or a .1.1-1-0.95-0.8 if this would better rate or score the particular attribute of the properties. In the latter case while 1 is not at the middle of the range shown, it would be the number from which the others are chosen.

As any multiple of a scoring schema produces the same result, then using 100 or 10 might be more intuitively acceptable for valuations; perhaps 100, because of its direct relationship with 100%. However, to encourage the use of (generally) simplicity, particularly to reduce ambiguities, scores based on 10 may be more appropriate.

K. A refinement to this approach, that only requires a movement in **one** direction, would be to start at the high end of the range and to make this the 100% point; then work down from that high point to the lower valued score points based on the relative differences between the properties for that attribute. All other relevant principles would still apply.

The last step in building a valuation model is to carryout residual analysis of all **methods** or models developed.

The **ultimate test is to use the method that most consistently produces the best result**. This should be the model that produces the minimum residual values and which should appropriately reflect market reality.

2. References

The major references used by the writer in this series of articles are included as part of the article because of the extra information provided. Some comment is given on each reference as an aid to readers who may contemplate obtaining copies, where available, for their professional library and use. Wherever possible, means of accessing the materials are given where the author understands normal means of access, such as purchase, may not be available. Readers who have a question on any of these materials are welcome to contact the writer on **j4m8sq@bigpond.com**

A. Canning, George R.

1. *The Contemporary Direct Approach to Value*, The Canadian Appraiser, Winter, 2000.

2. *Putting it Right with* the Direct Comparison Approach, Canadian Appraiser Vol.49, Book 2, 2005

George Canning operates his own practice in London, Ontario and has written two excellent articles outlining the use in his practice of the Quality Points model using Excel SOLVER.

A direct link to the second article is: **https://www.aicanada.ca/images/content/file/Can_App_Vol_49_Bk_2_02-All.pdf**

B. Dilmore, G, *Quantitative Techniques in Real Estate Counseling*, Lexington, book (hardcover) 1981.

Dilmore provided the practical maturation of the QP model and before SOLVER had written his own computer program to find the optimum weights cited in Whipple. He gave freely of his time, papers and monographs and computer programs to Australian visitors. Google "Obituary Gene Dilmore" and enter the "Entrepreneur" site to judge his reputation.

C. eBay and the internet

Never overlook the internet for access to articles, purchase of current books and eBay for purchase of older and 'out-of-print' material.

D. Flaherty, J et al: *A Spreadsheet Approach to Business Quantitative Methods*, 1999. This is a second edition of *Quantitative Methods in Property,* 1996.

This 787-page text builds on the introductory Lombardo text (see 1 below) and was written for senior students and again uses the Excel spreadsheet methodology. Hard copies of the book are available although a start has already been made to transfer the contents (revised) to a free site on the web. To purchase or to peruse existing chapters (1 & 13) and other materials, go to http://www.spreadsheetmodels.com then, 'A Spreadsheet Approach to Quant methods'.

E. Graaskamp, JA: *The Appraisal of 25 North Pinckney: A Demonstration Case for Contemporary Appraisal Methods*, Landmark Research, Madison 1977

This classic monograph sets out the fundamental theory tempered with reality that builds on the earlier work of Ratcliff and then sets out a complete narrative valuation with margin comments by both the Valuer and an Editor. For access, see F. below.

F. Graaskamp, JA: *The Graaskamp Collection*, a 2CD-ROM SET. Wisconsin Real estate Alumni Association (WREAA).

These two CDs contain all of the academic written materials of Professor Graaskamp, including books, monographs, class notes and much more. The set contains the demonstration edition of 'The Appraisal of 25 N. Pinckney", cited at E. above and the Ratcliff book cited in J below. Google: "WREAA" for the CD set.

G. Graaskamp, JA: 1984 Australian Lecture Series in Real Estate Valuation and Investment Analysis.

Lecture No. 2 "Contemporary Appraisal – Market Comparison Approach" is a robust three-hour lecture which was presented widely in Australia and New Zealand. The 99-page hand out is available in the two-CD set. The author and RMIT University have CD audio copies of the lecture.

H. *James Graaskamp Landmark Research Digital Collection*.

This web collection of 170 professional reports by Graaskamp's consulting firm, Landmark Research Inc, consists mainly of appraisals, or valuations, demonstrating many of the concepts and techniques presented in this series. This is a rich source of material that demonstrates intellectual rigour and excellence in report writing. Google 'Landmark Research Collection', then 'Browse'

I. Lombardo, R: *Property Data Analysis* – A Primer, 2006 Draft of 2nd ed. School of Property, Construction and Property Management. 1st year undergraduate on-line text for Property, Valuations and Project Management students, RMIT University.

This 480-page text was written specifically for first-year undergraduate students at RMIT with the analysis software being based on Excel. For access to this text or three chapters of relevance to these articles, contact the writer on **j4m8sq@bigpond.com**

J. Ratcliff, R U: *Valuation for Real Estate Decisions* (Democrat Press, Santa Cruz, 1972). Reprinted in J A Graaskamp (Ed): *Ratcliff Readings on Appraisal and its Foundation Economics* (Landmark Research, Madison 1979)

This publication contains the complete text of Ratcliff's re-appraisal of valuation theory and includes the first outline of what is called the QP valuation model. For those sceptics wedded to the traditional concepts and techniques, this is an enlightening read. For access to the latter publication see F. above.

K. Reed, RG: Ed., *The Valuation of Real Estate* – particularly the Appendix, 2007, Australian Property Institute.

This is a comprehensive introductory text. There is a useful coverage of basic statistics including regression in the Appendix.

L. Squirrell, MD, Marshall, JR and Milne RA: Various lecture and workshop papers 1978-2008 and professional valuations 2007-2009.

While these materials are not 'published', the lessons from the field use of the concepts and techniques have provided important experiential material for these articles.

