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IN THE HIGH COURT OF NEW ZEALAND
DUNEDIN REGISTRY

AP58/94

BETWEEN **WAIORAU HOLDINGS LTD**

Appellant

AND **THE VALUER-GENERAL**

Respondent

Hearing: 19 August 1996

Counsel: W D Alcock for Appellant
M T Parker for Respondent

Judgment: 15 OCT 1996

JUDGMENT OF CHISHOLM J and I W LYALL (Lay Member of the High Court)

This appeal arises from a Land Valuation Tribunal decision given on 14 June 1994. That decision disallowed the appellant's objection to the respondent's assessment of the Cardrona ski resort land value as at 1 October 1990. The respondent had set a roll value of $910,000 for the land. It was claimed by the appellant, as objector, that the roll value should have been $560,000.

The appellant claims that the respondent fell into error in the application of various valuation principles, and that the Land Valuation Tribunal, by affirming the respondent's valuation, also fell into error. During the hearing of the appeal the capitalisation of rental method of valuation received particular attention. The appropriate rate of capitalisation and the impact of land development on the calculation of land value were also extensively canvassed.

Cardrona Ski Resort

Cardrona is a major New Zealand ski resort. At the time of the revaluation it was the only commercial ski resort known to be held under freehold tenure. It comprises 630.4788 hectares on the southern slopes of Mt Cardrona, Central Otago, approximately 57 kilometres from Queenstown and 33 kilometres from Wanaka. Access is achieved by way of a 12.5 kilometre private access road leading from Crown Range Road. At the time of the revaluation the ski resort was zoned *Recreational S* under the Queenstown Lake District Scheme. This was a separate zone covering existing ski-fields.

The ski-field was originally established by a partnership during the 1970's. In 1985 the land was transferred to a company to pave the way for a public float. In July 1988 terms were agreed for the sale of the ski-field as a going concern. Final settlement of that sale took place on 31 December 1989.

Although the 1988 agreement for sale and purchase was not produced to the Land Valuation Tribunal by way of evidence, it is plainly a relatively complicated document or series of documents. In broad terms the evidence indicates that 50% of the shares in Waiorau Holdings Limited were purchased initially and that such sale was coupled with an option to purchase the remaining shares by 31 December 1989 at a price reflecting 1988 and 1989 trading results. The option was duly exercised. The final price of the total business including freehold land, as a going concern, was $9,780,000.

Within the ski resort industry this was a unique transaction because the sale included freehold land. Final settlement of the sale occurred nine months before the roll revaluation of the Queenstown Lakes District as at 1 October 1990. It was accepted by both the appellant and respondent that this transaction had been at arms length.

Land Valuation Tribunal Decision

The Tribunal expressed the view that the difference between the valuers on each side was "largely one of simple arithmetic within the methodology applied by each of the Valuers". It noted the absence of comparable sales, that the sale of the Cardrona ski-field was the only sale available to the valuers, and that the valuers had placed considerable emphasis on the capitalisation of rental method of valuation.

As to the capitalisation of rental method, the Tribunal noted that disagreement between the valuers was confined to the capitalisation rate to be applied. The Valuer-General considered 12% to be the proper rate, and the objector 17.57%. The Tribunal attributed the difference between the valuers to their different assessment of the "risk factor".

In the Tribunal's view neither valuer had been able to offer conclusive evidence as to the appropriate risk factor. But it preferred the respondent's approach that:

> "12% is an appropriate return for a land owner who does not have to take all the risks associated with the operation of the ski-field but does not have a risk-free investment, as the rental is based on turnover, and will therefore vary according to the quality of the snow season. The land owner does not have to expend money at the beginning of each ski season to prepare the field, for what an operator would normally hope would be a good season and therefore his risks are lower."

It followed that the Tribunal accepted the respondent's rate of 12%.

Having regard to the absence of comparable sales evidence, other than the one sale of the subject property itself, the Tribunal accepted that consideration of alternative valuation methodologies was appropriate. It noted that the respondent's valuer had utilised three different methods when assessing land value and had adopted the most conservative outcome based on the built-up land value method. Such an approach was expressed by the Tribunal to be "acceptable and fair".

