BEFORE THE TARANAKI
LAND VALUATION TRIBUNAL

IN THE MATTER of the Maori Reserved Land Amendment Act 1998

AND

IN THE MATTER of Applications for Determination of Compensation

BETWEEN:

NP 2 **A I** and **K J WILLIAMS**
of Lower Puniho Road, Okato

NP 31 **P M** and **C J WOODMASS**
of Kokiri Road, Manaia

NP 89 **B I** and **D WILLIAMS**
of Meremere Road, Ohangai

NP 110-111 **I R** and **L G DIACK**
of Winks Road, Manaia

NP 140 **WHATALOTTA HEIFERS LIMITED**
of Waverley Beach Road, Waverley

NP 142-143 **L W** and **V A WILLIAMS** and **D C WOODS** of Buchanan Road, Ohangai

NP 144 **L W** and **V A WILLIAMS** and **D C WOODS** of Tihi Road, Ohangai

NP 147 **C M** and **P J CHRISTIE**
of Kina Road, Oanui

Plaintiffs

AND: **THE ATTORNEY-GENERAL**

First Respondent

AND: **THE CHIEF EXECUTIVE OF THE MINISTRY OF MAORI DEVELOPMENT**

Second Respondent

RESERVED DECISION OF TARANAKI LAND VALUATION TRIBUNAL

TRIBUNAL:

Chair:	His Honour Judge M E Perkins
Members:	Mr J W Briscoe, Mr W A Cleghorn, QSM, JP
Dates of Hearing:	3-6, 9-12, 18-20 April 2001
Counsel:	Mr J E Hodder and Mr D R Kalderimis for the applicants Mr M T Parker and Ms L Rongo for the respondents
Date of Decision:	13 August 2001

Introduction

[1] The Tribunal has had placed before it test cases involving ten Maori Reserved Land Leases by the seven leasehold owners as applicants. We were informed at the outset that there are approximately 150 similar applications awaiting determination. By agreement between the respective advisors for the applicants and the Crown respondents, the Tribunal has been asked to determine the compensation in respect of the current applications. Without binding any of the other applicants awaiting the hearing of their applications it is hoped that our determination in respect of the present applications will assist in resolution of all applications without further hearings.

[2] The hearing of this matter including presentation of evidence, site visits and legal submissions spread over 13 days. The Tribunal is grateful for the assistance rendered by counsel and the witnesses particularly the valuers who had obviously spent considerable time in preparation. We are grateful to the leaseholders themselves who gave up valuable time to attend the Tribunal hearings and provide evidence for our assistance.

[3] Sections 3 and 4 of the Maori Reserved Land Amendment Act 1998 prescribe the Tribunal's jurisdiction in this matter. We have to decide what compensation if any is payable to the applicants in accordance with the method set out in s 4 of that Act.

[4] As an alternative the applicants instead of proceeding with applications before this Tribunal, were entitled to have compensation calculated under the formula set out in the second schedule of the Maori Reserved Land Amendment Act 1997 and payable in 1998. The present applicants and those awaiting a hearing have chosen not to follow that course.

[5] It is helpful in this introduction to set out s 4 of the 1998 Maori Reserved Land Amendment Act 1998 in its entirety.

> **Determination of compensation by Land Valuation Tribunal -**
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> (1) Where a lessee files an application under section 3(5)(b), the Land Valuation Tribunal has jurisdiction to determine, in accordance with this section, the amount to be paid to the lessee by the Crown as compensation for—

(a) The change to a more frequent rent review; and

(b) The change to a fair annual rent based on the unimproved value of the land; and

(c) The conditions imposed by the Maori Reserved Land Amendment Act 1997 on the assignment of the lessee's interest in the lease.

(2) The Land Valuation Tribunal must, as soon as practicable after 1 January 2001, determine the market value as at 1 January 2001, of the lessee's interest in the lease.

(3) That market value must be determined—

(a) First, on the basis of what that market value would have been, as at 1 January 2001, if the Maori Reserved Land Amendment Act 1997 and this Act had not been proposed or enacted; and

(b) Second, on the basis of what that market value is, as at 1 January 2001, in the light of the enactment of the Maori Reserved Land Amendment Act 1997 and this Act.

(4) The Land Valuation Tribunal may, in making determinations under this section, take account of relevant valuation evidence arising after the commencement of the Maori Reserved Land Amendment Act 1997 or this Act.

(5) The amount of the compensation payable to the lessee under subsection (1) is the market value determined under subsection (3)(a) less the market value determined under subsection (3)(b).

(6) Every application made under section 3(5)(b) must, subject to this section, be dealt with by the Land Valuation Tribunal in accordance with the provisions of the Land Valuation Proceedings Act 1948, which is to apply with all necessary modifications.

(7) In this section,—

Land Valuation Tribunal has the meaning given to it by section 2 of the Land Valuation Proceedings Act 1948:

Lessee has the meaning given to it by section 16(4) of the Maori Reserved Land Amendment Act 1997.

[6] Subsection 3 provides the Tribunal with the basis upon which it must determine the market value of the lessee's interest in the lease. That in turn provides the components to be entered into the mathematical calculation set out in subsection 5, and thereby calculate the sums of compensation in each case.

[7] During the course of the hearing the Crown respondents alleged that the two alternatives in subsection 3 are both hypothetical valuations, particularly having regard to the matters specified in subsections 1(a), (b) and (c). The applicants allege that while the first alternative contained in subsection (3)(a) is a hypothetical

assessment the market value under subsection (b) is not. We will deal with those allegations more fully later in this decision.

[8] In this case we are dealing with the effects of the 1997 and 1998 amendments to the Maori Reserved Land Act 1955 insofar as such effects relate to leaseholders' interest in the land in question. Counsel in their submissions provided us with the history leading up to this legislation. This included the basis for the second amendment in 1998. This has been of considerable assistance to us in providing background and our gaining a perspective as to our role in this matter. A concise summary of the history to this matter is contained in the article by The Rt Hon. Sir Geoffrey Palmer, "*Westco Lagan v A-G"* [2001] NZLJ 163. Even though the author modestly states that he has "simplified what was an extremely difficult story to make a relatively simple point" the article highlights some of the constitutional issues giving rise to the legislation we have to interpret.

[9] As can be seen from the statutory provisions the amendments have affected lessees' rights of assignment, introduced more frequent rent reviews and changed the basis for calculation of such reviews from a fixed formula to one of fair annual rental.

[10] The purpose of the amendments, is to provide a method whereby Maori owners of the freehold, represented by Parininihi Ki Waitotara Incorporation (PKW), may, within two generations, purchase back the leasehold interests while at the same time providing for compensation to both lessors and lessees for substantial rights which are affected by the legislation. For leases, which continue pending completion of the purchase back procedures, rentals are to be more regularly reviewed and assessment of rents is put on to a market rental basis.

[11] Having considered the statutory provisions under which we are to make our decision in this matter and before leaving this introduction, it is necessary to refer to the decision of the Court of Appeal in *West Coast Settlement Reserves Lessees Association Inc. v Attorney General* (1998) 3 NZ Conveyancing Cases 192, 802. The decision in that case arises out of circumstances surrounding the 1997 and 1998 amendments to the Maori Reserved Land Act 1955 to which we have adverted. With the imposition of the amended formula, under which we are to make our decision as

contained in the 1998 amendment, there was uncertainty surrounding the meaning of the word "proposed" which had been introduced for the first time in section 4(3)(a) of that Amendment Act. That terminology was not part of ss 16 and 18 of the 1997 Amendment Act.

[12] The continuing issue which remained after the 1998 amendment, which amendment had otherwise clarified the date upon which values were to be assessed, is succinctly set out in the following passage from the judgment of Justice Blanchard who delivered the decision in the Court of Appeal:

> The lessees and the Association continued to be concerned about the basis upon which the market value would be determined. They argued that the announcement of Government proposals for changes to the leases and of an intention to alter their terms by legislation has depressed market values of leases from 1993 onwards, and that a true "before and after" comparison requires allowance to be made for that shadow cast over the leases after the Government's announcement. It was this concern which led them to seek amendment of the 1997 Act. But afterwards they remained worried about the meaning which valuers and the Tribunal might give to the words "if the Maori Reserved Land Amendment Act 1997 and this Act had not been proposed or enacted" in s 4(3)(a) of the 1998 Act. Particular concern was expressed about the meaning of the word "proposed".

[13] As a result of the submissions which had been made to the Court, the following declarations were then made and are binding on us:

> (1) In section 4(3)(a) of the Maori Reserved Land Amendment Act 1998 (the "1998 Amendment"), the term "proposed" does not mean "introduced into the House of Representatives", but includes any proposal publicly announced by the Government in 1993 or subsequently for changes to the Maori Reserved Land Act 1955 (the "1955 Act") to the same substantive and economic effect as those identified in section 4(1) of the 1998 Amendment.
>
> (2) There is no substantive or economic difference between the Government's 1993 published proposals for changes to rent review frequency and a move to market-related rentals, and those changes enacted in the Maori Reserved Land Amendment Act 1997 and identified in sections 4(1)(a) and (b) of the 1998 Amendment, and
>
> (3) In applying section 4 of the 1998 Amendment, the Land Valuation Tribunal should have regard to the legislative intention that lessees are not to be compensated for the Government proposing or Parliament enacting matters extraneous to those identified in section 4(1) of the 1998 Amendment.

[14] In its reasoning for these declarations the Court of Appeal stated the following conclusions and observation which we set out in full as they give us assistance as to how we are to approach our assessment of compensation to the lessees for:

(a) The change to a more frequent rent review;

(b) The change to a fair annual rent based on the unimproved value of the land; and

(c) The conditions imposed by the 1997 Act on the assignment of the lessee's interest in the lease.

They read as follows:

> **Conclusions**
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> In argument before us Mr Parker, for the defendants, realistically accepted that "proposed" in s 4(3)(a) is not to be equated with "introduced" and has to be read as encompassing Government proposals prior to the introduction of the Bill in 1996. That must be so for otherwise Parliamentary Counsel [would] have used the obvious word "introduced". More importantly, it would make no sense for Parliament to have directed the Tribunal to disregard any effect on values arising from the proposals in the Bill and in the Act but for the Tribunal then to be unable to make adjustments for any detrimental effect of identical or nearly identical proposals made by the Government at an earlier time with an indication of its intention to bring in legislation. The benefit conferred by s 4(3)(a) would be illusory. We do not believe that can have been intended. Indeed, it seems to us that s 4(3)(a) simply underlines what may already have been implicit in s 18(3) of the 1997 Act quoted earlier.
>
> In the two most crucial respects the proposals published by the Government in April 1993 differed only very slightly from what was eventually enacted in 1997 and in the meantime there had been no suggestion of anything different. They were (a) that after an initial period there would be seven yearly rent reviews and (b) that rentals would be set at market levels on each review. In the legislation the suggested 14 year period before the first of the new reviews was replaced by a specified date for the first review of each lease. After 31 December 2000 the leases are phased into the new market rent regime in four bands over the next four years. The banding is to facilitate administration of the rent review process by spreading the administrative burden.
>
> The legislation uses in relation to rent levels the expression "fair annual rent", the same expression as is used in the Public Bodies Leases Act 1969. That requires assessment of a market rental.
>
> Mr Parker expressed the Crown's concern lest s 4(3)(a) be construed in a way which might permit the Tribunal to take into account the effect on values of any proposal made by the Government in 1993 or thereafter which was not equivalent to those matters described in s 4(1). We believe this fear to be unfounded. In terms of s 4(1) the

> compensation is to be for the three listed matters only, and for nothing else. It cannot therefore be awarded for the effect of any alteration or proposed alteration to any other lease term. However, s 4(3)(a) requires the Tribunal to look beyond the exact changes to rent review, rent levels and assignment terms and requires it to make allowance for any effect of Government proposals relating to those three matters. Thus the effect of proposals from the Government having substantive and economic equivalence is to be taken into account in the Tribunal's assessment. As noted, there was a relatively minor difference concerning commencement of the rent reviews but the proposals for the rent regime can fairly be regarded in this context as the equivalent of what was enacted.
>
> It is our understanding from exchanges with counsel during argument that any impact of the right of first refusal is very small in comparison with the alleged adverse effect on values of the other changes. (An allowance of only an additional 1% is made under the formula in Schedule 2 of the 1997 Act - see cl.16.) To the extent that the proposal in 1993 for termination after two further renewals, with the lessors enjoying a right of first refusal in the meantime, may have had a greater effect than if the Government's announcement had described only the right of first refusal finally enacted, that proposal will not have substantive and economic equivalence.
>
> If the Tribunal finds that to be the position, the additional adverse effect of the proposal for termination of perpetual renewals is not to be the subject of compensation.
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> **Observation**
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> This judgment is concerned only with the meaning of particular words in s 4(3)(a) of the 1998 Act. We have concluded that those charged with valuing the lessees' interests must disregard certain adverse effects on the value of the leases after the announcement of the Government's proposals in April 1993. We have proceeded upon the assumption that there were in fact such adverse effects but we make no finding on that factual question which is a matter for the Tribunal. Nor do we indicate any view on the valuation method by which the Tribunal, guided by our declaration, is to make allowance or adjustment for any such adverse effects. The Tribunal will adopt whatever method it considers most appropriate and is free to receive such valuation evidence as it believes will best assist it in making the required determinations.