M. Squirrell, MD, *Uncertainty in Real Estate Decisions*, The Valuer, 28:375-86 (January 1985), and, in "*Readings in Property Economics*", AIVLE now API 1997.

This is a 1979 literature review of fundamental risk concepts in real estate and gives an overview of strategies to measure and control the phenomena. The third part focuses on the risk issue in valuations and makes the case for reality in reporting valuation outcomes as a range.

N. The Appraisal Institute (USA)

1. Fisher, C Jr: *Mathematics for Real Estate Appraisers*, 1996.

This is a useful slim (40 pages) volume dealing with basic mathematics for valuers covering uses under algebra, geometry/ trigonometry, finance, statistics with a final piece on problem solving.

2. Linne, M, Kane, S and Dell, D. *A Guide to Appraisal Valuation Modeling*, 2000.

This 95-page booklet provides an introduction to statistical techniques and their adaption from mass appraisal to their usefulness in the singe property valuation case. About half the book is devoted to regression analysis. The authors have written for practitioners, avoiding the use of academic approaches to the teaching of the concepts and techniques.

3. Kane, S, Linne, M, Johnson, J. *Practical Applications in Appraisal Valuation Modeling*, 2004.

This 200-page book by the same authors builds on the earlier Guidebook and delves deeper into statistical concepts and techniques that a valuer might consider.

These three publications are available from The Appraisal Institute from their website (www.appraisalinstitute.org).

O. Whipple, RTM: *Property Valuation and Analysis*, 2nd Edition, Law book Company, Sydney 2006 (& 1995).

This book was reviewed by the writer in the March 2009 edition of the *A&NZ Property Journal*. I repeat my last two sentences from that review: "It is the reviewer's strong opinion that this is the preeminent book for serious practising valuers operating in a "western economy" and "This is a required book for the senior valuation student to study and for the practicing valuer to advance."

3. Reports and reporting requirements

Australian Property Institute (API) members should generally follow the principles contained in the *Australian and New Zealand Valuation and Property Standards.* However, parallel to these standards, the following are suggested fundamental principles and rules that should prevail for valuation reports:

- Only include 'relevant to the issue' material in a report.
- Keep asking yourself 'so what?' and if still relevant, answer this question in the report.
- Follow a logical sequence. A valuation report moves from the general to the particular – it should systematically lead the reader to the conclusion.
- Call all 'non-narrative' inserts 'Exhibits' and sequentially number them. Place them in the report 'asap' after their first reference in the report (not in the Appendix). A business report does not include 'treasure hunts' to find photos, plans and other material shown as Exhibits.
- Appendices. Should only contain bulky material. A good rule is that if the materials are more than two pages, then summarise/extract for use in the body of the report, perhaps use this as an "Exhibit" in the main body of the report, and place the original in the Appendix.
- Map and Plan Exhibits must always have: a heading, scale (or 'not to scale') and, a N or direction point or arrow.
- More than one 'typographical error' may suggest the content was carelessly composed as well.
- Use summaries to show how the data and information is drawn together to reach a conclusion. The following are three such tables that would be expected in the report where the QP model is used. These would be supported by relevant exhibits showing graphs as appropriate.

A suggested report outline (relevant to a typical complex valuation)

This report format would be more suited for properties that are being sold, purchased or for mortgage valuations. Some changes may/will be required for rental, financial reporting, insurance or compulsory acquisition valuations.

Transmittal letter

(Includes street address, purpose of valuation, value conclusion and range including. sale terms, critical assumptions and limitations, any suggested further use or action)

1. Executive Summary
   - 1.1. Instructions
     (Recital of instructions, date, source etc.)
   - 1.2. Purpose of Valuation
     (Reason for valuation)
     (Relevant definition of value)
   - 1.3. Property Address

Summary of primary unit selection

Unit	Coefficient of Correlation r	Coefficient of Determination r^2
$/m^2 of site area		
$/m^2 of GLA		
$/m^2 of NLA		
$/m^2 of frontage		
$/m^2 of land & buildings		

Comparison of valuation methods for predictions

Measure Mean	Quality Points	Regression
Low		
Predicted Value/Price		
High		(-)
Std. Deviation		(-)
Range - 1 Std Deviation	(-)	
Std. Error of the Estimate	(-)	
Range - 1 Std. Error		
Coefficient of Variation - COV (or)		
Coefficient of Deviation - COD		

(-): no entry – statistic not available

Comparison of valuation models on sales

Measure	Mean Quality Points	Regression
Absolute Total of Variance		
Total (actual) Sale Prices		
% Variance		
Mean Absolute Deviation		
Coefficient of Variation - COV (or)		
Coefficient of Deviation - COD		

1.4. Registered Proprietor

(Detail of legal interest being valued)

1.5. Occupier

(Including summary of any lease or leases)

1.6. Title Details

1.7. Encumbrances

(Summary of any encumbrances registered on title)

1.8. Property Details

(Brief summary of property, improvements etc.)

1.9. Planning

(Summary of statutory planning framework as it affects subject property)

1.10. Date of Inspection

1.11. Date of Valuation

1.12. Valuation Rationale

(Summary of approach to valuation including summary of primary valuation methodology & supporting methodology)

1.13. Valuation

(Include preamble: "This valuation summary forms part of and should not be used or read independently of this report in its entirety")

Valuer's Signature

Valuer's Qualifications

Report Date

2. Instructions

2.1. Background and Brief

(Recital of instructions, date, source etc.)

(Append full Copy of Instructions as Attachment #1.)

2.2. Purpose of Valuation

(Background & context of valuation – from instructing party's' perspective)

(Outline of what valuation is going to be used for: "This valuation has been prepared to ……..")

2.3. Definition of Value

("For the purpose of this valuation the most appropriate definition of value is, "……..")

(State critical assumptions, assumed terms, treatment of permits etc.)