The Tribunal commented that it was well aware that a fair and equitable base for rating and other purposes depended on consistency and uniformity. It said that an amendment to the Valuer-General's assessment "without very good cause, could well lead to considerable distortion with long reaching effect within a particular region". Bearing that in mind the Tribunal concluded that the objector had not persuaded it that the respondent's assessment was wrong and confirmed the respondent's assessment of the land value at $910,000.

Issues Between the Parties

As the appeal progressed it became apparent that the issues between the parties were relatively narrow. To some extent they had crystallised following the Tribunal's decision. But neither party accepted that the differences between the two valuers came down to simply a matter of arithmetic; the differences went considerably deeper and involved issues of valuation principle.

In some respects the parties were on common ground: they agreed that there were no comparable sales; that the only market evidence directly applicable was the evidence arising from the sale of the Cardrona ski resort itself; that in the circumstances utilisation of more than one method in arriving at a valuation was understandable and appropriate; that the appropriate rental rate for the purposes of the capitalisation of rental method of valuation was 2.5% of gross turnover; and that the overall capitalisation rate reflected by the Cardrona resort sale worked out to 17.57% for the *total* transaction.

There are two primary issues. The first such issue concerns the capitalisation rate to be applied. An inter-related issue about whether a lower risk factor should apply to the land only, or whether there should be a common global risk factor for all components of the ski-field resort, also arises. The second primary issue concerns the impact of land development on the calculation of "land value", as defined by the Valuation of Land Act 1951 ("the Act"), pursuant to the capitalisation of rental method. The ultimate issue is, of course, whether the appellant has discharged the onus under s20(8) of the Act of showing that the respondent's roll valuation was wrong.

Approach of Valuer-General

Mr Sheppard's evidence before the Tribunal on behalf of the respondent indicates that he used three methods in arriving at a land value of $910,000: a capitalisation of rental method; a built-up land value method; and a comparison method.

Capitalisation of Rental Method

A facsimile from the respondent to the appellant dated 4 December 1990, which forms part of the evidence, indicates that initially Mr Sheppard used a gross turnover figure of $4 million, a rental factor of 2.5%, and a capitalisation rate of 10%, which pointed to a land value of $1 million. The facsimile expressly stated that the land value arrived at by that method "includes development expenditure of $500,000".

By the time of the hearing before the Land Valuation Tribunal, the gross turnover figure used by the respondent had been reduced to $3,650,000 which equated with actual turnover as then ascertained by the Valuer-General through the appellant's valuer, Mr Laing.

The agreed rental rate of 2.5% produced a notional rent of $91,250. The calculation had, however, been further modified, first, by increasing the capitalisation rate from 10% to 12% and, secondly, by adding development expenditure of $500,000. The calculation was:

Capitalised rental $91,250 @ 12% = $760,000

Add Land Development expenditure $500,000

Indicated Land Value $1,260,000

Mr Sheppard considered that a capitalisation rate of 12% for the land as a separate component was necessary to reflect a lower risk factor in respect of the land. According to his evidence before the Tribunal this stance was not inconsistent with his concession that 17.57% was appropriate for the total business including the land. He considered that the land component should attract a lower risk factor, and that a global approach for the total business, including land, was inappropriate.

The addition of land development expenditure as a separate item was explained by Mr Sheppard on the basis that the capitalised rental figure of $760,000 reflected nothing more than undeveloped land or, expressed differently, land excluding improvements. Accordingly it was necessary to add the value of any development work which fell within "land value" as defined in the Act. He considered that $500,000, being 50% of land development expenditure, fell into this category. Accordingly that amount was added to the capitalised rental figure to arrive at "land value" by the capitalisation of rental method.

Built-up Land Valuation Method

This approach involved the base rural value of the land as the starting point followed by the addition of ski resort resource consent costs plus land development costs. The calculation was:

Base rural land value @ $50.00/ha $31,500

Plus Resource consent costs $375,000

Plus Land Development costs $500,000

Indicated Land Value, say, $910,000

Since this was the lowest land value indicated by the three methods, it was chosen by the respondent as the land value for the purposes of the 1990 revaluation.