[15] In evidence we received from the valuers, this final observation was not specifically addressed, although Mr Larmer, the applicants' principal valuer assumed that any adverse effect from 1993 to 1997 by proposals <u>other</u> than the actual legislative changes would be expected to have worked its way out by the expiry of the three year period to 1 January 2001. Certainly the respondents did not argue otherwise in this regard. We assume, in the absence of such evidence, that there are no adverse effects on value from announced proposals which were not finally included in the legislation. The issue which was the subject of some evidence and

substantial dispute between the valuers during the course of the hearing was whether there were additional adverse effects on value from what we shall refer to as general, social and commercial considerations arising during the period from 1993 to 1 January 2001.

Evidence

[16] During the course of the hearing we heard evidence from a number of witnesses on behalf of both applicants and the respondents. In so far as the valuers and economists are concerned, their evidence was directed towards supporting the particular methodology adopted on behalf of one or other of the respective sides of this dispute, and providing the basis for criticism of the opposing party's methodology.

[17] The applicants presented evidence from Mr C M Christie, Mr A I Williams, Mrs C J Woodmass, Mrs S B Frost and Mr L W Williams, who are all lessees or former lessees of West Coast Settlement Reserves leasehold land.

[18] The applicants also presented evidence from the following:

(a) Mr J Coppersmith, a partner of Price Waterhouse Coopers, Wellington. Mr Coppersmith gave evidence directed solely to the issue of the effects of taxation.

(b) Mr T A Crighton, a registered valuer and chartered accountant from Christchurch.

(c) Professor N C Quigley, Pro-Vice Chancellor of Victoria University of Wellington.

(d) Mr I R McKillop, Rural Lending Manager and Registered Valuer with the National Bank of New Zealand Limited in New Plymouth. Mr McKillop appeared in answer to a witness summons.

(e) Mr R S Gordon, registered valuer and associate of Staples Rodway, Chartered Accountants of Stratford. Mr Gordon also appeared in answer to a witness summons.

(f) Mr J P Larmer, registered valuer and registered primary industry consultant of New Plymouth. Mr Larmer gave evidence as the primary valuer witness for the applicants.

[19] The following witnesses gave evidence on behalf of the respondents:

a) Professor T P Boyd, Professor of Economics at Queensland University of Technology.

b) Mr I J Burgess and Mr W J Charteris, both Registered Valuers and employees of Quotable Value New Zealand Limited.

c) Mr J D Neild, Agricultural Consultant and Advisor. (Mr Neild's evidence was submitted in writing by consent without him being called and without cross-examination).

d) Mr J K W Isles of Wellington, Consulting Economist.

The Applicants

[20] Mr Christie, Mr A I Williams, Mrs Woodmass, Mrs Frost and Mr C W Williams, all detailed their experiences in the sale and purchase of the leasehold properties. This included the effects as they perceived them to be of the right of first refusal and their experience and attitude to the statutory second schedule compensation as opposed to applying to this Tribunal for compensation. They stated in evidence that their understanding was that the purchase price of the West Coast leasehold land properties had for many years prior to the1990's, been set at levels of between 70-80% of freehold market prices.

[21] Mrs Frost gave particular evidence as to the attempt made by her and her husband to purchase leasehold land in 1998 at a price equivalent to 40% of freehold market price. She believed that that was the generally accepted ratio then and at the present time. She gave evidence of their costs associated with their attempt to purchase at that time. In respect of their own leasehold property, Mr and Mrs Frost ultimately accepted the statutory compensation offered by the Crown calculated under Schedule 2 of the 1997 Amendment Act.

[22] Mrs Woodmass gave evidence of her experience with an attempt to sell their leasehold property, and the manner in which PKW exercised its right of first refusal in that case.

[23] Mr L W Williams gave particularly helpful evidence to the Tribunal. He is a fourth generation farmer in the South Taranaki area. Both he and his family have owned freehold and leasehold properties over the generations. Mr Williams is also an agribusiness consultant, and is a co-owner of an agricultural investment and management company currently managing 30 dairy farms, milking 14,000 dairy cows, with a total capital of $100m. Mr Williams is the Deputy Chairman and nominated spokesperson for the West Coast Settlement Reserves Lessee's Association, and has been closely involved in consultations with government over amendments to the Maori Reserved Land Act 1955. As an experienced farmer and agribusiness manager, he has extensive experience in the purchase of West Coast leasehold lands. During his evidence he detailed transactions that he had been directly involved with, as well as issues relating to the financing of those transactions. Based on his knowledge and involvement with the West Coast leasehold properties, Mr Williams gave evidence that prior to 1993 those properties sold for approximately 70-75% of their equivalent freehold value, but currently the properties are selling at around 40-45% of their equivalent freehold value. This evidence, as will be seen, to a large extent corroborated the evidence of Mr Larmer.

Mr McKillop

[24] Mr McKillop's involvement with the West Coast leasehold lands began in 1976. Apart from short periods away from Taranaki, his involvement has continued since then.

[25] His evidence detailed the methodology adopted by the former Rural Bank, now part of the National Bank of New Zealand Limited, when advancing funds to the lessees of the West Coast leasehold lands. In his 30 years of experience in the Bank, both he and fellow bank officers established the equivalent freehold value of the leased property being offered as security, based on comparable sales. The market value of the lessee's interest in the properties was then reflected by the value of the percentage discount. Such discount was determined by reference to market sales

evidence and consideration of the terms and conditions of the lease. Mr McKillop advised that the percentage discount or ratio prior to the early 1990's was between 70-75%, but sometimes as high as 80% of freehold value. Since 1998, he says, that ratio has changed to approximately 40% of market value. Mr McKillop also presented in evidence, details of actual West Coast leasehold land farm sales. There were four prior to 1992 and five after 1998. His evidence showed the method of the analytical approach and the percentage discount or ratio reflected in the purchase price.

The Applicants' valuers

[26] As we have indicated, the applicants' principal witness was Mr J P Larmer. Mr Larmer is a Registered Valuer with over 30 years experience, most of it in the Taranaki region. He has extensive experience in rural land matters and has been intimately involved in West Coast Settlement Reserves leasehold land since 1990. His detailed and comprehensive evidence traversed his involvement in and knowledge of the leasehold lands, the background and history of the leases, compensation, legal and valuation principles and his valuation methodology.

Valuation Methodologies - Applicants

Mr Larmer

[27] In his evidence for the lessees, Mr Larmer, described the test case properties as extending from Okato, south west of New Plymouth, to Waverley, south of the land district boundary at Whenukura. A schedule of the test case properties is as follows:

TEST CASE PROPERTIES:

Test Case	LVT Nos	Name	Areas	District
1	2	AI & KJ Williams	65.6ha	Okato
2	31	PJ. CM Woodmass	44.1ha	Kapuni
3	89	G Williams Trust	29.7ha	Ohangai
4	110, 111	IR & LJ Diack	48.5	Manaia
5	140	Whatalotta Heifers Ltd	254.3ha	Waverley
6	142, 143, 144	LW & V A Williams & D C Woods (Ohangai Trust)	69.2ha – A Block 178.0ha – B Block	Ohangai
7	147	CM & PJ Christie	76.3ha	Oaonui

Where properties comprise more than one lease, those leases have been combined.

[28] The properties farmed by Messrs Williams and Christie, are operative dairy units. The Woodmass property was a major portion of a leasehold/freehold dairy unit, which has since been purchased by PKW and farmed in conjunction with adjacent land. The Diack property was originally part of a larger dairy unit but in recent years has been used as a back up unit to an intensive dairying operation some 1km distant. The G Williams Trust property was recently farmed as a small grazing unit but is now leased by PKW to adjacent dairy farmers who graze the rough country and dairy on the balance. The Ohangai Trust property was a traditional sheep and cattle unit but the front country is now intensively dairied while the higher land at the rear is grazed by cattle. Whatalotta Heifers at Waverley was a traditional sheep and cattle unit but since being purchased by a heifer grazing syndicate has been intensively stocked with up to 1,000 heifers.

[29] Mr Larmer met with the Valuers for the Crown. By early February 2001 agreement as follows had been reached as to the Capital Values and Land Values, and as a consequence, the value of structural improvements, for the seven test cases:

Lessee	Improvements	Land Value	Capital Value
AI & KJ Williams	$284,000	$1,066,000	$1,350,000
P J &CM Woodmass	$170,000	$790,000	$960,000
G Williams Trust	$100,000	$400,000	$500,000
IR & LJ Diack	$86,000	$734,000	$820,000
Whatalotta Heifers Ltd	$300,000	$1,800,000	$2,100,000
Ohangai Trust	$230,000	$1,440,000	$1,670,000
CM & PJ Christie	$250,000	$900,000	$1,150,000

These figures are the equivalent freehold values, effective as at 1 January 2001. It was from this point on that Mr Larmer for the Lessees and Messrs Burgess and Charteris for the Crown, parted company in their approach as to the assessment of the values.

[30] Mr Larmer described the task of the valuers and also this Tribunal, to be the establishment of the market value of the Lessee's interest, defined on two different premises. On the one hand the market value is to be assessed at 1 January 2001 taking full cognisance of the amending legislation and the reaction or response to this since the amending legislation came into force on 1 January 1998. On the other hand, the assumption is to be made that the proposing or enacting of the amendments has not taken place but in all other respects the Lessee's interest is to be valued on exactly the same basis as the first or actual market value scenario. In other words, a "with and without" valuation or as it has been described, a "before and after" valuation.

[31] Mr Larmer referred to the normal market definition of market value as set out in the New Zealand Institute of Valuers' Valuation Standards at VCP4.CL.5 as :-

> The estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arms length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

[32] We interpolate that this is accepted as a general valuation approach and is confirmed in the leading texts on the subject: Salmon, <u>*The Compulsory Acquisition of Land in New Zealand*</u> and Speedy, <u>*Land Compensation*</u>.

[33] The Court of Appeal decision regarding *Boat Park Ltd v Hutchinson* also confirms this approach and further confirms that there can in the case of a series of purposes for a valuation be only one "market value":

> It follows that there cannot be a Market Value for one purpose and a Market Value for another purpose. The price for which a willing seller would sell the property to a willing but not over anxious purchaser cannot vary depending on the purpose of the valuation. Market Value remains the same irrespective of whether the valuation is required for mortgage lending purposes or for selling purposes or for buying purposes.

[34] The Court added, when commenting on whether or not the hypothetical approach is appropriate when valuing for mortgage purposes, as follows:

> It has long been recognised that Valuers should select the most reliable method of valuing the property in question and, to the extent that it is sensibly and practicably possible, should then verify the value arrived at by reference to other methods. No one method is generally regarded as conclusive, and for that reason prudent valuers check the valuation which they arrived at following the most reliable method, by any other method which is appropriate in the circumstances. At times the valuation may represent a collage of approaches. Two or more methods may properly be applied and in respect of the subject property and the correct market value be determined by a critical comparison of the results obtained by the application of those various methods. Hence, various valuation approaches are available and none should be necessarily excluded unless, for a particular reason, they are inapplicable to the subject property.
>
> Certainly, the sales comparison approach is the preferred approach. The valuer analyses evidence of past and current sales transactions of comparable properties making appropriate adjustments for the subject property in order to arrive at the market value. But such evidence may not be conclusive - or even available. Reference to other approaches is the only other way to either verify an indicated market value or, if there is no comparable sales evidence, arrive at a market value. In respect of land, such as farmland, valuers may refer to what is known as the Capitalisation or Productive Valuation method where the Valuer converts or capitalises the productive income….