3. The Subject Property *(Legal Description & Parameters)*

3.1. Property Address

3.2. Site Dimensions & Area

3.3. Proprietor

(As shown on title and including detail of legal interest being valued)

3.4. Occupier/Lease details

(Lease history, including past performance, implications)

3.5. Title Details

3.6. Encumbrances

(Detail easements, mortgages, leases, etc registered on title)

3.7. Caveats

(Details of any caveats registered on title, implications.)

3.8. Unregistered Encumbrances

(Detail any potential encumbrances not shown on title such as occupiers outside of lease arrangements, access to other property over title etc and implications)

4. Statutory Planning *(Legal Description)*

4.1. Zoning

(Reference Attachment #...; Extract of relevant Planning Scheme)

4.2. Planning Overlays

(Reference Attachment #...; Extract of relevant Planning Scheme)

4.3. Existing Permits

(Detail any existing Planning Permits which exist on property, including comment on compliance with Permit Conditions)

4.4. Current Use

(Include comment on compliance with statutory framework)

4.5. Rezoning potential/Permit applications

(Comment on any existing applications which may be in place for rezoning or planning permits)

(Comment on any potential for rezoning or higher and better use via planning permit application)

5. Property Description *(Physical Attributes)*

5.1. Location

(Macro view of location, relationship to key nodes etc)

5.2. Site Description

(Frontage, depth, shape & topography)

5.3. Current Use

5.4. Structural Improvements

5.5. Other Improvements

(Fencing, paving, car parking, pasture, rural improvements etc.

5.6. Fixtures Fittings & Chattels

(Detail treatment of fixtures, fitting and chattels in valuation: included or excluded in valuation? Schedule as appropriate)

5.7. Surrounding Development & Land Use

(Detail surrounding land use & quality of surroundings)

5.8. Linkages & Attributes

5.8.1. Linkages

(Transport & connectivity considerations)

(Relationship with adjoining properties and other linked properties and uses)

(Exposure – from the site, views, aspect, outlook.

5.8.2. Dynamic Attributes (Psychological responses & perceptions)

(Perceived amenity)

(Socio-economic considerations)

(Perceived quality of location)

5.8.3. Environmental Attributes

(Physical factors such soil, sub-ground conditions, water table etc.)

(Contamination)

(Economic, social ethical & political context)

5.9. General Market Conditions

(Macro level consideration of market & trends)

5.10. Alternative Use Scenarios & Development Potential *(If relevant)*

(Political constraints & opportunities)

(Summary of alternative scenarios)

(Selection of most probable scenario)

5.11. Adopted Highest & Best Permitted Economic Use

(Alternatively Most Probable Use)

(Rationale for selection & detail any assumptions made)

6. Valuation Methodology

6.1. Most Probable Buyer

(Consideration of profile of most alternative purchasers)

(Profile of most likely buyer)

6.2. Market Evidence

(Basis of selection of relevant evidence, show photo and sale & property details of Comparable sales used.)

(Considerations if normative *economic approach being used)*

6.3. Primary Valuation Approach – including valuation rationale.

(Outline of technique)

(If relevant - Selection of primary unit of comparison, including R2 test)

(Detail application of technique)

(Indicated range of value from this technique as well as indicated value or most probable price)

6.4. Supporting Methodology

(Outline of technique)

(If relevant - Selection of primary unit of comparison, including R2 test)

(Detail application of technique, answer "Will it work")

(Indicated range of value from this technique as well as indicated value or most probable price)

(The Primary Methodology or Supporting Methodology should include a consideration of a Quality Points approach with a clear rationale as to why – if it has not been applied or adopted as one of the relevant primary or supporting techniques)

6.5. Adopted Value

(Including a reconciliation of any conflicting indicators from primary & supporting methodologies)

(Assessment of most probable price and/or (fair) market value, within a defined and supported range – if relevant)

7. Valuation

7.1. Valuer's Interest

(Statement confirming independence & absence of conflict of interest)

7.2. Date of Inspection

7.3. Date of Valuation

7.4. Limiting Conditions & Key Assumptions

(Check measurements & survey)

(Native Title)

(Contamination)

(Report Reproduction)

(Third Party Use)

(Life of valuation)

(GST Treatment)

(GST Assumption re: market evidence)

(Reliance on provided information)

(Assumed terms)

(Development potential assumptions/ permit assumptions)

(Assumptions regarding any costs)

7.5. Valuation

(Assessment of most probable price and/or (fair) market value within a defined and supported range – if relevant)

Valuer's Signature

Valuer's Qualifications

Report Date

APPENDICES

#1 Copy of Instructions

#2 Copy of Title

#3 Planning Scheme Extracts

#4 .....etc

4. Reporting the value conclusion

Introduction

Valuers have typically been trained to report a single-figure outcome. Many valuers are troubled when the suggestion of reporting a range is raised and often retreat from discussion with, but 'our clients only want a single figure' or 'many of our clients only read the summary'. However, these arguments should not be used as a justification to avoid addressing this fundamental valuation issue when appropriate.

It may be that the concept of 'one value for all purposes', articulated by Dr Murray in *Principles and Practice of Valuation*, suggests that a range should not be reported, or perhaps even avoided or not recognised. The writer strongly supports this concept of 'one value for all purposes' on both moral and ethical terms. However, if you change any aspect of the definition of value, or your analysis does not reveal (effectively) only one single number, then reporting a relevant value range with argued reasons does not violate the basics of this principle. This issue was addressed in the first paper in this series.

There are numerous court cases in Australia that allude to the reality of a value range outcome that valuers experience. The reader is referred to the short extracts from cases to be found in Rost & Collins at Chapter 4, third edition, page 100:

Henderson v. Liverpool Plains Shire Council, Robson & Jarvis v. Minister of Education (SA), and The Valuer-general v. Fenton Nominees Pty Ltd. and, from Page 551: The Commissioner of Succession Duties (S.A.) v. Executor Trustee and Agency Co. of South Australia.

