

**BEFORE THE AUCKLAND LAND
VALUATION TRIBUNAL**

LVP NO 014/01

IN THE MATTER of the Rating Valuations Act 1998

AND

IN THE MATTER of an objection pursuant to section 32 of
the Act

**BETWEEN VICTORIA PARK MARKETS
 LIMITED**

Objector

AND

AUCKLAND CITY COUNCIL

Respondent

TRIBUNAL

Chair:

His Honour Judge J D Hole

Members:

P J Mahoney, Esq
K G Stevenson, Esq

Date of Hearing:

13 and 14 May 2002

Counsel:

W G Manning for Objector
E J Child for Respondent

Date of Decision:

27 August 2002

DECISION OF THE TRIBUNAL

Introduction

[1] On 1 October 1999 the Council revalued the property known as Victoria Park Markets for rating purposes. As the Council had adopted the annual value system of rating it was necessary to determine the annual value of the property.

[2] Section 2 (1) Rating Valuations Act 1998 defines “*annual value*” as the greater of :

- (a) The rent at which the property would let from year to year, reduced by –
 - (i) 20% in the case of houses, buildings, and other perishable property;
and
 - (ii) 10% in the case of land and other hereditaments;
- (b) 5% of the capital value of the fee simple of the property.

Capital value is defined in s.2 (1) of the Act:

.....the sum that the owners estate or interest in the land, if unencumbered by any mortgage or other charge, 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.

[3] The statutory definition does not refer actual rent but a hypothetical rent. One hypothetical tenant is envisaged. It is anticipated that the rental will be for a term of one year.

The Property

[4] The property is a 8.1 hectare commercial site at the western edge of Auckland’s central business district. It is adjacent the suburb of Freemans Bay. Victoria Park and the Southern Motorway Viaduct are nearby. The site consists of an entire block of land bound to the north by Victoria Street West, to the east by the intersection of Victoria Street West, Drake Street and Wellesley Street, to the south by Drake Street and to the west by Union Street. The Freemans Bay shoreline was once located in this general vicinity and part of the site has been reclaimed from the Waitemata Harbour.

[5] The site was once used as a refuse incinerator plant. Later it became a City Council works depot. Many of the buildings from those earlier times remain today. A multilevel car park is situated at the eastern end of the site.

[6] For about the last seventeen years the property has been used as a destination shopping market containing a wide range of boutique, tourist, food and general retail premises. Some of the premises consist of indoor shops; others are outdoor stores. They are separated by uncovered courtyard and corridor areas and are surrounded by the parameter walls and buildings. The complex is well known and trades as Victoria Park Markets. The distinctive brick buildings and chimney constitute a local landmark and heritage feature.

[7] Unique features of the site include:-

- (a) The wide range of types of traders on the site, including small stall holders which would not be found in mainstream shopping centres;
- (b) The short term nature of many of the tenancies. Indeed, many of the traders simply have a licence to occupy a site on a month to month basis;
- (c) The layout and partitioning combines a mix of indoor and outdoor premises and common area;
- (d) The heritage character and historical significance of the site and buildings;
- (e) Traders generally focus on the tourist trade;
- (f) The site is limited by its nature and the design of existing buildings.

Valuation Methodology

[8] Annual value has long been used as a measure of valuation for rating purposes. One methodology for assessing this type of value is known as the “*profits basis*”. Both valuers in this case have used this method. The methodology is appropriate

where there is a need to ascertain the rental value of a property which is rarely or never leased; or where there is a lack of comparable rental evidence; or where the property is designed for a particular trading purpose and its value is dependant on the opportunity to trade and make profits; or where the profits are not dependant on the personal skill of a particular tenant.

[9] The methodology assumes the existence of a hypothetical head lessee/average tenant for the site (which is assumed to be vacant and available to be let) and seeks to determine, on the basis of the trading accounts available at valuation date, what rental bid would be made for the site. It is rent, not profit, which is the measure of annual value. However, the method recognises that in the absence of more direct evidence, the ability to earn profits can offer a useful guide as to the determination of a hypothetical rent.

[10] In adopting this method the valuer establishes the likely annual gross earnings a tenant would expect to receive from the property. The estimated gross earnings may or may not be identical to the actual gross earnings which are achieved. A deduction is then made for those costs and expenses (operational costs) which are the responsibility of the tenant. From the balance, an amount is deducted to reflect the tenant's share (his likely remuneration as well as compensation for risk). The balance equates to the amount which the tenant could offer to pay as rent.

[11] In New Zealand, the calculation of annual value requires the assessment of the gross annual rent and then allows for a statutory deduction of 20%. This statutory deduction is intended to account for the deduction of "*working expenses*". Accordingly, when applying this methodology in the New Zealand context one assumes that the tenant pays one global rent sum for the right to occupy the property, and is not separately responsible for rates, insurance and repairs. These are the responsibility of the owner.

Issues

[12] The issues which have arisen in this case are:-

- (1) What is the correct starting point for the assessment of revenue?
- (2) How much should be allowed for tenant's risk and profit?

(3) What expenses are properly tenant's expenses?

Starting point for assessment of revenue

[13] Under this head, there is approximately \$240,000 difference between the valuers. Mr Dean, the valuer for the objector, on 10 November 1999 (ten days after the valuation date) prepared an independent assessment of the property's total gross rental. He did not do this for the purposes of ascertaining its annual value. At that stage he was unaware of the possibility of these proceedings. The assessment was undertaken to determine the capital value of the property for its inclusion in the owner's accounts. After investigating the various tenancies he determined that the total gross revenue to be obtained from the property was \$2,332,741.00 per annum. From this figure he deducted an allowance for bad debts in the sum of \$25,826.00 leaving \$2,306,915.00.