> An error in any premise or step in this extensive exercise can have a cumulative or multiplying effect and seriously impair the reliability of the ultimate figure arrived at. It is for this reason that the hypothetical Subdivision Approach is most often used as a check on other methods. But it is a legitimate valuation tool and cannot be arbitrarily excluded from the valuer's task in arriving at the market value of the property…
>
> If, on the basis of comparable sales evidence, and the market history of the subject property, the Valuer is able to arrive at an assessment of the Market Value, he or she could probably undertake the Hypothetical Subdivision exercise in order to verify or check the indicated values. If comparable sales evidence is not available or, for one reason or another, is not appropriate this method may be the only means of arriving at the Market Value. In utilising this approach, of course, caution will be required lest an erroneous assumption or estimate warp or vitiate the resulting figure.

[35] Mr Larmer's primary approach in determining the current market values for the various properties was to consider sales of both freehold and leasehold properties. He sought to establish relativity between freehold and leasehold transactions. To that end he analysed such relativity of sales between 1989 and December 1992 which may be defined conveniently as *pre shadow* transactions; and on the other hand such relativity of sales that have occurred since 1 January 1998 when the legislation was enacted. He referred to these as *post amendment* transactions. However, directly comparing sale prices of leasehold and freehold transactions might be misleading and therefore after deducting the value of structural improvements from similarly located parcels of land with similar physical and productive characteristics, a useful degree of uniformity may be established. This difference between the equivalent freehold land and leasehold land value was defined by him as *tenure discount*. From an analysis of these ratios or tenure discounts Mr Larmer sought to establish a relativity between the price paid for a leasehold property and the equivalence to freehold land.

[36] In all calculations, Mr Larmer separated out the value of structural improvements and adopted the approach (as did the respondents' valuers) that the value of these improvements remained constant. Two separate calculations were applied. One utilising the analysed data gathered for the pre shadow period. The other utilising the post amendment period data. He excluded from calculation all sales evidence from what he called the transitional period ie January 1993 to December 1997. In doing so, Mr Larmer contended that he was excluding:

a) Any sales that could have been influenced by the release of the Marshall Review and Framework for Negotiation in April 1993 and subsequent working group reports;

b) Amending legislation prior to the final enactment of the Maori Reserved Land Amendment Act 1998;

c) Factors referred to in the Court of Appeal decision which we are to exclude;

d) Other general factors which, while not necessarily accepted as being present may, if they did exist, influence value.

[37] This approach was endorsed by Professor Quigley whose evidence we shall refer to shortly. The selection of the period January 1989 to December 1992 as the pre shadow era encapsulated the open market transactions of leasehold interests particularly in the latter part of the 1980's when many of the leases were nearing the end of a 21 year term.

[38] The final three years of the 12 year period adopted by Mr Larmer for direct evidence was from 1 January 1998 when the 1997 amendment came into force through to 1 January 2001 which is the required date for valuation. He comments, correctly in our view, that the reason for the 1998 Amendment Act deferring assessment of compensation to Lessees by three years was so that market reaction to the 1997 and 1998 Amendments Act could be judged. This was taken up in the final submissions of Mr Hodder.

[39] The extensive sales analysis schedules produced by Mr Larmer realised a 73.4% leasehold to freehold ratio for dairy farms (after eliminating the two highest and two lowest outliers) and a ratio of 73.6% for dry stock farms. Equivalent figures for the 'post amendment' period were 43.6% and 44.8% respectively.

[40] Refining the analysis for pre shadow sales he established a tenure discount as a percentage of land and dairy company shares at 35.11%, (after eliminating the two highest and two lowest outliers) for dairy farm transactions, and a figure of 34.61%

for dry stock farms. On a tenure discount basis the analysis yielded 68.1% for dairy farms and 69.3% for dry stock farms.

[41] Mr Larmer also accounted in his sales analysis for alterations to the dairy company share requirements since the commencement of the pre shadow period (January 1989), with some of the value that previously resided in the land value being transferred out to dairy company shareholdings. In order to make a valid comparison between the pre shadow situation with nominal shareholding only, and the post amendment situation where the requirement is currently two $1 shares for every kilogram of milk solids supplied, the asset transference from land value to shares needed to be added back. In the case of operative dairy units he therefore factored the tenure discount against the land value plus shareholding as a primary comparison.

[42] Adopting a tenure discount approach based upon the analysis of comparable sales not only followed recognised valuation principles but followed the practice adopted by buyers and sellers of these leasehold lands as well as banking organisations that has been traditional for a large number of years and is confirmed by the lessee witnesses Mr Gordon and Mr McKillop.

[43] In his sales evidence, Mr Larmer discussed market conditions, historic events impacting on farm land values, and movement in prices paid for dairy farm properties from early 1972 through to the present date, commenting also on the adverse publicity in the late 1980s, early 1990s, on issues relating to Maori occupation of certain freehold land. He is of the opinion that this stigma remains a live issue to the current date and was present through the 1980s and 1990s and was therefore factored into pre shadow and post amendment prices paid for land.

[44] Mr Larmer's evidence included a detailed analysis of each individual test case property listing the comparable sales used to arrive at both the agreed equivalent freehold value and the tenure discount on both the 'before' valuation and the 'after' valuation.

[45] At the conclusion of his assessment of compensation based on the comparable sales/tenure discount methodology, Mr Larmer detailed his cross check on his values and compensation calculations by using an economic approach to valuing the lessees

interest based on a financial model that attempted to replicate the market approach to valuing the expected future cash flows to the lessee. He gave the appropriate information to Mr Crighton, who prepared the assessments based on this financial model. In adopting this approach, realistic values or inputs had to be established for the model.

[46] These factual inputs involving no subjective judgement were as follows:

- Contract rent
- Prescribed rent rate
- Period to next rent review - 'before' scenario
- Period to next rent review - 'after' scenario
- Rent review interval - 'before' scenario
- Rent review interval - 'after' scenario

[47] Other inputs that required market analysis and subjective judgement were:

- Current rental value (i.e. the updated unimproved value agreed upon or determined by arbitration).
- Fair annual rental rate (i.e. the rate that would be agreed upon or determined by arbitration).
- Resultant updated rent as at 1 January 2001 (i.e. the contract rent set after agreement or determination of the previous two inputs).
- Costs of a rent review - 'Before' (i.e. for a 21 year regime with a prescribed rent rate).
- Costs of a rent review - 'After' (i.e. for a 7 year regime with a market rent rate).

- Land inflation rate (i.e. future land value movements rather than a measure of inflation in general).

- Costs inflator (i.e. a measure of inflation in general - the CPI).

- Discount rate (i.e. to arrive at the present value of future estimated cashflows).

[48] Mr Larmer prepared a schedule of the factual inputs, calculated the current rental value based on his assessment of the Unimproved Value of each property and determined the Fair Annual Rental Rate and the resultant updated rent as at 1 January 2001. These figures were then supplied by Mr Larmer to Mr T A Crighton, whose evidence will be dealt with later.

[49] In his evidence, Mr Larmer stated that in his opinion, a financial modelling approach to value loss, which is mathematically robust, may deliver 'theoretically correct' outcomes provided realistic inputs are used and appropriate discount rates used. However, Mr Larmer drew the Tribunal's attention to the difficulties experienced in endeavouring to factor in to the financial model an appropriate adjustment to recognise the 'Right of First Refusal' available to the lessors under the amending legislation.

[50] Mr Larmer's key assumptions made in the lessees' interest model are a land inflation rate of 3% per annum, CPI adjustment for the periodic cost of review of 2% per annum, a fair annual rent rate of 5% and a discount rate of 6%.

[51] In assessing his Unimproved Values for each of the properties, Mr Larmer made reference to this exercise being one of the most difficult and imprecise valuation exercises due to the often total lack of comparable sales evidence, particularly in the intensively developed dairy farming locality of Taranaki. No details of how he arrived at his Unimproved Values were supplied by Mr Larmer. His assessment of Unimproved Value of the Land and Improvements to the land is scheduled as follows:

LVT No.	Name	Land Value	Land Improvements	Unimproved Value
NP 2	A I & K J Williams	$1,066,000	$466,000	$600,000
NP 31	P J & C M Woodmass	$790,000	$350,000	$440,000
NP 89	G Williams Trust	$400,000	$140,000	$260,000
NP 110 – 111	I R & L J Diack	$734,000	$234,000	$500,000
NP 140	Whatalotta Heifers Ltd	$1,800,000	$720,000	$1,080,000
NP 142, 143, 144	Ohangai Trust	$1,440,000	$540,000	$900,000
NP 147	C M & P J Christie	$900,000	$520,000	$380,000

[52] The difficulty in assessing unimproved value is confirmed in the schedule below showing the applicants' and the respondents' respective valuers' assessment of these Unimproved Values:

		Larmer	Burgess
NP2	A J & K J Williams	$600,000	$714,000
NP 31	P M & C J Woodmass	$440,000	$530,000
NP 89	B I & D Williams (G Williams Trust)	$260,000	$320,000
NP 110-111	I R & L F Diack	$500,000	$609,000
NP 140	Whatalotta Heifers Limited	$1,080,000	$675,000
NP 142,143,144	L W & V A Williams & D C Woods (Ohangai Trust)	$900,000	$854,900
NP 147	C M & P J Christie	$380,000	$265,000

[53] In his determination of a Fair Annual Rental Rate, Mr Larmer made reference to rural sector 'Glasgow' lease rates ranging from 3.2% to 6.25%, in excess of 7% for forestry leases and Te Aute leases in Hawkes Bay ranging from 4.75% to 6.25% with an expected compromise final settlement at 5.5%.

[54] The Tribunal's attention was drawn to the memorial to be entered on the Certificates of Title of each of the test case properties which referred to Schedule 1 of the Maori Reserved Land Amendment Act 1997. Such memorial (with some exceptions) grants a right of first refusal to each party to the lease on assignment by either party to a third party.

[55] Schedule 1 to the 1997 Amendment Act provides that where a lessee wishes to assign his or her interest in the lease to someone other than a specified assignee, then PKW must be offered the opportunity to purchase the lessee's interest on the same

terms offered to that third party (or at market value if the assignment is not for valuable consideration). The right of first refusal does not operate when the transfer is to a 'specified assignee', which means that a lessee (who was a lessee at 1 January 1998) may transfer his or her interest to the lessee's spouse, children or co-lessee (who was a lessee at 1 January 1998) without activating the right of first refusal. The Schedule provides for a similar effect where the lessee is a company or a trust although the entity must have been a lessee on 21 August 1996.

[56] Although the Right of First Refusal operates in both ways, that is the lessor's interest must be offered to the existing lessees if a sale is contemplated, Mr Larmer contended that and to use his words; "in practice it is a one way street". In his opinion, PKW would be very unlikely to sell their interests and that within two generations, PKW will have very likely purchased all the West Coast Settlement Reserved Land leases. This opinion is based on his experience with and knowledge of the market over the last three years since this provision was enacted, coupled with the fact that the land in question is Maori freehold land and is therefore subject to the restraints on sale as contained within the Te Ture Whenua Maori Act 1993.

[57] Mr Larmer was of the opinion that the provisions relating to the right of first refusal had a detrimental effect on saleability and value. He was further of the opinion that these effects were already factored into the market based analysis but that the effects had to be factored into the financial based model in addition to Mr Crighton's calculations.

[58] Rather than create an additional inclusion into the formula, both Mr Larmer and Mr Crighton agreed that an adjustment for the right of first refusal would be made by a separate calculation undertaken by Mr Larmer. This was similar to the approach used by Mr Burgess, the respondents' principal valuer, in his valuations, although with different conclusions.

[59] In arriving at these adjustments, Mr Larmer considered the costs associated with a leasehold farm sale as detailed in evidence presented by Mrs Frost. He also referred to the likely impact of a memorial registered on the title of freehold land granting the rights contained within Section 27B of the State Owned Enterprises Act 1986 and drew attention to the Auckland Land Valuation Tribunal decision -

Auckland Grammar School Board v Department of Survey and Land Information (1995) DCR 937, where after commenting that a deduction of 5% - 10% seemed appropriate for the existence of a Section 27B memorial the Tribunal allowed a deduction of 6.7% of market value.

[60] Mr Larmer also referred to an article 'The Effect on Value of s27B Memorials' (July 1996) NZ Conv Law and Practice 5, written by Mr Ross Calderwood (then Manager of Valuation Services - Valuation New Zealand), wherein Mr Calderwood concluded that a difference/discount of between 5% and 20% was evident in sales records of properties that were subject to a s27B memorial, such discount being dependent on location and Maori claim activity.