Again, in previous papers in this series (first and third) the issue was canvassed and the reporting of a range advocated, when appropriate. In the first paper the following comment was offered.

5. Reporting a Range.

It is rare for a valuer to be able to state with 100% certainty the value or price prediction of a property, and that even after the most meticulous sale price adjustments

to standardise sales data to the subject, the same (adjusted) price does not result for each sale property. Further, it may well be relevant for a range to be explicitly sought as different terms and conditions of sale are examined.

Occurrence of Ranges

1. Ranges may result (after proper and thorough analysis) because the differences between the identified attributes are either not recognised, and/or, the appropriate adjustment/s, have not been made. This may be due to a paucity of market information.

2. The terms and conditions of the sale are not fully known. Privacy laws are increasingly exacerbating this problem.

3. The 'vagaries' or 'imperfections' of the market. This refers to the 'chatter' of markets and the constant (at least of small) movements up and down of price levels that occur due to market imperfections , regardless of discernable 'trends'.

A property can have a different value or price on the one day due to different assumptions. This may happen due to:

A. Change in the terms and conditions of sale such as providing, or not, vendor terms that are more favourable than those offered/available in the open market for that property.

B. Changes in assumptions regarding future permitted use. Possible changes of this nature can be extensive both in number and in impact, particularly property with emerging development potential. In many cases the probability – often as perceived – of obtaining the necessary permissions will suggest a higher price than where the probability is very low.

C. Analysis of who the most probable purchaser might be may not reveal a degree of certainty sufficient to identify a purchaser or group of purchasers who will, essentially, purchase for the same use or purpose. Examples include purchasers who are investors and intend to rent, as against others who intend to own and occupy. This refers to a 'two-tiered' market and may require two different sets of comparables to be analysed (rather than a mix).

D. The presence of 'synergy' in a transaction often associated with a purchase of an adjoining property by an existing owner. For example, the sum of the value of an existing property and an adjoining property may be greater if in one ownership than if left in separate ownerships.

Expensive, developed and diversified property markets such as high-value residential property may produce few, and not very comparable, sale properties...

What should the valuer do?

1. Clearly establish the terms and conditions of the sale properties, and that of the subject property including its most probable (future) use and other emerging uses, and most probable purchaser or buyer class, where appropriate.

2. Carefully and explicitly state all assumptions around the terms and conditions of sale, the value/price and use definition, and where appropriate, alternatives to those that emerge during the analysis that the client should be made aware of.

3. Report different outcomes for different situations when appropriate.

Identifying the range

A. An aid (only) is to report ranges based on statistical measures such as the standard deviation or standard error as appropriate.

Care must be taken in adopting such ranges. In the case where the range is due to a relatively poor set of 'sales', then both experience and logic should show that wide measures of dispersion will produce a wide value range due to the poor quality and/or quantity of the sales data available. Such dispersion is not due to either the unexplainable 'vagaries' of the market, or, differences in the various assumptions that can or should be explicitly stated.

Expensive, developed and diversified property markets such as high-value residential property may produce few, and not very comparable, sale properties, creating difficulty in adjustment to the subject. The statistical range produced may be very wide, and even improbable and of little use. A more homogenous market, often available in other residential cases, may provide evidence of high quality with a tight statistical dispersion and provide a basis for constructing a range which the valuer can feel confident with. Common and intuitive sense must be applied.

The reality is that in most cases the valuer is not working with enough sales to be able to draw statistically based conclusions with confidence.

B. **Quality Points.** There is no clear reason why ranges generated by different assumptions on use, terms and conditions of sale and the like cannot be incorporated in the QP model.

If some of the comparable sale properties are sold with cash to the seller and others at reasonably similar vendor terms, then this feature can be tested as a scored

attribute, although if the terms of sale can be accurately ascertained, transactions can be standardised (converted to cash) 'above' (or before) the rating portion of the analysis. This is generally the preferred method as the terms of sale are converted to a finite number rather than scored (5, 3 or 1 etc.).

Similarly, where a 'two-tiered' market is identified then this feature can be treated as a scored attribute, but this may not be suitable to a particular valuation task.

What will be important in these circumstances is the careful evaluation of the measures of quality of the output and the economic logic of the differences and range revealed.

If differences in a sale attribute are so varied between the properties then adjustments outside QP on this issue may best be done to the sale prices before the QP analysis (see above).

C. While a. and b. above provide objective approaches, evidence-based experience is usually available to the experienced valuer.

D. If you get very wide ranges, look for scapegoats, rogue properties and eliminate them and repeat the analysis. It is usually prudent to eliminate 'out-of-line' properties from the analysis. However, if there are only a small number of sales, even those that appear to be 'out-of-line' may need to be given detailed consideration. The task is to seek an explanation for their divergence from the expected. If the explanation is not in the property's attributes, then it usually lies in the terms and conditions of the transaction or the buyer and seller motivations. There will usually be some explanation other than the 'imperfect market'.

The following is an interesting example of correctly identifying an apparent market anomaly. Market analysis undertaken by RM2 (valuation firm in Melbourne) of CBD development site sales in Melbourne identified one property which, although purchased as a long-term development opportunity, was primarily purchased for medium-term owner occupation. When included in the data set this transaction was an outlier – its inferior location did not seem to have the appropriate impact. The owner-occupation requirement or motivation of the purchaser compared to the remaining transactions (all pure long-term development opportunities) indicated a premium had been paid for the site.

