

BEFORE THE WELLINGTON
LAND VALUATION TRIBUNAL

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LVP. No 4/94

IN THE MATTER of the Valuation of
Land Act 1951

BETWEEN WARREN NIGEL
DIFFEY and SUSAN
MARIE DIFFEY

Objectors

AND THE VALUER
GENERAL

Respondent

Date of Hearing: 8 March 1996

Date of Decision: 8 May 1996

Counsel: The Objectors in person.

Mr M T Parker for the Respondent

RESERVED DECISION OF THE WELLINGTON LAND VALUATION
TRIBUNAL

INTRODUCTION: The issue in this case is whether, in assessing the capital value of a property, the Valuer General is required to take into account the existence of a lease which affects that property, and which therefore may impact on its valuation.

THE FACTUAL BACKGROUND: Mr and Mrs Diffey are the registered proprietors of a 4,627 square metre property at 7 Bisley Street, Palmerston North. It has an industrial zoning. In 1987 a building was constructed on the land. It consists of a five bay manufacturing workshop, with office, staff room and storage amenities. As from the 1 December 1989, the land and the building were leased to the New Zealand Railways Corporation.

The lease was commonly known as a "net" lease in that the tenant was responsible for all outgoings. The term of the lease was ten years, and the annual rent was \$54,000.00 per annum. The rental was to be reviewed every two years. The lease contained what is commonly known as a ratchet clause, ie on each rent review, the rent could not be reduced below the level payable during the preceding twelve months.

As a result of restructuring, the tenant, New Zealand Railways Corporation, vacated the premises in late 1991. It could not however, avoid its contractual responsibility to continue to pay the nominated rental for the next eight years. It sought to sublease the property, but it discovered that it would have difficulty in doing so at anything like the same rental which it had agreed to pay. It seems that either the market conditions which pertained at the time the lease was negotiated, had deteriorated; or the Corporation had agreed to pay an initial rental well in excess of market rates.

The current market rental for similar properties in Palmerston North was declining. In other words, whoever owned the property with this particular tenant, was virtually guaranteed a rental in excess of current market rates, for the foreseeable future, and possibly for the next eight years.

In the event, the Corporation was able to arrange a sub lease at a reduced rental. Although not relevant to the valuation exercise, it is pertinent to note that in the two sub leases which were entered into after 1 October 1991, the rental was reduced to under \$40,000 per annum.

In 1991, the Valuer General conducted the three year revaluation of the Palmerston North City. The effective date was 1 October 1991. The original assessed valuation for the property was as follows:

Capital Value	\$363,000
Land Value	\$136,000
Value of Improvements	\$227,000

The owners lodged an objection. They submitted that the Capital Value was too low. As a result, the property was re-inspected by the Valuer General who offered to amend the figures as follows:

Capital Value	\$390,000
Land Value	\$136,000
Value of Improvements	\$254,000.

The Objectors decided to continue with their objection. The Valuer General accepts that the original valuation was too low. He accepts that this Tribunal should amend the figures in line with his suggested amendments. He contends that any increase above that level is not warranted.

In this case, the Tribunal has had the benefit of hearing from two registered valuers. Ms F R Dalgety representing the Valuer General, and Mr-T H C Taylor representing Mr and Mrs Diffey. Each valuer has approached his or her task from a different philosophy.

The Valuer General accepts that a lease is not a charge within the meaning of S 2 of the Valuation of Land Act 1951.

"Land value", in relation to any land, means the sum which the owner's estate or interest therein, if unencumbered by any mortgage or other charge thereon, might be expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a bona fide seller might be expected to impose, and if no improvements (as hereinbefore defined) had been made on the said land:

However, in this particular case, the Valuer General considers that the actual contracted rental should not be taken into account in valuing the property, because it is so far ahead of the market rental. He takes the view that all commercial buildings should be assessed on the basis that they could potentially receive the appropriate and current market rental. In this way, there is no need to examine the leases, or lack of them. Each property is given a notional market rent (whether or not such rent exists or is paid), and is valued accordingly. In this way a measure of uniformity is obtained.