[61] Mr Larmer contended that the provision of the right of first refusal was more detrimental than the existence of a s 27B memorial in that under the provisions of s 27B, full compensation will be paid if the land is taken back to redress Maori grievances whereas the right of first refusal remains until such time as the leasehold title is extinguished by merging with the freehold title (i.e. when it is purchased by PKW). He was also of the opinion that a deduction for right of first refusal would vary according to the likelihood or probability of PKW exercising its rights.

[62] He concluded by making the following adjustments:

LVT No.	**Name**	**Value up to $1,000,000**	**Excess over $1,000,000**
NP 2	A I & K J Williams	12.5%	5.0%
NP 31	P J & C M Woodmass	15.0%	5.0%
NP 89	G Williams Trust	15.0%	5.0%
NP 110-111	I R & L J Diack	15.0%	5.0%
NP 140	Whatalotta Heifers	12.5%	5.0%
NP 142-144	Ohangai Trust	15.0%	5.0%
NP 147	C M & P H Christie	10.0%	5.0%

[63] These adjustments were factored off the 'before' leasehold market value inclusive of Dairy Company shares, where applicable.

[64] Finally, Mr Larmer presented a table scheduling Mr Crighton's financial model of the compensation adjusted for the right of first refusal and compared those figures assessment with his own market sales approach using the 'tenure discount'.

[65] The figures arrived at are as follows:

LVT No.	**Name**	**Crighton Financial Model**	**Adjust-Ment for ROFF**	**Calcu-lated Compo (Crighton)**	**Market Approach (Larmer)**	**Diff-erence $**	**Diff-erence %**
NP 2	A I & K J Williams	249,329	127,000	377,029	380,000	-2,971	0
NP 31	P J & C M Woodmass	185,619	110,400	296,019	280,000	+16,019	+5.7
NP 89	G Williams Trust	117,518	54,750	172,268	145,000	+27,268	+18.8
NP 110 & 111	I R & L J Diack	204,278	85,500	289,778	240,000	+49,778	+20.7
NP 140	Whatalotta Heifers	479,435	149,000	628,435	630,000	-1.565	0
NP 142-144	Ohangai Trust	402,234	159,000	561,234	490,000	+71,234	+14.5
NP 147	C M & P J Christie	165,228	90,000	255,228	300,000	-44,772	-14.9

[66] Mr Larmer's explanation for the larger variations centered around the differences in unimproved value as a result of different original land cover or vegetation. For instance NP 147 – Christie, was originally bush covered land. Conversely NP 89 – G Williams Trust and NP 110 & 111 – Diack were originally open scrub covered properties.

[67] Mr Larmer concluded that Mr Crighton's economic approach as a secondary methodology generally confirmed his tenure discount primary methodology and reiterated his contention that financial model methodology was sensitive to small changes in assumed inputs and was a less preferred approach to the comparable sales methodology that he had adopted.

[68] Professor Quigley supported Mr Larmer's view that he should exclude market information from 1993 to 1997, (see paragraphs 18 and 19 of Professor Quigley's primary brief of evidence which we set out in full later in this judgment). He also re-emphasised that Mr Larmer's calculation of loss is undertaken on a conservative basis. While we have to be careful having regard to the Court of Appeal's decision,

in not taking into account aspects of the proposals which were not eventually incorporated into the legislation, Professor Quigley is of the view that there was uncertainty about the changes to lease terms and the potential for compensation well before 1993, which resulted in depressed lease prices prior to that time. This means in Mr Larmer's conclusions, that the benchmark prices from the period 1989 to 1992 are lower than they would have been had the Acts not been anticipated. It is to this extent Professor Quigley believes that Mr Larmer's estimate of the loss to lessees resulting from the Acts is conservative, (paragraphs 22-26 of Professor Quigley's primary brief of evidence).

Mr R Gordon

[69] The acceptance and common usage of applying a ratio discount by farmers and land professionals as well as valuers in Taranaki was reinforced by Mr Gordon, the Valuer retained by PKW, as well as Mr McKillop.

[70] Mr Gordon, who appeared as a summonsed witness, gave evidence of his understanding of the ratio between leasehold and freehold land, and the recognised methodology for valuing lessees interests. Prior to his current employment, Mr Gordon was employed by the Rural Bank and during those 16 years, he and his colleagues adopted the same practice as Mr McKillop when assessing the value of the leasehold properties. This consisted of determining the freehold market value and deducting from that value a 'tenure discount', to use Mr Larmer's terminology, resulting in a lessee's interest that equated to between 70-75% of freehold value. The values were based on the analysis of comparable sales which Mr Gordon explained in detailed analysis of a hypothetical property following very closely the methodology used by Mr Larmer and Mr McKillop in their evidence.

[71] Mr Gordon also advised that he has analysed sale and purchase agreements since the 1998 Amendment Act, and notes that the ratio of leasehold value to freehold value is now between 35-50%. This is a change which he puts down to the alteration in the terms of the leases by virtue of the legislation, being the new rent-setting formula, reduction in the rent review periods from 21 – 7 years, increased costs associated with 7 year rent reviews, the effective loss of perpetual renewal and PKW's right of first refusal.

[72] In respect of the right of first refusal, he stated that in his opinion the implications of this had not been fully appreciated and were only now being felt in the market.

[73] Finally, Mr Gordon stated that since the 1998 amendment, PKW had purchased 8 farms which had been placed on the market, or where an assignment of the lease has been proposed. PKW have declined to purchase 17 properties which have fallen within these categories.

Mr T A Crighton

[74] Turning now to the evidence of Mr T A Crighton from Christchurch. Mr Crighton had been supplied with a copy of Mr Larmer's evidence and the following information:

> Details of each of the test case properties;
> The date of valuation;
> Lease/tenure details both pre and post amendment dates;
> Current rent and rent review provisions pre-amendment;
> Rent review provisions post-amendment;
> Unimproved or rental value and market rent rate for each test case property;
> Lessee's costs associated with each rent review.

[75] Mr Larmer and Mr Crighton, in consultation, agreed upon a future land inflation rate, consumer price index expectations and discount rates. Mr Larmer's instructions to Mr Crighton were to develop a financial model to estimate the lessee's interest in the test case leases on a "before" and "after" basis. This relates to the period prior to the amendments to the Maori Reserved Land Act 1955 and a period following those amendments. Such calculations were to be used as a secondary cross-check approach on market behaviour, and as a means of testing the validity of Mr Larmer's primary methodology. Mr Crighton was therefore asked to determine market value using a method similar to the investment approach adopted by the respondents' valuers.

[76] In opening, Mr Crighton stated that he had reviewed the quantum and suitability of the market evidence available to Mr Larmer, and concluded that the extent of this evidence allowed Mr Larmer to have full confidence in utilising it as the primary method of valuation. He emphasised that the financial model which he adopted must be regarded as a secondary approach only.

[77] In his calculations, Mr Crighton adopted a pre-tax model using a 6% return (3% capital gain plus 3% income return). In his opinion there are too many significant assumptions which have a major influence on the outcome that need to be made to convert the pre-tax discount rate to a post-tax equivalent. These include the lessee's income tax bracket and proportional cash return and capital gain variations between rent reviews.

[78] The financial model merely estimated the value of the lessee's interest in the unimproved value and did not include the value of improvements. The model assumed that the land rent is well approximated to the market rent and that relationship remained constant for the term of the lease. The market rent was assessed as 5% of the unimproved value and the lessee's interest was calculated in perpetuity, which for the purposes of Mr Crighton's model he assessed at 200 years. Mr Crighton contended that extending the model in perpetuity as opposed to a limited period of 50 years as adopted by the respondents' valuers, would add approximately 15-18% to the assessed compensation.

[79] In jointly determining the future land inflation rate with Mr Larmer, Mr Crighton reviewed historical land inflation rates from 1954 as compiled by Quotable Value New Zealand. This revealed averages in 10 year steps ranging from 7.2% to 8.93%. He also noted that the Consumer Price Index geometric average over the same period, ranged from 1.7% to 11.2%.

[80] A study of both sets of statistics revealed no obvious co-relation to Mr Crighton apart from noting that land inflation exceeded the Consumer Price Index by approximately 2.3% over the 45 year period studied. Substantial changes in land inflation occurred between 1980 and 1999 coinciding with the significant economic changes to rural government subsidies, and tax regimes, together with growth in farm productivity and payouts.

[81] Mr Crighton concluded that in his opinion, the nominal rate of land inflation over the next 40-50 years would exceed the Consumer Price Index by around 1%, and accordingly he adopted 3% as the nominal rate of land inflation. He also included a factor to adjust the rent review costs from one review date to the next, adopting 2% as an approximate figure.

[82] A financial model must include a discount rate to reflect the opportunity cost or required rate of return on capital that the lessee has in the farming business. This capital includes stock and plant, lessee's interest in the unimproved value, lessee's development and improvements, working capital and intangible assets. In arriving at the return, Mr Crighton researched rates of return obtained for similar operations and used a capital asset pricing model (CAPM) as a cross-check. These two methods may not arrive at the same result due to the generally accepted fact that farmer owner/operators accept a lower return than would be shown in a CAPM.

[83] Mr Crighton also noted that the shares of listed farming companies tended to trade at significant and persistent discounts to the net tangible asset backing of the company, and cited examples where shares had traded at discounts of up to 70% of net tangible assets. He suggested that this may be due to imperfect information, incidents of "valuation lag", being the time between reporting asset values and changes in market for land and other assets, and owner/operator factors in relation to the difference in prices paid for farmland by owner/operators and registered farming companies.

[84] We were asked to note that when buying farms, owner/operators not only consider current and expected profitability, but were also aware that they would obtain "free" housing, tax deductible expenses relating to transport etc, be "buying a job" and may consider lifestyle issues. Purchasers of shares in listed farming companies on the other hand ignored these issues and tended to require a higher direct monetary return than individual owner/operators.

[85] Accordingly, Mr Crighton considered that if required rates of return for listed farming companies are to be used to arrive at returns for owner/operator farmers, then adjustments need to be made to those returns to take account of the other considerations mentioned earlier.

[86] Mr Crighton undertook the following steps to arrive at his discount rate:

(a) Calculate expected returns from historical data of owner/operator dairy farmers;

(b) Determine required rate of return for listed farming companies using a CAPM and weighted average cost of capital (WACC);

(c) Determine possible adjustments for housing, tax benefits and lifestyle considerations, and adjust the CAPM;

(d) Reconcile the answers from Step (3) and Step (1);

(e) Consider whether any further adjustments are required for the difference in required returns for those owner/operators on leasehold land and owner/operators on freehold land.

[87] To determine annual cash returns, Mr Crighton utilised data contained in the New Zealand Dairy Board's Economic Survey of Factory Supply Dairy Farmers 1989-1999. This showed average pre-tax returns on operating assets of 3.6% with a maximum of 7.4% and a minimum of 1.9%. The total return on assets includes the income return plus any capital gains over the period. Mr Crighton calculated this to be an appreciation in real land prices of approximately 2.3%.

[88] From these figures, Mr Crighton arrived at an expected gross return on assets of 6% made up as follows:

(a)	Expected pre-tax income	3%
(b)	Expected real land inflation	1%
(c)	Expected price inflation	2%
	TOTAL:	**6%**

[89] In his calculations for the second step Mr Crighton took account of the usual funded mixture of debt and equity and the costs thereof. This included the after tax required return on equity, weights of debt and equity in the capital structure and the after-tax return on debt required. He also factored in a risk free rate of return and a risk premium or market price of risk. His risk-free rate was based on 10 year government stock at around 6% per annum, and for his tax rates he used corporate marginal rates of 33% and a personal marginal tax rate of 36%.

[90] His market risk premium was the difference between the expected returns on the market portfolio, less the after-tax risk-free rate. He also considered that based upon empirical market evidence, the post-corporate and investor tax market risk premium average was around 9%. Mr Crighton also used a weighted asset beta, to adjust the non-diversible position of the risk to investors, which showed a weighted average very close to that of Tasman Agriculture Limited, a listed farming company.