E. There is a suggestion that where purchasers are assembling or consolidating the purchase of multiple sites to form a large development site from sometimes reluctant vendors that

the vendors seem to need the high end of any range or beyond to treat when they become aware that a 'site is being assembled'. I strongly suggest the value definition is incorrect – do purchasers want to buy a particular property in the market? Will the potential vendor understand the particular purchaser's pressures and motivations? *You can probably bet on this.* The particular potential purchaser's aspirations, etc., are too far away from the requirements of the 'fair market value' definition to be applicable when a site is being assessed in the context of a site assembly exercise. This can be an example of a classic mis-specification. Movement to a 'Most Probable Price' definition and approach would, or should, solve this dilemma. After all, the vendor is in a near monopoly position – at least in the short-term.

F. Residuals can provide useful information. If, when examined, a pattern is found in the residuals, it probably suggests there is another variable or attribute which has not been identified, or alternatively that the variables are not all properly measured in terms of the differences between the properties.

With more sophisticated statistical software programs such as MINITAB is available, the residuals ratios can be examined – particularly the 'standardised residual' for each sale (which is the residual divided by the standard deviation of each residual). Consideration can then be given to those with a standardised ratio of two or more, and those that now seen to be seriously 'out-of-line' can be discarded and then the model re-run. If there is still a problem it may be with both the weights and the attributes, and, **with integrity,** they can be examined and changed. However, to maintain integrity in the process it is important that relative rankings not be changed without very good reason, which cannot be simply to get a better statistical result!

In this analysis we are presumably dealing with sales that were not identified as being a problem during the prime unit choice analysis. That is, those outliers have already been discarded.

It is important to always ensure that all features of the subject which are scored are also found in the sales set.

... the weights adopted reflect those of the most probable buyer – always consider that perhaps the wrong 'most probable' buyer has been identified.

Also, it is important to be sure that the weights adopted reflect those of the most probable buyer – always consider that perhaps the wrong 'most probable' buyer has been identified.

G. Examine article headed "Uncertainty in Real Estate Decisions" cited above.

In particular, Section 111 of this article provides a more formal discussion by a number of prominent USA academics. Appendix B to the article is the definitive statement on transaction zones in valuations by Professor Ratcliff should be carefully read.

H. Examples of reporting a valuation conclusion as a range can be found in the valuations (appraisals) contained in the "Landmark Research Collection" available on the Internet as described under 2. REFERENCES, at H. *James Graaskamp Landmark Research Digital Collection*. Examples are shown at:

- Appraisal of 17–21 East Main Street.
- Appraisal of Post Office Annex.
- Appraisal of 25 N. Pinckney.
- An appraisal of 1 East Main, Madison, Wisconsin.

5. Regression analysis, including multiple regression analysis (MRA)

The third article in this series of four introduced the use of multiple regression analysis (MRA) as an objective valuation model in the case of the 'single property'' valuation. In discussing MRA the discussion was careful to do this within a setting of a framework of violations of important regression assumptions that real estate, in this context, will usually exhibit. Nevertheless, some guidance on avoiding or mitigating these impacts was offered. A recent Melbourne valuation using MRA was shown as an example. This passage continues that discussion.

Regression can work reasonably well for the valuer, even if only part of the total analysis is used, for example

A. Regression can identify non-market transactions in an objective and systematic way. One of the quality controls is to examine the residuals analysis, looking for properties that have large residuals or relatively large residuals. Some programs will quickly give standard deviations for each sale property when the model is applied to them. Such properties, that are not fitting well, now known as 'outliers', can be discarded and the model re-run and examined. In most cases a marked improvement can be expected.

B. Outliers or properties discovered so deep into the analysis presumably have a significant non-comparability feature(s) with the other sales. As the property has

been seen as comparable to get this far, it may well be found in the terms and condition of the sale transaction.

C. Regression can identify variables which are most useful as predictors of value, as discussed in the second paper in determining units of comparison.

D. Regression can estimate the collective cost of property with a high degree of reliability.

a. For example, regression can give a prediction of the likely total cost of an amalgamation or assemblage of multiple lots of a block with a high degree of reliability. Part of this occurs because of the impact of offsetting errors.

b. Regression can also be very valuable in estimating the total value of a community based on homogeneous property types. This can be useful in the local government area, though the pro-rata share to each property is a different problem where results using regression seem mixed.

E. Regression can identify value influences be they adverse or positive. For example, in a 1979 study of flats (R. Webster, RMIT University) in the Melbourne upper income suburb of Kew, an examination of the 'partial correlation coefficients' (between all variables) revealed that 'distance to shops' was strongly negatively correlated with price, though the other 'distance' variables had a positive relationship, as might usually be expected.

F. In residential, significant variables may be built around:

a) Living area in square metres – may explain (r2) up to 80% of the differential,

b) Location factor– consider use of a geo-code,

Note: Postcode numbers should not be directly used as a variable, though a 'dummy' could be constructed based on such locations, if relevant.

c) Quality Factor – consider a composite variable if necessary.

These three variables may often be expected to be highly cross-correlated. A way to overcome this is to multiply all three variables together, or to try other ways of combining them.

d) Other variables that might be useful include year built/improved, number of stories, utility spaces.

Multiple regression analysis can become very complex. For the practical valuer, the question to be asked is, does it reasonably work when applied back to the sales? MRA is rarely covered in first year undergraduate valuation studies. However for those valuers who have studied MRA after 'Statistics 101' and who understand the key issues, they should, when conditions are suitable, seriously consider its use, either as the primary method of valuation or as a check methodology.

Acknowledgements

The writer is particularly grateful to the following people who provided significant assistance in the preparation of this series of articles dealing with Objectivity in valuations.