The valuation of each commercial property will therefore be a reflection of the property's age, size, situation, and sustainable rent. If a rental has been fixed which does not reflect market conditions, or if a building receives no rental at all, then any consequential valuations reflecting such leases or lack of them could produce substantially differing values in respect of similar buildings.

Ms Dalgety appears to have accepted that because of the existence of the current lease, with its long term, reliable tenant and high rental, an investment purchaser would probably be willing to pay something extra for the additional income which would be generated. She argues however, that such additional income is no longer a valid reflection of the market worth of the property. She suggests that as with all leases, the terms and conditions will change as will the circumstances of the parties. In particular she argues that the Tribunal should take account of the need for uniformity of values between comparable properties.

As to the latter point, Mr Parker concedes that the Valuation of Land Act does not specifically require uniformity of values in the context of a roll revision. The Tribunal takes the view that S 41 (4) cannot really be advanced as an argument to support any suggestion that comparable properties should have similar valuations. Furthermore, there is no provision in the Act to support the supposition that the existence or absence of any unusual lease provisions should be ignored.

It is also argued that a major reason for any roll valuation and revision, is for the purpose of rating. For this reason it is desirable to secure uniformity so that the rate burden falls equitably on all ratepayers. However it could equally be argued that a commercial building which is subject to quality leases, should have a higher value than a comparable building which is vacant and unleased. In such a case the rating burden would still fall equitably. As it happens, the Palmerston North District is rated on land values, so that any disparity in capital values is irrelevant. Counsel for the Valuer General points out that this system could be changed in the future.

Mr Taylor's argument is based on the decision in *The Valuer-General v Radford and Company Limited AP 172/89*, a decision of the Administrative Division of the Wellington High Court. In that case, the issue was whether the land value (and capital value) should be reduced by an amount calculated as the burden of the current leases. The maximum value of the property was as a redevelopment. For this to be achieved, nine shops would have to be demolished. Each shop was the subject of a lease which had a number of years to run. The valuer for Radford had estimated the cost of acquiring vacant possession in order to demolish the buildings. Each tenant would have to be paid a significant sum to surrender the lease. The Wellington Land Valuation Tribunal reduced the capital value by these amounts. Its decision was upheld by Justice Greig in the High Court. His Honour said at page 15;

"As I have said, what was required to be done was to value the owner's interest, that is to say the freehold interest affected, as it was, by the existence of the leases."

He had earlier in his judgment made other comments which in our view placed the interpretation of the Act beyond any doubt.

"What was the respondent's estate or interest? It was a fee simple, a freehold estate or interest in the whole of the land in that separate property. Without improvements and unencumbered by any mortgage or other charge it remains affected, from the point of view of realisation, by the leases. A bona fide seller offering for sale his freehold estate subject to these leases will realise or expect a sum, which takes into account the benefit or detriment of these leases. (Our emphasis). In my judgment, therefore, on a plain reading of the relevant definitions and section the valuer must take into account the effect of the leases so far as they have any effect on the expected realisable sum. That seems to be consistent with the assumption that the land, though notionally vacant and without buildings, is not restored to its primitive or primeval state but is subject to all the existing charges which may affect its value at the date of valuation....."

A lease, though a private contractual arrangement and not an environmental factor applying unilaterally and without any contribution by the owner is still a present feature or factor which needs to be taken into account."

This case is different because here the argument is that the lease enhances the value of the owner's interest. The Tribunal takes the view that as a matter of principle, there is no difference between taking into account the burden of a lease, or its benefit. The issue is whether the existence of the lease with its beneficial rental provisions should affect the valuation, or whether the Valuer General is right to ignore the actual rental and assess the property on the basis of its notional market rental.

The Objectors' argument is based on S 2 of the Valuation of Land Act 1951 which defines the capital value as follows:

"Capital value" of land means the sum which the owner's estate or interest therein, if unencumbered by any mortgage or other charge thereon, might be expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a bona fide seller might be expected to require;

The Tribunal accepts Mr Taylor's submission that in simple terms the Valuer General seeks to determine the market value which is synonymous with selling value. The VNZ document which accompanies the Notice of Valuation describes Capital Value in these terms:

"The Valuer-General's assessment of the market value of your property, without any chattels, if it had been for sale at the date of the valuation."