[91] Using that information, Mr Crighton arrived at a post-tax nominal and pre-tax nominal WACC for farming as follows:

(a)	Risk-free rate	6%
(b)	Tax-corporate	33%
(c)	Tax-personal	36%
(d)	Asset beta	0.35%
(e)	Market risk premium	9%
	WACC Nominal Post-Tax	**6.9%**
(f)	Effective tax rate, assuming that 50% of the total return is in the form of tax-free capital gain	16.5%
	WACC Nominal Pre-Tax	**8.37%**

[92] Mr Crighton's calculations for the third step have been estimated as the pre-tax equivalent cash flows for owner/occupier housing based on weekly rent of $150.00 grossed up to the pre-tax equivalent at a rate of 33%, and the other cost benefits based on $100.00 per week also grossed up to the pre-tax equivalent at a rate of 33%. Both calculations are expressed as a percentage of the opening operating assets which were based on the NZ Dairy Board Survey figures for opening operating assets in 1998/99 of $1,489,173.00. These calculations resulted in an adjustment of 1.3%.

[93] Mr Crighton then reconciled the difference between the CAPM estimate pre-tax nominal required return of 8.37% and the expected return of 6% as follows:

(a)	Expected pre-tax nominal CAPM returns	8.37%
(b)	Less monetary adjustments	1.3%
(c)	Less implied non-monetary benefits adjustment	1.07%
(d)	Expected pre-tax nominal return for owner/operator farmers	6%

(The non-monetary benefit adjustment is an allowance for the "lifestyle" factor.)

[94] In considering the fifth step, Mr Crighton's research revealed that the difference between expected returns for lessees and those for freehold farmers was inconclusive, and he therefore assumed the returns to be the same. Based on all his analysis, therefore, Mr Crighton adopted a pre-tax nominal discount rate of 6%.

[95] Adopting all the data gathered as detailed above, Mr Crighton then calculated the loss in value for the test cases derived from a comparison of the values of the lessees' interest in the unimproved value "before" and "after" the legislative changes to the lease terms and conditions as at 1 January 2001. Such losses excluded any value loss resulting from the inclusion of the right of first refusal provisions in the new leases. These figures are incorporated in Mr Larmer's evidence and were included earlier in this decision.

[96] Mr Crighton concluded his pre-prepared brief of evidence by confirming that the approach taken by Mr Larmer in determining the impact of the right of first refusal, was in his opinion the correct approach rather than attempting to integrate this factor into a financial model by amending the discount rate or by some other means.

[97] In a supplementary brief of evidence, Mr Crighton drew attention to the differences and the similarities between the factors in his financial model and those adopted by the respondents in their financial model. The differences in inputs included:

(a) The discount rate – the respondents' 8.4% is based on investment portfolio returns – the applicants' rate of 6% is based on cashflow and capital gain. Mr Crighton had based his input on the empirical evidence described earlier, and he noted that the respondents' discount rate was higher than any return contained in the NZ Dairy Board Survey and that no account had been taken for capital value increases. However, it was noted that the respondents' land inflation rate of 2.5% was almost the same as the applicants' rate of 3%.

(b) Perpetuity – respondents 50 years, applicants 200 years.

(c) Rent Review Costs – the respondents did not include any provision for rent review costs.

(d) Land Inflation Rate – the respondents and the applicants agree on a Consumer Price Index Rate of 2%. The respondents use a 0.5% real land inflation rate based on rule of thumb, while the applicants use 1% based on the dairy land price index. Mr Crighton advised, however, that in his opinion this difference was not significant.

(e) Unimproved Values of Land - on which Mr Crighton did not comment as he had had no part in assessing these inputs which had been determined by Mr Larmer for the applicants.

[98] In conclusion, Mr Crighton commented that he had re-constructed the respondents' model, which was essentially the same as his own, and tested it and found it to be robust. Using his inputs and running the calculation to 200 years rather than the 50 years used by the respondents, he showed an increase in compensation of $37,000 on one of the test properties (NP 2 – AI & K J Williams). This increase was put down solely to running the model for 200 years as opposed to 50 years.

Valuation Methodologies - Respondents

Professor Boyd

[99] Professor Boyd is Professor of Economics at Queensland University of Technology. Previously he was Professor of Property Studies at Lincoln University. His main fields of research are investment analysis, valuation methodology and valuation of partial property rights. He has had 30 years experience as a valuer and property analyst in New Zealand, Australia and South Africa. He was instructed by Quotable Value New Zealand to assist in preparing the valuations for the respondents in this hearing.

[100] His evidence related specifically to the use and justification of that use, of an investment model in assessing compensation for the rural properties in question. This was as opposed to the utilisation of a comparative market approach. In essence he established the methodology and defined the inputs into the investment model which Mr Burgess and Mr Charteris then utilised.

[101] Professor Boyd considered that the compensation was primarily related to the three specific changes contained in s 4(1) of the 1998 Amendment Act which have been set out earlier.

[102] The two market values as set out in ss 4(3)(a) and (b) of the 1998 Amendment Act then had to be determined taking into account only the effects of those three conditions on the market value. To Professor Boyd, this caused conceptual problems as he was of the opinion that direct market inference or comparison would include other factors unrelated to the three listed conditions. His basic premise is that under s 4(3)(a), a hypothetical valuation is required. On the other hand he considered that the market leasehold properties would, as he put it, “have been influenced by lessor dissatisfaction about perceived injustices in the existing leases”.

[103] He considered that it was impossible to obtain market evidence for the purposes of s 4(3)(a) “before” valuation because it is a hypothetical situation. From that he deduces that a simulation exercise, or use of an investment model is appropriate. Although he acknowledged that a comparative market approach could be used in the “after” valuation process, it was not desirable to compare two valuations using different approaches, and therefore he chose to adopt the investment method for both the “before” and “after” valuations. Of interest to the Tribunal was his comment that there was a requirement to make numerous adjustments to sales figures if using a market based approach to take account of:

(a) Value changes as a result of economic or social factors;
(b) Different sizes of properties;
(c) Variation in land usage;
(d) Re-evaluation of the worth of lessee goodwill;
(e) Physical change to properties.

[104] Considering these factors, he was of the opinion that analysis of market sales would involve a large number of subjective assumptions which would probably result in values containing a wide error range. The Tribunal believes that assessing such factors is part of the everyday skills used by valuers involved with rural properties. We are also of the view that market value encapsulates the very matters to which he refers.

[105] Professor Boyd then set out the details of an investment valuation using the basis that an investment is the present worth of the present and future benefits that can be derived from that investment. The payment of rent by a lessee derived a right in real estate and the amount of rent was a major factor in the perceived benefits to a lessee. He identified three elements relating to the lessee's interest as being:

(a) The profit or benefit rent;

(b) The lessee's physical assets;

(c) A goodwill or going concern factor.

[106] By using this approach he considered that the profit rent could be assessed on a "before" and "after" basis, and that the lessee's assets would be unlikely to change in the interim. However, the goodwill factor could, in his opinion, change due to the assignment clauses referred to in s 4(1)(c) of the 1998 Amendment Act. He proceeded to argue that other than this the goodwill factor would be the same on a "before" and "after" basis, after making a deduction for the effect of the assignment from the latter. In his model he considered that quantifying the present value of the profit rent over a 50 year period was appropriate.

[107] Regarding land inflation, he adopted 2½% per annum, a market rental rate of 5% with 7 year reviews, and a discount rate of 8.4% pre-tax. The latter was drawn from mortgage, composite risk-free and medium risk investment rates.

[108] It appeared to the Tribunal that in spite of Professor Boyd's views regarding the large number of subjective assumptions required in an analysis of market sales, there are also a number of assumptions made in compiling the various figures to be applied to his model. In fact, under cross-examination Professor Boyd agreed that using separate components was more complicated than simply doing a sales comparison analysis in relation to the "after" situation.

[109] Some of the assumptions were at variance with those figures adopted by Mr Crighton. This disagreement between the valuers cogently illustrates the reason why the investment method perhaps should only be used by valuers of rural properties as a secondary method or check against a comparative sales market assessment.

[110] Surprisingly, Professor Boyd also acknowledged that his model did not provide for an accommodation of the right of first refusal, and that he had not been instructed to give that matter consideration, and therefore had not done so. We consider this unhelpful and the result of course is the rule of thumb approach adopted by Mr Burgess as to this factor which needs to be included in the equation when using the investment method.

Mr I J Burgess and Mr W J Charteris

[111] The respondent's valuer witnesses were Mr I J Burgess and Mr W J Charteris, both registered valuers and employees of Quotable Value New Zealand, based in New Plymouth.

[112] In the same way that Mr Larmer has considerable valuation experience in the Taranaki areas, so too do the valuers retained by the Crown. Mr Burgess has considerable valuation experience in Taranaki and Wanganui areas, and he was supported by Mr Charteris, who also has similar experience but confined mainly to valuation work with the former Valuation Department now Quotable Value. Mr Charteris effectively adopted the methodology used by Mr Burgess, which in turn had been derived from that designed by Professor Boyd.

[113] Mr Burgess presented evidence detailing the respondent's methodology and approach which was based on Professor Boyd's financial model, and provided specific valuation and compensation evidence on seven of the test case properties. Mr Charteris, using the same methodology and approach, presented specific valuation and compensation evidence on the remaining properties.

[114] Mr Burgess commenced his evidence with an overview of valuation approaches that he had utilised and quoted from the New Zealand Institute of Valuers Valuation Standard 1P.VS 1-1 Cl.1.3 – Market Value Basis of Valuation. It is perhaps helpful to quote it in full because Mr Burgess only quoted it in part:

> *Market Value* is estimated through application of valuation methods and procedures that reflect the nature of the property and the circumstances under which the given property would most likely trade on the open market. The most common methodologies of estimating Market Value include the Sales Comparison Method, the Capitalised Income or Discounted Cash Flow Method, and the Cost Method.

[115] Mr Burgess continued with a quotation from IP. VS 1-1 Cl 1.5 of that Standard which commences:

> All *Market Value* measurement methods, techniques, and procedures will, if applicable and if appropriately and correctly applied, lead to a common expression of *Market Value* when based on market–derived criteria.

The section continues –

> Sales comparison or other methods of market comparison should evolve from market observations….The Capitalised Income 'Method' or the Discounted Cash Flow Method should be based on market-determined cash flows and market-derived rates of return.

[116] Having satisfied himself as to the standards he should use, Mr Burgess indicated that he would adopt both a sales comparison as well as a discounted cash flow approach to determine market value. However, he considered that it was not possible to use a market approach to determine the market value under section 4(3)(a) of the Maori Reserved Land Amendment Act 1998. That is, what that market value would have been, as at 1 January 2001, if the 1997 and 1998 Amendment Acts had not been proposed or enacted. In his opinion that section 'is clearly a hypothetical situation as there are no leasehold properties of this nature, and therefore no market evidence available, as at 1 January 2001.' However, he was satisfied that market evidence was available to support the 'after' valuations defined in Section 4 (3)(b) where sales had occurred in the light of the enactments. He referred to other changes affecting the market, which in his opinion should not be compensated for under Section 4 (1).

[117] He stated that as a result of these changes he would have to adjust his 'after' valuations using the market sales approach to remove the effect of those changes. As it would be difficult to objectively analyse and quantify the effect of some factors he concluded that the market sales approach was likely to be nothing other than a useful check method while the discounted cash flow approach would provide a more appropriate assessment of values for farm properties during that period.

[118] Based on an investment approach, he stated that the value of an investment is the present worth of the future and present benefits that could be derived from an investment, which in the case of leasehold land included benefits of profit rent, good will and a lessee's physical assets. Essential to the investment approach is the

derivation and application of market information which in his opinion included the market value of the unimproved nature of the property, market rental rates and a market derived discount rate. He considered that the investment approach provided a distinct advantage over the market sales approach in that it only measured the impact changes in compensatable items.

[119] In his conclusion regarding valuation approaches Mr Burgess reiterated that the market sales approach was not an appropriate means of assessing values under Section 4(3) as there was no ‘before’ evidence and that it was difficult to accurately and objectively assess the value of non compensatable items in the ‘after’ market value. However, the investment approach being based on market derived factors, only quantified the compensatable items defined in Section 4(1) of the 1998 Amendment Act.

[120] Mr Burgess was also of the opinion that properties sold before the legislation was either proposed or enacted were selling at 73% of freehold value. He contended that any analysis did not make allowance for the type of original cover, property type, size, locality or productive capacity. He argued that the only way to determine individual ‘before’ values for each property using the market sales approach, would be to compare each subject property with market derived parameters. These he contended could be described as fairly broad brush and at best used as a supporting method. That is an interesting comment when related back to the New Zealand Institute of Valuers Valuation Standard IP. VS 1-1 Cl. 1.5 and the phrase ‘market-derived criteria’.