Graeme Balfour, Deputy Valuer General for Victoria

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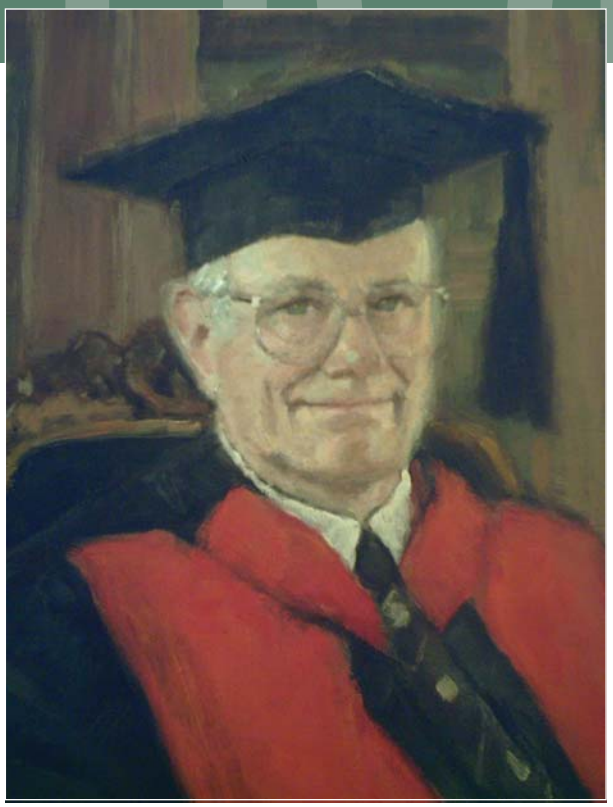
Ron Rogers, Urban Economist, Rogers Milne & Associates Pty Ltd

Robert Milne, Valuer, RM^2 Rogers Milne Marshall

John Marshall, Valuer technician. RM^2 Rogers Milne Marshall.

Naturally the writer takes full responsibility for all of the contents..

Emeritus Professor Doctor Reginald Thomas Milner Whipple LFAPI



It is with sadness that we report on the passing of Dr Tom Whipple, Life Fellow of the Australian Property Institute.

Dr Tom Whipple was both a leading property academic and author in the Western world and had been for some 25 years.

In 1949, he started his professional life by joining the Commonwealth Bank of Australia, where he gained experience in Mortgage Financing and Real Property Conveyancing.

... publications and significant papers ... too numerous to list ... are used in America, England and New Zealand as well as Australia.

For the next 15 years, he continued to explore real estate and real estate consulting, holding varying roles and positions that would allow him to travel to destinations in South-East Asia, South and East Africa, even Hawaii.

Dr Whipple was admitted as an Associate of the Commonwealth Institute of Valuers in July 1960. He was elevated to Fellow in February 1984.

His academic accreditation includes a Ph.D., Diploma and Master of Town and Country Planning, all of which were gained at the University of Sydney. His academic standing has been recognised internationally through being Visitor by Invitation to the University of Cambridge and Aberdeen, England and Visiting Fellow, Princeton University, New Jersey and the University of Wisconsin, USA. In 1982 he launched the Postgraduate Course in Land Economy and in 1989 was appointed as the inaugural Professor in Valuation and Land Economy at Curtin University of Technology, Perth. On his retirement from the chair academic recognition was granted by elevation to Emeritus Professor in 1998.

Published books include *Property Valuation and Analysis* 1995 and *Urban Renewal and the Private Investor* 1971. He also edited *Real Estate Valuation Reports and Appraisals, Accounting for Property Development and Commercial Rent Reviews – Law and Valuation Practice* for the Law Book company. Other publications and significant papers are too numerous to list, many of which are used in America, England and New Zealand as well as Australia.

Tom had been an active member of the Institute for many years. In particular he had been a member of a team that set up the Property Education Foundation and had served it as both Secretary and Member of the Board of Trustees.

Tom developed the Property Course in Western Australia to its current standard. He had done this by working closely with both the Institute and the property industry thus ensuring its current relevance. He had given unstintingly of both his time and knowledge and had always been available to give papers to Continuing Professional Development seminars and other occasions.

By his leadership and example Emeritus Professor Dr Reginald Thomas Milner Whipple had shown himself to be a worthy recipient of an Australian Property Institute Life Fellowship. ■

Land Acquisition – 6th Edition by Douglas Brown

Reviewed by Professor Chris Eves

Since 1972, Land Acquisition has been a leading text for both Australian lawyers and property professionals involved in the area of property acquisition and resumption throughout Australia.

The revised 6th edition continues the excellent work that the author has provided over the past 30 years. This is an important reference for both students and practitioners involved in the valuation of property that is being acquired or resumed for statutory purposes.

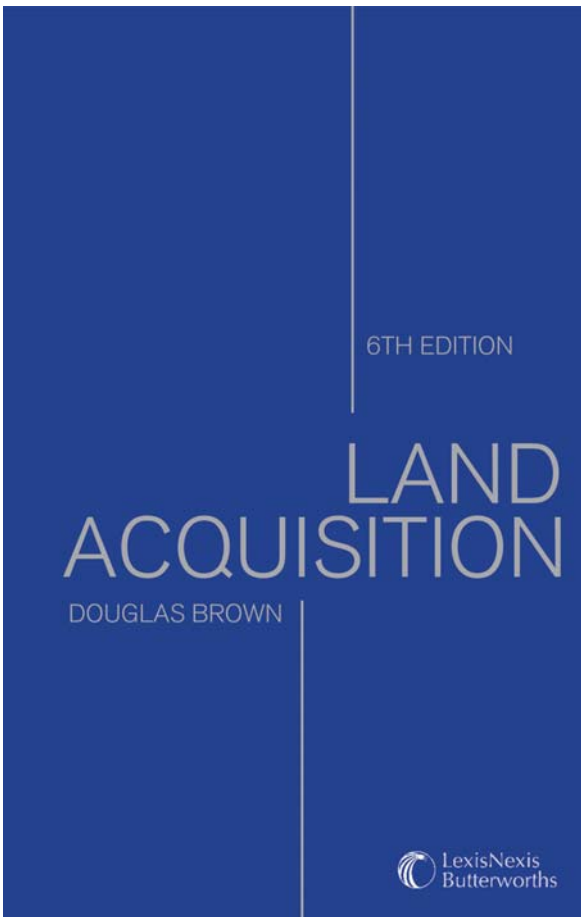
An important aspect of the book is the fact that the issues involved in this process are discussed generally and then also applied on a state-by-state basis, providing a very useful comparison of the different legislation and processes for land acquisition across Australia. Property acquisition issues are comprehensively covered, with a very practical and easy to interpret analysis of the past and recent case law associated with this area of property ownership and valuation.