Any valuation which does not reflect the true market value would render the above statement meaningless. In assessing the capital value or market value, the Valuer General will take into account the willing buyer/willing seller principle. Mr Taylor's argument is that if the Valuer General ignores the details of a lease, then he excludes from his consideration an important part of the willing buyer/willing seller concept.

Mr Taylor points out that rating is not the only purpose behind the roll valuations. Roll values may be used for a variety of purposes including the raising of finance. If a willing buyer is looking at a commercial property there will generally be two options. One, to purchase it as an investment, and the other, to purchase it in order to occupy it. In either case, the details of any lease will impact on the price to be offered. Factors which the purchaser will take into account will include:

- Location
- Tenant Quality
- Lease Quality (including rent, term and conditions)
- Building Quality
- Use/Zoning
- Rent Level.

The Tribunal accepts that these aspects of the lease will have considerable impact on the price which the willing purchaser is going to offer, and which the willing seller will accept.

In those circumstances, it seems to us artificial, for any valuer to look at valuing a leased property on the basis of what it should be earning in rent, rather than what it is receiving.

We agree with Mr Taylor that in valuing the property, the Valuer General should have taken into account the lease over the subject property. In coming to this decision, the Tribunal has concerned itself only with interpreting the Valuation of Land Act, in the light of the binding authority in *Radford's* case.

In the light of this finding we have examined Mr Taylor's valuation bearing in mind the onus of proof contained in S 20 (8) of the Act.

- We accept that the valuation should be carried out using an investment approach. The property is owned as an investment and is most likely to be sold as one. The prevailing issues will be tenant quality, lease term, lease conditions, rental income, market rent, operating expenses, and the capitalisation rate.

At the hearing, Mr Taylor accepted Ms Dalgety's assessment of the market rental value at \$48,773.00 per annum as at 1 October 1991. Furthermore he accepted Ms Dalgety's assessment of the Capital Value of the property of \$390,000.00 if the contract rent was disregarded. Her assessment was arrived at by the capitalisation of the market rent at 12.5%.

Taking into account the benefit of the lease (including tenant quality, lease quality and rent quality), and in the absence of any contrary evidence on the method of taking such a benefit into account, we have adopted the formula used by Mr Taylor (after adjusting his capitalisation rate from 11.5% to 12.5%).

We have accordingly fixed the Capital Value at \$417,000 by the following method.

Accepted Capital Value (disregarding the contract rent) as at 1 October 1991		\$390,000
Plus Benefit of the Lease		
Contract Rent	\$54,000 pa	
Market Rent	<u>\$48,773 pa</u>	
Benefit	\$ 5,227 pa	

The capitalised benefit being the present value of \$435.58 per calendar month payable in advance discounted at 1.0417% pcm for the remaining lease term of 8 years and 2 months (rounded) \$ 27,000


Capital Value \$417,000

We apportion the Capital Value as at 1 October 1991 as follows:

- Value of Improvements	\$281,000
Land Value	\$136,000
Capital Value	\$417,000

At the hearing, Mr Diffey asked for costs. There is no provision in the Act which allows a Tribunal to award costs, and we do not intend to establish such a precedent. However, in saying this, we are of the view that this is a case where the objectors should be entitled to some monetary compensation from the Crown for the gross delays in having their case resolved. The objection was transferred to Wellington from Palmerston North on 1 February 1994. It came before the Tribunal by way of a pre hearing conference on 20 April 1994, when a fixture was requested for half a day. The fixture took place nearly two years later. There is no suggestion that this delay was caused or in any way contributed to by the respondent or the Crown Law Office. The delay arose because of the inability of the District Court, to schedule one of the two Judges eligible to chair the Tribunal, for a half day fixture.


E W UNWIN
Chairman, Wellington Land Valuation Tribunal


M SELLARS
Member