[14] Coincidentally, the total gross income ascertained from the accounts to 31 March 2000 amounted to \$2,357,450.00 which after allowing for bad debts in the sum of \$25,826.00 left a balance of \$2,331,624.00. In these circumstances, Mr Dean decided that it was safe to use the figures mentioned in the accounts to 31 March 2000 as a basis for his assessment of revenue as at 1 October 1999.

[15] The Council submitted that the correct starting point was the accounts for year ended 31 March 1999. This was because these accounts were in existence at the valuation date; whereas the accounts to 31 March 2000 were not. The objector is correct in that any assessment must be made upon the basis of information which is available as at the valuation date. However, Mr Dean's use of the accounts to 31 March 2000 is understandable because of the proximity between the gross revenue shown in those accounts and that independently estimated by him on 11 November 1999.

[16] The Tribunal considers that the correct method of ascertaining the total gross revenue is to use information available to the valuer as at the valuation date. This includes Mr Dean's assessment as at 10 November 1999 (as the information from which his assessment was made was available to him as at 1 October 1999). As it happens this approach more accurately reflects the continuing downward trend in revenue as shown in the annual accounts over this period.

[17] By adopting Mr Dean's assessment of gross revenue, there is no necessity to take into account the extraordinary items which affected the revenue shown for the year ended 31 March 2000. These items include:

- a one-off payment of \$240,000.00 made by McDonalds when it bought its way out of a lease of one of the sites during the 1998/99 year; and
- the fact that as at 30 June 1999 part of what is known as the "destructor" building ceased to be used for rental purposes.

Tenants Profit and Risk

[18] Mr Dean thought that there should be an allowance of 15% of the total gross income less bad debts to allow for the tenant's risk and profit. Mr Mathers, the valuer for the Council, considered that 6% of his equivalent figure was appropriate. Mr Mathers suggested that the 6% represented a fee for rendering management services. He related this to management charges payable for large commercial investments including multi-tenanted office buildings and shopping centres. This is in contrast to the basis adopted by Mr Dean who submitted that the deduction is not solely for management but also should reflect the risk associated with the enterprise as well as the motivation to earn some profit. The Tribunal agrees with the objector that a hypothetical tenant is motivated by a desire to earn profit. This depends upon the generation of revenue and maintenance of costs. Neither is free of risk. Revenue, in particular, can be uncertain.

[19] Therefore one of the matters which should be considered in the tenant's risk for this particular property is the fact that many of the tenancies and licences are terminable upon one month's notice. Mr Dean, however, considered that because of the risk associated with monthly tenancies and licences, it was appropriate to suggest that the hypothetical tenant would convert them to annual tenancies and licences. To do this would involve a significant reduction in revenue; up to 50% in respect of the licences to occupy and 25% in respect of the more formal monthly tenancies.

[20] The Tribunal considers that this type of deduction (which is discussed in **Re Waite's Valuation** (1943) 3 MCD 110) is really part of the risk assumed by the hypothetical tenant. In these circumstances this factor should be included in the profit and risk allowance. Indeed, to some extent it is already reflected in the income

stream from which the total gross rental has been ascertained. This has been so for a long time.

[21] Other matters relevant to the assessment of profit and risk by a tenant are that:

- The tenant employs no capital in earning its income;
- The tenant assumes all the risks associated with the business enterprise;
- The tenant bears the property expenses; and that
- The hypothetical lease is for a term of one year. This is of significance as the evidence discloses a downward trend in income over recent years. If the term of the lease were longer then a higher profit and risk allowance would be appropriate.

[22] Taking these factors into account, and recognising the parameters of 6% (Council figure) and 15% (objector's figure) the Tribunal concludes that an appropriate allowance for tenant's profit and risk is 12.0% which is equivalent to 21.7% of net revenue.

Tenant's Expenses

[23] There was considerable debate between the parties about what should constitute the proper expenses of the tenant (as distinct from the expenses of the property owner). The practical reality is that this discussion achieved little. After allowing for bad debts, the expenses attributable to the tenant by the Council amounted to \$862,116.00 as at 31 March 1999. The objector's figure, based on the accounts to 31 March 2000 amounted to \$865,143.00. Both these figures included an adjustment for sewerage and other common charges which were presumably owner's expenses. As there is such a small difference between the two figures it is futile to examine the arguments in detail. Suffice to say, that for the purposes of assessing the annual value the Tribunal accepts the Council figure of \$862,116.00.

Calculation of Annual Value

[24] For the reasons set out above, the Tribunal assesses the annual value attributable to the property in the following manner:-

Gross revenue as at 1 October 1999	\$2,332,741
<u>Less</u> allowance for tenants risk/profit (including bad debts) – 12.0%	<u>\$ 279,928</u> \$2,052,813
<u>Less</u> tenants expenses	\$ 862,116
Fixtures and fittings (as agreed by parties)	<u>\$ 20,000</u>
	\$1,170,697
<u>Less</u> statutory deduction – 20%	<u>\$ 234,139</u>
Assessed annual value	\$ 936,558 =====

Capital Value

[25] There is no necessity to consider the calculation of capital value. The capital values assessed by both parties are less than the annual value set out above.

Judge J D Hole
(Chairman)