Comparison Method

The comparison method was based on the Mt Hutt ski-field in Canterbury. From a 1990 Mt Hutt figure for land excluding improvements agreed during arbitration, Mr Sheppard arrived at a "skier day" value of $6.20 by utilising Mt Hutt statistics over four years prior to 1990. He then applied that "skier day" value to Cardrona after he had arrived at the Cardrona "skier days" by using statistics for that field over four years prior to 1990. This led to a figure of $600,000 for Cardrona in respect of land excluding improvements. His calculation was:

Land Excluding Improvements $600,000

<u>Plus</u> land development $500,000

Indicated Land Value $1,100,000

Again 50% of land development expenditure was added to reflect the added value arising from that expenditure.

<u>Approach of Appellant</u>

The capitalisation of rental approach was central to the analysis conveyed by the evidence of Mr Laing, the appellant's valuer. He considered that the Cardrona ski resort sale was unique because the sale included freehold land. His analysis of the sale transaction indicated a profit earnings ratio of 17.57% before tax. He considered this to be the overall capitalisation rate reflected by the sale of the business, and in this respect he and Mr Sheppard are in accord. His calculation was:

Gross operating and other revenues $3,650,777

Notional Rental being 3,650,000 x 2.5 = $91,269

Capitalised at 17.57% $519,459 = say $520,000

He then rounded the figure up to $560,000 "to allow for variations which could occur in the market's approach to an assessment".

Mr Laing did not accept that there should be a separate, and lower, capitalisation rate for the land. Nor did he accept that it was appropriate to add land development expenditure as a separate component when arriving at a value by the means of the capitalisation of rental method. He considered that any increase in value by way of land development expenditure had already been reflected in gross turnover and that the capitalisation of rental calculation did not produce the value of land exclusive of improvements but in fact produced "land value" as defined by the Act. He considered that Mr Sheppard's approach had taken into account the added value arising from land development expenditure twice.

Capitalisation Rate to be Applied

As mentioned earlier, two separate but inter-related issues arise in respect of the capitalisation rate. First, whether in all the circumstances it was appropriate to apply a different capitalisation rate for the land. While the Tribunal did not expressly refer to this aspect, it is probably implicit from the Tribunal's decision that it supported the application of a lower rate for the land. Secondly, the appropriate capitalisation rate to be applied in all the circumstances. The Tribunal accepted that 12% was appropriate. On both of these issues there was a sharp conflict between the evidence of the two valuers.

To arrive at the Cardrona "land value", as defined by s2 of the Valuation of Land Act 1951, it is necessary to notionally separate that land value from the remaining components of the Cardrona ski resort. The capitalisation of rental method of valuation brings into focus whether special features relating to the Cardrona ski resort justify a departure from the traditional valuation approach of differentiating between various components such as land, structural improvements, plant, machinery and chattels, according to risk. Mr Sheppard considered that there was no justification for departing from the traditional approach in respect of the Cardrona resort, and that in all the circumstances the land component should carry a lower risk factor. On the other hand, Mr Laing considered that the land component was so dependent on, and interwoven with, the ski resort business that it should not be separated out with the result that one global risk factor should cover all assets included in the business.

Our conclusion is that it was not contrary to proper valuation principle or practice to apply a different, and lower, capitalisation rate for the Cardrona land. When the land has been notionally separated for the purpose of arriving at "land value" as defined in the Act, it is difficult to avoid the conclusion that the risk factor associated with the land is lower than the risk factor or factors associated with the remainder of the ski resort business. We consider that in that notional situation the fate of the Cardrona land is not inextricably tied to the fate of the ski resort business. The primary risk would rest with the lessee as operator of the business. Failure of the business would not automatically destroy the potential of the land for use as a ski resort by another lessee or by the owner. The land enjoys characteristics which make it inherently attractive as a ski resort: it has a favourable geographic aspect and location; it is within the snow belt; it has suitable topography and zoning; and, as at 1990, it was able to demonstrate a consistent "skier day" performance over four seasons. These factors support the view that the land is a safer investment than the other ski resort business assets and would accordingly justify a lower yield on account of risk than the remaining assets.