There is a logical format to the book, commencing with acquiring property, and following with the procedures involved in the process of property acquisition, compensation issues and finally the very comprehensive coverage of the valuation issues associated with land acquisition.

The chapter on compensation would be of importance and interest to practising valuers, particularly those with a limited exposure to this area of property, and students due to the very thorough definitions and explanations of all the aspects associated with the determination of compensation in land acquisition.

For any valuer who is currently or proposing to practise in the area of statutory valuation and property acquisition, the final chapter of the book particularly provides the legal perspective in relation to the valuation of property for acquisition purposes. This chapter covers a range of topics including valuation inspection matters, reports, valuation methodologies and issues of liabilities.

This is an easy to read and follow text and provides a very comprehensive and informative overview and analysis of the compensation and valuation issues associated with land and real property acquisition in Australia. As the text addresses the statutory and legislative requirements for all states, as well as the Commonwealth, it is suitable for all Australian-based valuers. The text is recommended for all valuers working in areas that deal with land acquisition and resumption, as well as students studying these units at university. ■



Legal Notebook

Recent cases, headline issues and new legislation

Dr John Keogh
Barrister at Law

Dr Keogh commenced practice at the NSW Bar in 1990 with a focus on property, planning, building and construction law and commercial matters and was awarded a law doctorate from UTS in 2000.

A classic successful case in Adverse Possession

~ SUPREME COURT OF VICTORIA – COURT OF APPEAL ~

Whittlesea City Council v Abbatangelo [2009] VSCA 188 (31 August 2009)

The main issue in this case was whether the trial judge had erred in finding that the Respondent had acquired good title by adverse possession to a parcel of rural land situated at Mernda in Victoria. Whittlesea City Council was the "paper owner" of the land. The Court of Appeal, constituted by Ashley and Redlich JJA and Kyrou AJA, found that the trial judge's decision was correct and dismissed the appeal.

The Facts

The subject land ("the Land") is approximately half an acre in size and was originally Council land. The Respondent and her husband purchased the adjacent five acre property in 1958 ("the Respondent's property").

At the time of the purchase the boundary fencing of the Land was situated on its title boundaries. The Respondent repaired the fence from time to time and eventually removed the fence on the eastern boundary of the Land. Furthermore, they installed a gate in the northern boundary fence of the Land, sufficiently wide to permit access by a vehicle. The Respondent used the Land for a number of purposes, including grazing livestock.

The Respondent and her family lived in Geelong during a five-year period (1970-1975), awaiting the construction of a house on the Respondent's property in Mernda, but they returned on weekends to feed and water the stock which they had left behind on the Respondent's property and on the Land. When the house was completed the family returned to Mernda.

The path to litigation

In 2004 the Respondent learnt that the Victorian Government planned to introduce legislation to abolish adverse possession claims against land owned by councils, thus, she instructed her solicitor to advise the Council in writing that she would be making an adverse possession claim in respect of the Land. The Council responded that it would vigorously oppose any application to acquire the land by adverse possession. Soon after, the Council erected a fence on the eastern boundary of the Land and installed a chain and padlock on the gate in the northern boundary fence. The Respondent removed the fence.

The Respondent commenced proceedings against the Council, seeking a declaration that she had acquired title to the land by adverse possession.

Acts establishing adverse possession of the Land

The Respondent relied upon the following acts as establishing adverse possession of the Land:

a) *installation of the gate;*

b) *maintenance of fences on the boundaries of the Land, including the southern boundary fence, without seeking financial contribution from the Council;*

c) *use of the Land for grazing, shade, shelter and at times enclosure of the variety of animals kept by the Respondent and her family from approximately 1960;*

d) *installation of the bathtub trough;*

e) *maintenance of trees and vegetation, including mowing of grass, and removal of noxious weeds and pests – foxes, snakes and rabbits;*

f) *the clearing of fallen timber and maintenance of a fire break;*

g) *the expending of money, and the provision of labour, to carry out the various kinds of work on the Land;*

h) *the holding, from the 1960s, of occasional barbeques and social gatherings on the Land;*

i) *the playing by the Respondent's children, grandchildren and extended family on the Land;*

j) *the construction of children's swings and a rudimentary cubbyhouse-like structure on the Land;*

k) *the removal of the fence on the eastern boundary of the Land in approximately 1986; and*

l) *use of the Land for sporting and recreational activities such as horse riding, archery, football, horse training, rabbit shooting, bike riding, 'paddock bomb' driving and cricket.*

Applicable Principles and Legislation

Legislation

The relevant Victorian Act in relation to adverse possession is the *Limitation of Actions Act 1958* ("the Act"). Section 8 "Action to recover land" of the *Act* provides that *"no action shall be brought by any person to recover any land after the expiration of fifteen years from the date on which the right of action accrued ...".*

> ***"Ordinarily, of course, enclosure is the most cogent evidence of adverse possession and of dispossession of the true owner."***

Section 18 "Extinction of title after expiration of period" of the Act provides that: "*... at the expiration of the period prescribed by this Act for any person to bring an action to recover land ... the title of that person to the land shall be extinguished.*"

As to when the right of action accrues, section 9(1) refers to the date upon which the person whose title stands to be extinguished "has ... been dispossessed or discontinued his possession", whilst section 14(1) provides that "[n]o right of action to recover land shall be deemed to accrue unless the land is in possession of some person in whose favour the period of limitation can run ('adverse possession')".