[121] Continuing with his approach in establishing a ‘before’ value using an investment method led Mr Burgess into the very difficult area of unimproved values. In order to establish future rentals he sought to inflate the unimproved value as at 1 January 2001 by a land inflation factor until the next review date and then apply the prescribed rental rate of 5% to that unimproved value. He then claimed that the process could be repeated for a 50 year period, as an approximation for infinity. We believe that as the matter being dealt with is perpetual renewal, this premis is flawed. Similarly the Tribunal finds that the sales evidence produced relating to unimproved values was limited and unconvincing.

[122] Mr Burgess then proceeded to approach the determination of the market value as at 1 January 2001, in the light of the enactment of the 1997 and 1998 Amendment Acts providing a comprehensive analysis of some 85 leasehold sales that occurred in the period 1 January 1998 to 1 January 2001. On average, he considered properties were selling for 70.9% of the calculated lessees' interest and 43.5% of the freehold value but claimed that these figures again did not make any allowance for the type of original cover, property type, size, locality, or productive capacity. He considered that the 'after' sales were at significantly lower proportions of both the calculated lessees' interest and freehold value than the 'before' sales, but was of the opinion that these differences were not solely attributable to the introduction of the legislation. Accordingly, he felt that those differences were therefore not totally compensatable.

[123] He also considered that a number of other changes had occurred which required adjustment as non-compensatable items, those being:

- The issue of dairy company shares
- Changes in the unimproved value to land value ratio
- The stigma currently attached to leasehold properties
- Transitional risk associated with uncertainty as to the level of future rentals
- The effect of compensation on the market.
- Progression through the term of the lease (i.e. proximity to the next rent review)

[124] Mr Burgess then went on to in his words "attempt to analyse the effect each of these issues has had in the market place". His conclusions are summarised as follows:

a) Dairy Company Shares – if the real estate market remained unchanged the requirement to purchase shares would result in a loss in value and the total unimproved value (both lessor and lessee interest) with some reduction in land improvement but not structural improvements. The effect would also flow on to other classes of land suitable for dairy grazing or conversion to dairying.

b) Changes in the UV/LV ratio – factors affecting this ratio are changes to the costs of land development, changes to tax deductibility provisions and inflationary or deflationary movement in land prices impacting more significantly on unimproved value than development costs. This is particularly so when the movement of land prices exceeds general inflation rates.

c) Stigma – Mr Burgess referred to a description of stigma as "the detrimental impact on property value due to the presence of a risk perception-driven market resistance." He indicated that this risk to the Taranaki leasehold properties is evidenced by leasehold properties selling well below their investment value and the withholding of leasehold properties from sale as the vendor would not expect to achieve realistic prices. However, we note that Mr Burgess in cross-examination went on to say that the availability and payment of compensation had the effect of increasing the supply of leasehold properties for sale. He also alleged that publicity by lessees in their crusade for maximum compensation and protests by Maori interests at recent leasehold auctions exacerbated the stigma.

d) Transitional risk – this relates to the fact that the rent reviews are not due until January 2003 and some uncertainty exists as to how the fair annual rentals will be assessed.

e) Effect on the market of compensation – his analysis of leasehold sales revealed a significant number of vendors had indicated to him that they would not have been prepared to accept the price they had received for the lease if it had not been topped up with a compensation payment. However, under cross-examination Mr Burgess declined to identify any of these vendors and indicated that in any event the effect of compensation paid has only had a marginal effect. He concluded that market value being a factor of supply and demand, had decreased due to the availability of compensation.

f) Progression throughout the term – without legislative change, rentals would have increased substantially at the next review and therefore leasehold properties attract a lesser price the closer they get to the review date.

[125] Initially in his evidence when using a comparative market approach Mr Burgess assessed an adjustment of 30%-35% that should be added to the "after value" to allow for these non-compensatable items. However under cross-examination he advised that that adjustment percentage had been based on earlier analysis which has not been submitted in evidence and he agreed that the adjustment of 30%-35% should be deleted.

[126] He concluded by saying that the subjectivity associated with this adjustment meant that the "after" market value using a market sales approach must be seen as a supporting methodology only.

[127] Mr Burgess then went on to describe his investment approach to determine the "after" values including determining future rentals by inflating the unimproved value as at 1 January 2001 by a land inflation factor projected out over a 50 year period utilising Professor Boyd's factor of 2.5%, a market rental rate of 5% based on market evidence, and Professor Boyd's discount rate of 5.6%.

[128] He assessed a profit rent for each rental period to enable his calculation to be completed and then added back the lessee's physical improvements at the same rate as was used in the "before" valuation. Mr Burgess then adjusted the value of the lessee's interest in the "after" valuation to accommodate changes in the assignment provisions or right of first refusal which had the effect of reducing the value.

[129] This assignment provision factor was stated by Mr Burgess to be difficult to objectively quantify and to use his words again he "decided to use a valuer's rule of thumb" to arrive at an appropriate factor of deduction of 5% for economic dairy farms, 3% for drystock and run-off farms and 1% for other properties. Mr Burgess was closely questioned and cross-examined on this analysis and he acknowledged that the figures were not based on any market evidence and were his judgement only. He conceded that a discount below 5% would fall within statistical margins of error. He also acknowledged that if a market approach using comparable sales was used

then no determination of a discount for right of first refusal was required. This confirmed the evidence of Mr Larmer.

[130] Mr Burgess then presented detailed workings for each test case property determining all "before" values using an investment or financial model approach and a market sales approach and investment or financial model approach for the "after" values. In each case Mr Burgess used as a starting point the freehold values that he and Mr Charteris had agreed with Mr Larmer.

[131] The land value component of these agreed values was further broken down into development improvements and unimproved values which were scheduled earlier in this decision.

[132] In each case under the market sales approach to the "after" market value of the lessees' interest, Mr Burgess added a sum to reflect what he described as the non-compensatable factors described earlier which he acknowledged under cross-examination were "rounding off" figures. Mr Burgess' valuations were supported by a comprehensive series of indices containing details of sales evidence, rental rate comparisons and methodology used to determine unimproved values. Under cross-examination some significant errors were conceded as being present in these indices.

[133] Mr W J Charteris also presented his evidence in a virtually identical format to Mr Burgess on the remaining test case properties.

[134] We list below the respondents' valuers' assessment of compensation for each of the test case properties in schedule form and incorporate for comparison Mr Larmer's assessment of compensation. The assessments of course arise from the calculation based upon the respective detailed valuations contained in the evidence.

		Respondent $	Applicant $
NP 2	AI & K J Williams	185,000	380,000
NP31	PJ & CM Woodmass	130,000	280,000
NP89	BI & D Williams (G Williams Trust)	85,000	145,000
NP110/1 11	IR & LJ Diack	45,000 95,000 140,000	240,000
NP140	Whatalotta Heifers Ltd	165,000	630,000
NP 142 NP 143 NP 144	(Ohangai Trust) LW & VA Williams & DC Woods	400 135,000 90,000 225,400	490,000
NP 147	CM & PJ Christie	80,000	300,000

Mr Neild

[135] Mr Neild, an agricultural consultant and advisory officer, was not called to give evidence but his written brief was produced in support of the methodology adopted by Professor Boyd and Mr Burgess. Attached to his brief of evidence was an appendix prepared for Quotable Value NZ. This comprised current costings for the development of:

a) flat land, originally in fern and flax;

b) medium to heavy bush on flat land;

c) as above, but with drainage required;

d) medium hill country;

e) wet, sand flats.

[136] We presume that the evidence of Mr Neild was for the purposes of providing information to enable Mr Burgess to reach his conclusions in respect of unimproved values. During the course of the hearing no further reference or comment was made by either party on Mr Neild's evidence.

The Economists

[137] Each of the applicants and respondents relied upon evidence from eminent economists to support their methodologies. The applicants called Professor N C Quigley and the respondents Mr J K W Isles. We have referred partly to Professor Quigley's evidence earlier when dealing with Larmer's approach to the shadow period and the valuation prior to the shadow period.

Professor Quigley

[138] Professor Quigley is a Professor of Economics and pro Vice-Chancellor (Commerce and International) at the Victoria University of Wellington. He holds an MA (First Class Honours) from the University of Canterbury and a PhD from the University of Toronto. He has authored or co-authored three books and over 20 refereed academic papers. His primary areas of research and teaching are applied microeconomics and financial economics. We received a copy of his Curriculum Vitae.

[139] In his main brief of evidence Professor Quigley concentrated to a considerable extent on analysing the approach adopted by Mr Larmer and in particular felt there was justification for excluding transactions and data relating to the period between 1993 and 1997. The reason for this was the fact that, following the announcements of legislative changes and the commencement of consultative processes but before the introduction of actual legislative changes uncertainty in the minds of the lessees would be at its greatest – resulting in aberrated market values. To use his words "the discount below the value of the lessee's interest in the absence of the Acts would have been greatest in the period from 1993-1997 when lessees knew that it was Governmental policy to change the terms of their leases but did not know what if any compensation would be paid". This seems to us to be the very point which the Court of Appeal was raising in its observation at the end of the judgment to which we have referred earlier. Professor Quigley expanded upon this issue in paragraphs 18 and 19 of his initial brief of evidence which we set out in full as follows:

> 18. One plausible interpretation of the data on the decline in the market value of lessees' interest between 1993 and 1996 is that the decline in value reflects:

> (i) Uncertainty about the payment of compensation (the probability that no compensation may be paid);
>
> (ii) The present value of any compensation that is paid;
>
> (iii) The proportion of the loss for which lessees' do not expect to be compensated (perhaps because of problems arising from the difficulty of calculating the precise magnitude of the losses); and
>
> (iv) The losses resulting from the delay in the receipt of compensation by lessees (since compensation was not paid at the point when the losses were sustained).
>
> This complex range of factors suggests that it will be extremely difficult to derive from data on sales of lessee's interest in the period 1993 – 1996 any easily interpreted information about the impact of the Acts.
>
> 19. If the price paid for the purchase of the lessee's interest includes the present value of the expected compensation payment, then the fall in the value of the lessee's interest will not accurately measure the loss suffered by lessees as a result of the Acts. Each sale of a lessee's interest from April 1993 until the end of 1997 incorporates in the purchase price the present value of the expected compensation. So long as sales of lessee's interest in the period 1993 – 1997 inclusive include a non-zero probability that some compensation will be paid, then these sale prices will understate the loss of lessee's resulting from the (expected) introduction of the Acts. For this reason I do not believe that data from 1993 to 1997 are helpful in assessing the compensation payable to the lessees affected by the Acts.

[140] Professor Quigley also indicated that once the legislation was put into effect the lessors had an incentive in most cases to exercise the option to purchase to remove uncertainty and transactional costs associated with a pending setting of rental rates.

[141] Professor Quigley also presented a supplementary brief commenting on the evidence of Professor Boyd, Mr Burgess and Mr Isles. We will not analyse all of that evidence which we have taken into account. Professor Quigley dealt significantly with Mr Burgess' evidence in respect of the non-compensatable factors that are alleged to have affected market value so as to render the tenure discount method adopted by Mr Larmer inappropriate. We deal with Professor Quigley's response as follows:

a) Dairy Company Shares

Professor Quigley agreed with Mr Burgess that the dairy companies' and co-operatives' policies in respect of acquisition and sale of shares may affect value by the result in some adjustment in the relative book values of shares and other assets.

However, he considered Mr Burgess had not looked at the wider dairy industry factors applying in this particular area and in particular the likelihood of greater ease of exit from dairy farming which will result from the proposals involving merger of Kiwi Co-operative Dairy Company, New Zealand Dairy Company and the New Zealand Dairy Board into the Global Dairy Company. This, he says, will have the effect of increasing the value of existing dairy farms:

> Farmers will be willing to pay more for land that is currently used for dairy supply if they know that they can exercise the option to leave the co-operative without foregoing some of the market value of their equity investment in the co-operative. Further, since a barrier to exit is always a barrier to entry, fair value exit provisions should raise the price of land that is being purchased for conversion to dairy land.

b) Changes in the UV:LV Ratio

Professor Quigley, in his analysis of this issue came to the conclusion that Mr Burgess was incorrect in asserting that:

> Development costs have a direct bearing on the unimproved component of property values, particularly in the high value brackets, as the higher the cost to develop, the lower the demand for unimproved land.