We do not believe that a sensible business person would accept that the risk relating to this ski-field operation was evenly spread over the composite items of land, structural improvements, plant, machinery, and chattels. So even if an average return of 17.57% is agreed as fair and reasonable for the overall parcel of assets, it does not follow that a potential purchaser or proprietor would be content, for example, to accept the same return for the plant and machinery as he would accept for the land. Plant and machinery associated with a ski-field operation must be susceptible to considerable operational wear and tear with consequent deterioration in value, whereas the land is clearly more durable.

Having reached the conclusion that it was in accordance with proper valuation principle for a different risk factor to be allocated to the Cardrona land, it becomes necessary to determine whether the rate of 12% utilised by Mr Sheppard was appropriate. In addressing this issue we keep in mind that both Mr Laing and Mr Sheppard were in agreement that the global capitalisation rate at the time the Cardrona business (including freehold land) was purchased worked out at 17.57%. Logically the less risky land component should be significantly below that figure. We consider that the rate of 12% for the land applied by the respondent is plausible and falls within the known framework of the sale nine months before the revaluation.

In our opinion it has not been demonstrated that utilisation of a 12% capitalisation rate involved an error in valuation principle. We agree with the conclusion of the Land Valuation Tribunal on this issue.

Impact of Development Expenditure

In each of his three calculations Mr Sheppard added a figure of $500,000 to reflect the added value arising from land development expenditure. This was equivalent to 50% of his starting figure for land development expenditure of $1 million. There is insufficient information for us to determine the veracity of the $500,000 figure. We note, however, that neither the starting figure of $1 million or the $500,000 figure adopted by Mr Sheppard have been challenged by the appellant.

Accordingly we proceed on the basis that $500,000 fairly represents the difference between bare and undeveloped land on the one hand and, on the other hand, "land value" as defined by the Act which includes some land development components. This means that the issue to be determined in relation to the added value arising from development expenditure is relatively narrow. But again the two valuers were in sharp conflict about the correct methodology when using the capitalisation of rental method of arriving at land value.

For the respondent Mr Sheppard's stance when he gave evidence before the Tribunal was that multiplication of gross turnover by a 2.5% rental factor produced a rental for bare and undeveloped land. Therefore to arrive at "land value" as defined any land development component which fell within the definition of "land value" had to be added. He considered that grading and levelling of the Cardrona land together with removal of rocks therefrom fell within that definition as a consequence of the second proviso to the definition of "improvements", and added $500,000 to reflect the added value arising from those items.

On the other hand, Mr Laing's evidence was to the effect that multiplication of gross turnover by a 2.5% rental factor produced, after capitalisation, "land value" as defined in the Act. His reasoning was that as the notional rental from which he assessed land value was turnover based it was a rental for the land in the condition in which it had been notionally leased. This meant that the benefit of any development work must have been included in the land producing the notional rental. It would accordingly have been wrong to take that factor into account again by adding it at the end of the calculation. He considered that Mr Sheppard's approach had taken the added value arising from land development expenditure into account twice.

The situation was further complicated by the respondent's change of position in relation to land development expenditure. Initially, as disclosed by the facsimile of 4 December 1990 referred to earlier, the respondent considered that the capitalisation of rental calculation included the $500,000 figure representing added value arising from land development expenditure. But when Mr Sheppard gave evidence before the Land Valuation Tribunal he adopted a different approach. His evidence at that time was that the capitalisation of rental calculation excluded land development expenditure with the result that the sum of $500,000 needed to be added to reflect the additional value arising from land development expenditure.

Mr Sheppard's explanations under cross-examination for these two different approaches were not convincing. One passage of the evidence carries the following explanation:

> "I just want to know why you changed your mind about the formula including a development component in 1990 and now say that development is separate?
>
> One of the reasons was that I have an actual figure for land development and I felt it more appropriate to take it out of the calculation to compare like with like because, as I have said repeatedly, the rental, the $91,250, is a reflection of the undeveloped land or the LEI [land excluding improvements] and this calculation shows the two, the LEI component and the additions, the development improvements."