Case law

Ashley J (as his Honour then was), in discussing the relevant principles in *Bayport Industries Pty Ltd v Watson* [2002] VSC 206, added or highlighted the following additional points:

- *When the law speaks of an intention to exclude the world at large, including the true owner, it does not mean that there must be a conscious intention to exclude the true owner. What is required is an intention to exercise exclusive control: see Ocean Estates v Pinder [1969] 2 AC 19. And on that basis an intention to control the land, the adverse possessor actually believing himself or herself to be the true owner, is quite sufficient: see Bligh v Martin [1968] 1 WLR 804.*
- *As a number of authorities indicate, enclosure by itself prima facie indicates the requisite animus possidendi. As Cockburn C.J. said in Seddon v. Smith (1877) 36 L.T. 168, 1609: "Enclosure is the strongest possible evidence of adverse possession."*
- *Russell L.J. in George Wimpey & Co. Ltd. v. Sohn [1967] Ch. 487, 511A, similarly observed: "Ordinarily, of course, enclosure is the most cogent evidence of adverse possession and of dispossession of the true owner.*
- *"It is well established that it is no use for an alleged adverse possessor to rely on acts which are merely equivocal as regards the intention to exclude the true owner: see for example Tecbild Ltd. v. Chamberlain, 20 P. & C.R. 633, 642, per Sachs L.J.*
- *"A person asserting a claim to adverse possession may do so in reliance upon possession and intention to possess on the part of predecessors in title. Periods*

of possession may be aggregated, so long as there is no gap in possession.

- *"Acts of possession with respect to only part of land claimed by way of adverse possession may in all the circumstances constitute acts of possession with respect to all the land claimed ...*
- *"Where a claimant originally enters upon land as a trespasser, authority and principle are consistent in saying that the claimant should be required to produce compelling evidence of intention to possess; in which circumstances acts said to indicate an intention to possess might readily be regarded as equivocal ...*
- *"At least probably, once the limitation period has expired the interest of the adverse possessor, or of a person claiming through him, cannot be abandoned."*

In respect to the current matter, the Court of Appeal stated that the following factors were relevant:

a) *The reference to 'adverse possession' in s.14(1) of the Act is to possession by a person in whose favour time can run and not to the nature of the possession. The question is simply whether the putative adverse possessor has dispossessed the paper owner by going into possession of the land for the requisite period without the consent of the owner, with the word 'possession' being given its ordinary meaning. Whether or not the paper owner realises that dispossession has taken place is irrelevant.*

b) *Factual possession requires a sufficient degree of physical custody and control. Intention to possess requires an intention to exercise such custody and control on one's own behalf and for one's own benefit. Both elements must be satisfied by a putative adverse possessor, although the intention to possess may be, and frequently is, deduced from the objective acts of physical possession.*

c) *In considering whether the putative adverse possessor has factual possession, a court has regard to all the facts and circumstances of the case, including the nature, position and characteristics of the land, the uses that are available and the course of conduct which an owner might be expected to follow. Each case must be decided on its own particular facts. Whilst previous cases can provide guidance as to the relevant principles which are to be applied, they should be treated with caution in terms of seeking factual analogies by reference to particular features of a person's dealings with land. Acts that evidence factual possession in one case may be wholly inadequate to prove it in another. For example, acts done by a putative adverse possessor who lives next to the relevant property may sufficiently evidence a taking of possession, whereas those same acts may be insufficient if done by a person who lives some distance from the property.*

d) *The intention required by law is not an intention to own or even an intention to acquire ownership of the land, but an intention to possess it. The putative adverse possessor need not establish that he or she believes himself or herself to be the owner of the land.*

e) *A number of acts which, considered separately, might appear equivocal may, considered collectively, unequivocally evidence the requisite intention.*

f) *Statements about intention by a putative adverse possessor should be treated cautiously, as they may be self-serving. But whilst a statement by a person that he or she intended to possess land will not be enough in itself to establish such an intention, it may be relevant when taken in combination with other evidence suggesting an intention to possess.*

g) *Mere use falling short of possession will not suffice. In some circumstances, a person's use of land may amount to enjoyment of a special benefit from the land by casual acts of trespass and will neither constitute factual possession nor demonstrate the requisite intention to possess. For example, where vacant land abutted a putative adverse possessor's land, occasional tethering of the claimant's ponies on the vacant land, and grazing them there, and occasional playing on the vacant land by her children were held not to suffice. Use and enjoyment of a special benefit and exclusive possession are not, however, necessarily mutually exclusive, for exclusive possession will usually entail use and special benefit. Use and enjoyment of a special benefit, on the other hand, will not necessarily amount to exclusive possession.*

h) *There is no separate requirement that the use to which the land is put by the putative adverse possessor be inconsistent with the paper owner's present or future intended use of the land, as suggested by Leigh v Jack (1879) 5 Ex D 264…*

(i) *Whilst inconsistent use is not required, it may be a factor, where it is present, which is indicative of factual possession and of an intention to possess to the exclusion of the paper owner.*

The Court of Appeal Findings

The Court of Appeal held that the trial judge had acted correctly in finding that the Council's title to the Land had been extinguished by the Respondent's adverse possession.

> *"73 ... For the reasons which follow, the respondent demonstrated both sufficient acts of factual possession and a manifest intention to exclusively possess the land for the necessary period. On a tenable view of the evidence, actual possession with requisite intent was continuous from the early 1960s until 2004. But even if the better view was that possession was broken during the period when the [Respondent's family] resided in Geelong – that is, between about October 1970 and February 1975 – there was, we consider, continuous possession with requisite intent for more than 15 years from the time that they returned to Mernda. From that time, the [Respondent and her family] engaged in a process of reinforcing and building upon what they had previously done in relation to the land. On the basis that time began to run no later than the end of February 1975, the appellant's title was extinguished at the end of February 1990 at the latest."* ■

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