His view was that such factors have no impact on the demand for land per se. He concluded, as set out in paragraph 23 of his brief:

> Mr Burgess appears to cite one factor that will increase the value of unimproved land (improvements in development technology) and one factor that may reduce the value of land (the change in the tax deductibility of development costs). In the absence of a formal analysis of the impact of these factors, I see no reason to assume that they would have a significant net positive or negative impact on the value of land, so I do not believe they undermine the value of a market approach to the assessment of compensation.

c) Stigma

Professor Quigley's views were that there was nothing in Mr Burgess' brief of evidence which would justify his assertion. Professor Quigley stated:

> It is not clear to me how the impact of stigma on land values is distinguished from the impact of uncertainty at a conceptual level, and there is unlikely to be any satisfactory means of obtaining a quantitative assessment of the impact of stigma separate from uncertainty.

d) Transitional Risk

Professor Quigley's views on this assertion by Mr Burgess were that there is nothing significant about the pending rent reviews in 2003. He was of the view that there is nothing unusual about the risk that lessees bear in facing an upcoming rent review and that instead of providing a depreciating uncertainty factor "the passage of the legislation has provided the lessees with much greater certainty than has existed for many years".

e) Effect of Compensation

Professor Quigley did not accept Mr Burgess' assertion that the availability of compensation would tilt the market in the purchaser's favour. He considered that this was contrary to rational economic behaviour and indeed if a property was offered at less than its market price competition between potential buyers would bid it up. Even if individual lessees used the availability of compensation to rationalise selling at a lower price that fact did not alter the true market price being what a willing lessee would accept and a willing potential lessee would pay.

f) Progress through the lease term

Mr Burgess presented the proposition that as rentals would increase substantially at the next review, sales at this stage in the lease would be less attractive. Professor Quigley countered by stating that Mr Burgess had not carried out the analysis which he (Professor Quigley) had and which he demonstrated in his supplementary brief. Contrary to what Mr Burgess alleged, a prospective lessee would be prepared to compensate the existing lessee for high rental payments they had made at the beginning of the lease and for foregoing (by selling the lease) the opportunity to obtain the benefit of what, through inflation would be lower rentals at the latter end. In other words while uncertainty about the pending rent review might depress the market this would be small in comparison to the advantages a lessee would derive from payment of rent below true market rents by the later stages in the lease.

[142] Finally in this section of his brief Professor Quigley commented upon the somewhat unscientific approach by which Mr Burgess rounded the non-compensatable factors to draw the conclusion that their effect was in the vicinity of 30%-35%. To use Professor Quigley's words:

> I consider that such non-rigorous approach to the assessment of a factor that has a major impact on his calculations detracts from the quality of his overall analysis.

We add our concern that such a percentage unscientifically based would have a significant negative impact on what the applicants may be entitled to receive by way of compensation.

[143] In his overall commentary on the evidence of Mr Burgess, Professor Boyd and Mr Isles, Professor Quigley commented:

> 51. A common theme in the three Briefs of Evidence presented by Mr Burgess, Mr Isles and Mr Boyd is to compare the "market" approach and the "investment" approach and to conclude that the latter represents the most effective means of assessing the compensation that should be paid to the lessees by the Crown for the matters prescribed in s 4(1) of the Maori Reserved Land Amendment Act 1998. I do not agree with this conclusion because the investment approach requires that we choose a number of critical parameters (including the market rental rate for a 7 year rent review period) that are extremely difficult to estimate from available historical data. We cannot have a high level of confidence that the 5 percent rate chosen by Mr Burgess and Professor Boyd is the correct market rental rate, and a range of evidence suggests that this rate is conservative. If the true market rate is higher than 5 percent, then the calculations of Mr Burgess will significantly understate the compensation payable to the lessees whose interests are affected by the Maori Reserved Land Amendment Act 1998.
>
> 52. In my view, the most fundamental reason to take the evidence from changes in the capital value of the land rather than the investment approach is that changes in capital value have been created by individuals putting their personal wealth on the line by buying and selling farm land. They have a much stronger incentive to make the correct assessment of the market rental rates than does any uninterested expert adviser. If the price at which the land is traded is too high (based on expectations of market rates that are too low) then the purchaser has transferred wealth to the seller. If the price at which the land is traded is too low (based on expectations of market rents that are too high) then the seller of the land will have transferred wealth to the purchaser. Incentives for the seller and the buyer to avoid these wealth transfers will ensure that data on market sales are (when correctly interpreted) far more informative than the predictions of valuers.

Mr Isles

[144] Mr Isles is a consulting economist based in Wellington. He has an MA Honours Degree from Canterbury University and a Wool Certificate from Lincoln College (as it then was). He is not a valuer but has extensive experience in ground rental issues and set out significant work with which he has previously been involved. He has had involvement with the lands subject to this dispute. He is a director of a number of public and private companies. His brief was to comment on the evidence of Professor Boyd and present his own views as to an appropriate approach to lessee compensation.

[145] Generally Mr Isles supported the methodology created by Professor Boyd. He considered that the land inflation rate of 2.5% to be generous. He agreed with Professor Boyd's assessment of market rental rates at 5%. He considered the discount rate adopted by Professor Boyd to be slightly generous. Interestingly he considered, because he favoured the investment approach to valuation, that the market sales approach is probably best used as a cross check rather than being the principle method of determining "compensation". This is surprising because first, one or other of the methods has to be used to determine "market value" not "compensation". Secondly, it was our understanding of the evidence of the respondents that the investment method was to be preferred because of the impossibility in one of the instances and great difficulty in the other in determining market value by use of the market sales approach.

[146] Mr Isles discussed his views on the methodology for calculating the compensation payable. His support of the investment approach is partly based on his view that it "directly focuses on the elements for which compensation is to be made without "noise" from non-compensatable factors". In his conclusion he also states:

> If "before" and "after" market values of lessees' interests are used as the primary determinant they run a pronounced risk of cluttering the allowable factors with other factors. Unbundling the historical and cross-geographical factors would tend to become circular.

We understand him to be saying that rather than going through the process of determining "before" and "after" values and feeding them in to the calculation to

arrive at compensation figures it is better to go straight to quantifying directly the three compensatable items specified in section 4(1) of the 1998 Amendment Act.

[147] As we shall elaborate later we consider this approach to be a departure from the method of assessing compensation contained in the legislation and highlights in our view a fundamental flaw in the investment method approach of the respondents.

Taxation

[148] Prior to the hearing commencing in this matter there were discussions between the parties and the Government. Agreement was reached that the parties would specify in their submissions before the Tribunal that they expect the Tribunal, in calculating compensation, to take into account the impact of tax on cashflows. In a media statement from the Minister of Finance it was stated that it had been agreed that a market value approach to compensation does incorporate the impact of tax on cashflows and what this means is that "both sets of leaseholders" will be compensated on a net of tax basis.

Mr Coppersmith

[149] Mr Coppersmith is a partner with Price Waterhouse Coopers, Chartered Accountants. He specialises in corporate finance. He participated in the preparation of a Memorandum for the Lessees Association. This considered the proposed changes outlined in the Maori Reserved Land Act Bill which had been introduced into the House of Representatives just prior to the hearing of this matter but subsequently withdrawn at the last minute by the Minister of Finance, following the agreements mentioned earlier.

[150] His evidence was directed towards the issues of taxation. In the Memorandum which he produced he considered that the use of either comparable sales or theoretical financial models to arrive at a market value inherently recognised that the values were post-tax.

[151] He produced a series of tables relating to the impact of taxation on a given cash flow producing an aggregate present value. The analysis demonstrated clearly that ignoring taxation as an expense resulted in an incorrect estimation of asset value.

Accordingly, in his opinion, where actual market transactions are used as the basis for any analysis, then, for any rational investor, the price paid would incorporate the impact of taxation. This evidence provided the basis for the submission from Mr Hodder that if the comparative market sales approach was accepted taxation was of no further relevance. We are also satisfied that the respondents have taken account of the impact of taxation in their calculations and indeed the commencement of this hearing was delayed by one day to enable such to be incorporated in the evidence then presented.

Legal Issues

[152] It is our perception that the different methodologies adopted by the respective sides in this dispute arise primarily from differing interpretations of the provisions contained in section 4 of the 1998 Amendment Act. As we have already indicated, it is the view of the respondents and their valuers and their expert economist that the formula contained in section 4(2),(3),(4) and (5) of the 1998 Amendment is intricately and exclusively linked with and indeed inseparable from, the three matters for which lessees are to be compensated as contained in s 4(1). It is the Crown witnesses' evidence that during the shadow period there were other factors from those contained in s 4(1), which had a depreciating effect on value which continued up to 1 January 2001. Therefore, the "market values" specified in both subsections (3)(a) and (b) are necessarily hypothetical valuations, which can only be determined by adopting the investment approach. Indeed Professor Boyd commented under cross-examination that if this were not the case then the appropriate method of determining "market value" under subsection (3)(b) should be the comparative sales approach adopted by Mr Larmer.

[153] The applicants argued that there was no evidence of any factor other than the three contained in s 4(1) which depreciated value during the shadow period, but in any event that subsection merely outlines the three matters for which the lessees are to be compensated, is declaratory and therefore the formula contained in subsections (3),(4), and (5) is to be applied independently of section 4(1). Mr Hodder submitted that in view of the fact that the Tribunal is required to determine "market value" the second basis of determination contained in subsection (b) is not a hypothetical valuation. In respect of both of the bases for determination under subsection (3) he

submitted that comparative sales is the appropriate method of valuation albeit backed up, but for cross-checking purposes only, by applying a methodology based on an investment model approach.

[154] Mr Parker, in his submissions on behalf of the respondents re-emphasised that any compensation awarded by the Tribunal must only be for the three changes specified in section 4(1) of the 1998 Amendment, which replicates section 16(1) of the 1997 Amendment. He further submitted that insofar as onus of proof is concerned, in valuation cases the onus is generally on an objector to show that its valuation should be preferred. While this case does not involve an objection Mr Parker submitted that there is a similar onus here on each of the parties in respect of their respective methodologies. We are not sure that having regard to the statutory provisions, particularly section 4(4), there is strictly an onus on any party in this matter. Apart from the parties presenting evidence as to the valuation methodology and its consequences it is then for the Tribunal to weigh that evidence and determine the 'before' market value and the 'after' market value in order to apply the mathematical calculation which the statute specifies as the method for arriving at the ultimate compensation.

[155] The comparison between the different approaches will already be apparent from what we have said in this decision. We believe that the approach of the respondents, which is summarised in the final submissions of Mr Parker is flawed. For instance it is mistaken in our view to endeavour, in the primary valuation method adopted, to separately quantify by application of a rule of thumb tacked on to a complex investment based formula, compensation for the impediment on the entitlement to assignment by virtue of the right of first refusal which is now incorporated as an implied condition in all of the leases.

[156] Going back to the period in the early 1990s, the position which the lessees at that stage anticipated, was that they would have continued as they had for many years simply applying leasehold discounts to freehold values to determine the purchase price of the leasehold properties. This state of affairs had continued for many years and there was nothing at that stage to suggest that it would not continue. This type of approach to valuation had applied regardless of the many fluctuations which have occurred over time in the business of farming. It is clear that any agitation from

Maori as to tenure had come to the fore prior to this time and indeed was not confined to leasehold tenure but also to freehold tenure as agitation in other parts of the country had shown. This is adverted to in the evidence of Professor Quigley and Mr Gordon. We mention this because it is particularly material to which approach we are prepared to accept.

[157] The approach taken by the valuer for the applicants, Mr Larmer, is that purchasers, in setting the consideration in transactions used as data in the comparative sales methodology have factored in the quantification for the loss of value occasioned by the right of first refusal. This contrasts with the subjective and somewhat arbitrary assessment as an "add on" in the investment methodology used to arrive at market value as Mr Burgess has done. Mr Crighton was forced to do this too but adopted figures calculated by Mr Larmer using what we consider as more acceptable rationale than the reasonings of Mr Burgess.

[158] The fact that the investment method cannot really cope with the concept of inclusion in market value of the right of first refusal is one issue. Of more concern is that once the arbitrary assessment for this item is made in the manner applied by the Crown, there is a departure from an assessment of a market value as required by section 4(3)(a) and a move to an attempt to directly but separately quantify this item as one of the components of compensation specified in section 4(1). This type of approach but for all three items in s 4(1) was that adopted by Mr Isles in his evidence. It is not tenable legally, having regard to section 4 when read as a whole.