Another passage provides a further explanation following questioning by the Tribunal:

> "In 1990 you identified the risk at two percent, now you have doubled it to four percent. Why did you do that?
>
> I just identified that - I included - my discount rate there included the development of improvements so in effect I was taking into account the improvements that got done to the property and additional to that I have re-visited and I felt that the two percent was inappropriate and I removed the development and improvements from it. I consider the four percent is an applicable risk rate to add to the base underlying leasehold percentages that are for commercial and industrial property."

Notwithstanding the explanations provided by Mr Sheppard for the two approaches, it is apparent that the underlying basis of the capitalisation of rental calculation had not changed: gross turnover was multiplied by a rental factor of 2.5% and the resulting figure was then capitalised. We are unable to comprehend how a change in the gross turnover figure from $4 million to $3,650,000 (to equate with actual turnover as advised by the appellant) and/or the change in the capitalisation rate from 10% to 12% justified the different treatment of land development expenditure. It is difficult to avoid the conclusion that this different treatment of land development expenditure was attributable to a change of mind on the part of Mr Sheppard. Whatever the explanation it is necessary for us to determine which approach is correct.

A review of the evidence before the Land Valuation Tribunal leads us to the conclusion that Mr Sheppard's second approach was right. In other words, the capitalisation of rental method utilising a 2.5% rental factor produced a value for bare land excluding improvements. Thus it was necessary to add any additional value arising from land development expenditure which fell within the definition of "land value". "Land value" 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."

The second proviso to the definition of "improvements" deems certain items including the grading or levelling of land or the removal of rocks or soil therefrom <u>not</u> to be improvements which means that such items are part of "land value". Mr Sheppard's uncontested figure for the added value arising from those items was $500,000.

A key factor in resolving this issue is the 2.5% rental ratio used by the parties. Our interpretation is that this relatively modest ratio is in line with the return that might be expected from bare land. It is also in line with the ratio commonly used for calculating rental in respect of Crown land used for ski-field purposes where the Crown, through the Department of Conservation, is providing the mountain slopes in an undeveloped state. In that situation all aspects of the ski-field development are undertaken by the lessee and are accordingly excluded from the rental calculation. We note that under cross-examination Mr Laing accepted that ski-field development work would be undertaken by the lessee. That concession supports the view that the 2.5% rental factor relates to bare land.

It seems that Mr Laing's reasoning concentrated on the gross turnover part of the capitalisation of rental equation. But the equation involves both a gross turnover factor <u>and</u> a rental ratio factor. As already explained, we are of the view that the rental ratio selected will reflect whether the value to be established is for bare land or land in a semi-developed state or developed state. And if the aim is to arrive at "land value" as defined, a rental ratio which would exclude improvements not within "land value" would need to be selected. We can see the sense in selecting a rental ratio which, following capitalisation, will enable the value of bare land to be determined. Then the added value arising from development expenditure can be added with relative precision.

Comparative figures produced in evidence also tend to support the respondent's value rather than the appellant's significantly lower figure. The evidence before the Land Valuation Tribunal included the following table:

SKI-FIELD	***4 YR AVE SKIER DAYS***	***LAND VALUE***	***LV/SKIER DAYS***
Cardrona	96,750	$ 910,000	$ 9.41
Remarkables	89,000	$1,000,000	$11.24
Treble Cone	34,000	$ 330,000	$ 9.71
Coronet Peak	34,250	$ 590,000	$17.23

Mr Laing's proposed land value of $560,000 for Cardrona would produce a land value/skier day figure of $5.80 which would be well out of line with other ski-fields. On the other hand, the figure of $910,000 produces a "skier day" figure which is in line broadly with the other ski fields.

Conclusion

We therefore come to what we believe is an inevitable conclusion that the land value of $910,000 set by the respondent as at 1st October 1990 for the Cardrona ski-field was a fair and reasonable assessment of land value at that time. We have not been persuaded that there was any error in valuation principle or practice in arriving at that figure.

The appeal is dismissed. Submissions as to costs are invited. If the respondent seeks costs a memorandum from his counsel should be filed and served within 21 days. Counsel for the respondent will have a further 14 days to file a memorandum in response.