[159] The respondents have endeavoured to criticise the applicants' approach to quantification of the introduction of the right of first refusal. They have downplayed its effects. By considering it in the context of the history of transactions in respect of the leasehold lands they claim that its effect on value has been minimal. For instance Mr Parker in his submissions criticised Mr Larmer's comment that the existing lessees and potential buyers are concerned about the limits on the ability to transfer to a family trust. He referred to Mr Charteris' evidence which shows that since 1981 only 20% of transfers have been to family interests. Also the respondents allegedly using statistical data wrongly determined that for the purposes of quantifying compensation, a period of 50 years (alleged to represent "infinity") should be adopted. The point in our view, is that the right of first refusal has resulted in the

loss of a significant potential in value of the leasehold interests. There was an in-built security of tenure in all of these leases and therefore an underlying basis of value. There was the entitlement should a leaseholder wish it, to retain leasehold interest in the family on a perpetually renewable basis whether or not in specific cases that wish was exercised. The fact that in only a minority of cases transfer to family interests has occurred or statistics show that properties generally change hands within 50 year periods does not undermine that underlying value. Mr Gordon confirmed in his evidence that the effect of the right of first refusal has been underestimated and we agree with that conclusion.

[160] Mr Hodder submitted that the approach to the 1997 and 1998 amendments should be that:

a) The amendments permanently and adversely affected relevant leasehold interests.

b) The Tribunal compensation option provides a market value alternative to the second schedule compensation model.

c) Compensation is determined by the valuations set out in s 4(3) of the 1998 Amendment and the mathematical calculation, which then follows.

d) The "after" valuation requires a real valuation as at 1 January 2001.

e) The "before" valuation is necessarily hypothetical but maintains a "market value" focus and

f) S 4(1) is declaratory and does not impose a constraint on s 4(3).

[161] We prefer this interpretation of s 4 of the 1998 Amendment Act. We do not accept that the words "in the light of the enactment" in subsection (3)(b) mean that the second valuation has to be a hypothetical valuation as the respondents suggest. Nor do we accept that market value is limited to those matters contained in section 4(1) by the Tribunal quantifying and adding back into the "market value" the effect of other factors which may have depreciated the market value of the leases during the "shadow" period between 1993 and 1997 and the post amendment period to 2001. That is of course assuming that the respondents are able to persuade us that there are

other such factors (and they have not). It is an approach contrary to the plain meaning of the legislation. It also tends to introduce a concept of a market value for one purpose being different from a market value for another purpose involving the same property in each case. This would be contrary to the ratio in *Boat Park Limited v Hutchinson* to which we have earlier referred.

[162] We are of the view that this issue needs to be determined by considering what in reality the legislation is asking the Tribunal to do in order to arrive at the quantification of compensation. In doing this we have considered the purpose of the legislation. That purpose, as is set out in the provisions of s 3 of the 1997 Amendment, does not really give much assistance beyond the actual provisions of section 4 which contain the method of calculation. However, section 3 of the 1997 Amendment Act effectively lays the foundation for the scheme of the enactments and as far as we are concerned sets the basis of approach imposed upon us in section 4 of the 1998 Amendment Act. The lessees are to be compensated for what are fundamental changes to the terms of their perpetually renewable leases and the loss of substantial property rights.

[163] We have earlier referred to the factors which the respondents have put forward as being factors other than those set out in s 4(1) and which may have resulted in a depreciation in the value of the leasehold properties leading up to 1 January 2001. Mr Burgess and Mr Charteris, the principal valuers for the respondents, refer to these items as non-compensatable factors. In reaching their final "after" value of the lessee's interest based on the comparative sales approach they have in each case added back, comparatively speaking, sizeable amounts which in turn have a substantial down grading effect on the quantification of the final compensation figures. Indeed in percentage terms, they have concluded that adjustments in the order of 30-35% are required.

[164] While Mr Burgess and Mr Charteris as experienced valuers, are entitled to form their views in respect of these items, we are concerned that theirs' is the only evidence on this point and is not corroborated by any statistical market analysis. At the end of the day we consider that their belief in respect of these items is not valid and the election of an adjustment in the order of 30-35% is totally arbitrary. Indeed it

seems to us that the application of these percentages is simply to cause the "after" market sales valuation to equate with the "after" investment model valuation.

[165] Significantly, Mr Burgess conceded it as a subjective, rather than an objective analysis and he resiled from the position he had earlier taken. Under cross-examination the following exchange took place between Mr Hodder and Mr Burgess which we regard as significant evidence (evidence page 312 – lines 13-33):

> **Mr Hodder**: So we have identified the fundamental difference. We say that if you are doing a valuation under subsection, if you are doing s 43(b), you look at the actual sale price, what somebody would have got for the property on 1 January. You don't do that?
>
> **Mr Burgess**: Yes, we do, but we make certain assumptions.
>
> **Mr Hodder**: But it's a simple proposition?
>
> **Mr Burgess**: Yes
>
> **Mr Hodder**: You would not have sold this property for $865,000 on 1 January
>
> **Mr Burgess**: No Sir.
>
> **Mr Hodder**: Right. Now the difference that we have got here is this $275,000 for non-compensatable items. Now, in your evidence you talk about 30 and 35% as a bracket which might be relevant to those non-compensatable items that you have identified in that evidence?
>
> **Mr Burgess**: Yes Sir
>
> **Mr Hodder**: How does this $275,000 relate to 35%?
>
> **Mr Burgess**: Um, Sir the 30-35% was on the basis of some earlier analysis that I have done that I haven't submitted in evidence, sum, Sir, the $275,000 is unashamedly a balancing factor between the market approach or the direct sales comparison approach I should say, and the investment approach to the valuation, and clearly there is some differences there, um, there is a major difference between the two figures and we attribute them to non-compensatable items.
>
> **Mr Hodder**: <u>So if we go back to paragraph 74 of your brief, should we just strike out the last sentence which says "I have concluded that an adjustment in the order of 30-35% is required</u>"?
>
> **Mr Burgess**: <u>Ah yes, I'd be happy for you to do that, Sir</u>

[166] At this point in the evidence we consider that Mr Burgess' use of a 30% - 35% addition to the "after" market sales value to take account of the non-compensatable items became seriously undermined. Significantly, no attempt was made to clarify the position in re-examination. If this factor is removed from the respondents' assessment of "after" value using the comparative sales approach, it would have a

significant impact on the calculation of compensation quite independently of the validity or otherwise of the investment model. It appears that the addition of the percentages was simply to provide an apparently meaningful comparison of the comparative market sales basis of “after” market value used as the “cross check” for the investment model “after” market value. From an evidentiary point of view if the “cross check” is undermined the reliability of the valuations arrived at by the respondents’ valuers using the investment model is also called into question.

[167] We prefer the evidence of Professor Quigley in respect of these claims. We are not satisfied that they exist as depreciating factors nor proved to have operated on values beyond the legislative changes.

[168] In summary then, we are faced with two differing interpretations of the effect in particular of the matters contained in s 4(1) of the 1998 Amendment and how that affects the formula which is contained in the succeeding subsections. We prefer the interpretation presented on behalf of the applicants. We believe that if the Legislature had intended, when depriving the leaseholders of substantial property rights, to require the Tribunal to approach “after market value” in the way espoused by Mr Isles, then this would have been expressed in clear and unequivocal terms. It is debatable whether such a valuation would truly be a “market value”. Indeed if that were the case it would render the formula contained in the subsequent subsections otiose. It would also mean that there would have been no reason to provide for a three year period of delay from the date of the amendments to that date when compensation was to be appraised. This period of delay was clearly deliberate and can have no other basis than to provide time for sales data to eventuate. Section 4(4) of the 1998 Amendment Act would also seem to confirm this.

[169] In allowing a three year period between the commencement of the legislation and the assessment of compensation we believe the Legislature clearly saw the need to enable time for the second schedule compensation formula to be put into effect for those who chose it. This, however, by the very nature of the 1998 Amendment Act cannot have been the only reason for this delay period. It must have been contemplated that during the period to 1 January 2001 market sales data would come into existence. If the period was to allow this to happen then the only conclusion to

be reached was that the Legislature contemplated assessment of market value on the basis of comparative sales.

[170] If the approach adopted by the respondents is correct that the investment or economic method is the one contemplated on a proper interpretation of the statutory provision then there would have been no need for this period of delay beyond the four month period from the Amendment Act except to enable the second schedule compensation payment to be effected. Indeed, if this were the primary approach contemplated then the methodology of Mr Isles of avoiding the circular route and simply going directly to putting a value on the three compensatable items could have been adopted. There would in such circumstance be no need to ascertain the two market values and complete the calculation.

[171] The difficulties, which have been presented to us on behalf of the respondents, must have been in the contemplation of the lawmakers. To meet that, a pragmatic solution consisting of the formula set out in the 1998 Amendment Act was adopted. We believe that the formula contained in subsections (3), (4), and (5) is specific. In particular we hold that subsection (3)(b) does require us to determine an actual market value as is submitted for on behalf of the applicants. Not, as submitted by the respondents, a market value which has further additions made to it in view of perceived, but not proven, depreciating factors outside those contained in section 4(1), nor a hypothetical market value based on an economic model which then has deducted arbitrary assessments for the depreciating value of the right of first refusal.

[172] We believe, as Mr Hodder has submitted, that the use of the phrase "market value" is deliberate. We are really left to use our best devices on the basis of valuation evidence in reaching the market value albeit hypothetical, in respect of the "before" valuation. However, we believe that it would be extending the terminology adopted in the particular section under consideration to say that we must then, having determined what the market value is, to make further additions and deductions for the other factors, which is the position submitted on behalf of the respondents. It involves a view of the three compensatory factors in section 4(1) which practically excludes the real function of the market value compensation formula contained in the subsequent provisions.

Conclusions

[173] In conclusion therefore after careful consideration of the evidence adduced and the respective merits of the valuation methods proposed we are firmly of the view that the comparative market approach adopted by Mr Larmer is the most valid. It seems to us that it is the only method which can robustly meet the criteria set out in section 4 of the 1998 Amendment Act. We do not accept Professor Boyd's allegation of conceptual problems with this approach. The section clearly requires us to determine market value on a 'before' and 'after' basis; the difference being the lessee's interest in the lease and in turn the quantum of compensation. Mr Larmer's methods for determining the "before" and "after" market values are also supported by other valuers with extensive experience with the lands in issue. Indeed one of these, Mr Gordon, is the very valuer employed by the lessor. He unreservedly supports Mr Larmer's evidence.

[174] We consider that for the reasons stated, applying the investment or economic or financial model, as it has been variously called, other than as a secondary cross check is fraught with difficulty. This method appears to us to be contrary to the requirements of the formula contained in section 4 and at variance with sound valuation principles and standards. It endeavours to deal directly with the compensatable factors in sections 4(1) rather than providing a true market value for the respective points in time. To adopt Mr Hodder's submission the consequence of this approach is an unreasonable "reading down" of the subsequent provisions. Even when dealing directly with those compensatable factors it cannot cope with all three and requires too many intuitive assessments as the evidence of Mr Burgess has shown. It then loses fairness as an appropriate and robust method of calculating the measure of compensation to which the applicants are entitled. In short we do not consider that the methodology and calculations submitted in evidence persuade us that it is a preferable method to the tenure discount method of Mr Larmer.

[175] In reaching our conclusions we consider we have had proper regard throughout to the declarations issued by the Court of Appeal.

[176] Having reached our conclusions we can see no reason to depart from the levels of compensation which result from the “before” and “after” valuations of Mr Larmer. Accordingly there will be orders that the compensation is assessed as follows:

(a)	NP2	A I & K J Williams	$380,000
(b)	NP31	P J & C M Woodmass	$280,000
(c)	NP89	B I & D Williams (G Williams Trust)	$145,000
(d)	NP110	I R & L J Diack	$ 83,000
(e)	NP111	I R & L J Diack	$157,000
(f)	NP140	Whatalotta Heifers Limited	$630,000
(g)	NP142	L W & V A Williams & D C Woods (Ohangai Trust)	$ 1,000
(h)	NP143	L W & V A Williams & D C Woods (Ohangai Trust)	$254,000
(i)	NP144	L W & V A Williams & D C Woods (Ohangai Trust)	$235,000
(j)	NP147	C M & P J Christie	$300,000

In view of the provisions of the legislation it is not appropriate to award any interest on the compensation assessed. The issue of costs is reserved. We allow the respective parties 21 days to provide memoranda as to costs following which the issue will be considered further.

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(M E Perkins)
District Court Judge
Chairman

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(J W Briscoe)
Member

____

(W A Cleghorn, QSM, JP
Member

Signed at pm on August 2001