The New Zealand Valuer

Vol. 25, No. 3 SEPTEMBER, 1982

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NEW ZEALAND INSTITUTE OF VALUERS

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The New Zealand Valuer

VOLUME 25 NUMBER 3

SEPTEMBER, 1982

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This Issue

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Published Quarterly as the official journal of THE NEW ZEALAND INSTITUTE OF VALUERS.

Council Office: Westbrook House, 181-183 Willis St., P.O. Box 27146, Ph. 847-094, Wellington.

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The New Zealand Valuer is issued to all members and Institute students, and is available otherwise by subscription.
Articles, Research Papers and letters are welcomed. They should be typewritten, and addressed to the Editor. Biographical notes of the author(s) should be sent with the manuscript. Opinions expressed by the Editor and contributors are not necessarily endorsed by the New Zealand Institute of Valuers. The Editor reserves the right to accept, reject or abbreviate material at his discretion. Business letters, subscriptions and advice of changed address, should be sent to the General Secretary.

Registered in New Zealand at P.O. H.Q. as a magazine.

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Book Review

Financial Appraisal

By Squire L. Speedy, J.P. B.Com. M.Phil. (Hons.)

Published by The New Zealand Institute of Valuers, this book is Mr Speedy's fourth publication in addition to the numerous articles and papers written by him and published in the Valuer over more than a quarter of a century.

Some of those works have been more scholarly than many of us are prepared to cope with. Not so this publication. It has an almost novel like style commencing with an absorbing history of the evolution of financial statements and from there, the reader is led through the accounting principles, a knowledge of same being so essential in order to appreciate modem financial reporting.

After discussing the principles behind the balance sheet, revenue statements, double entry and depreciation, Mr Speedy then brings the reader up abruptly with a chapter covering the `Limitations of Financial Statements'. Because of the prima facie accuracy of accounts the author explains the need for all those concerned with using accounting statements to understand the causes, effects and extent of these limitations. To the non-accountant, this chapter puts the whole system into proper perspective giving one a much deeper understanding of the following excellent chapter on the `Analysis and Interpretation of Financial Statements'. These two chapters by themselves should be compulsory reading for all valuers.

More meat follows when Mr Speedy goes on to discuss partnerships, company finance and trend statements (in the process of which we obtain an excellent background into the principles of borrowing), clubs and societies, properties, sinking funds, taxation and the valuation of business goodwill which must rate as one of the highlights of the book. To cap it all, he finally deals with inflation accounting.

In his preface, Mr Speedy explains that the book is called "Financial Appraisal" because it is intended to help valuers and then he very tentatively places in brackets "and others". That tentativeness is completely unnecessary because what has evolved is a book that achieves its aim. It describes `why' rather than `how' and because of this adherence to an explanation of the basic principles, it is a book likely to be of interest well beyond the valuation profession as such.

More importantly, even though the finishing touches to this publication were not made until after the 1982 Budget, it is a book that will surely have a very long shelf life unless there is a major upheaval in the whole accounting system. That possibility seems unlikely when a 1982 text explains at the outset its 1494 origins via Pacioli's legacy.

On reading this book the reviewer was more than a little jealous of Mr Speedy's students. Accounting education in the early days of valuation qualifications was limited almost entirely to the `howl' of Chapter 6 (Double-Entry Principle) with only a smattering of the `whys'. That took a whole year's study and yet Mr Speedy can make that but one of 19 chapters. As he explains, it is not essential to have an expert knowledge of the Double-Entry Principle but a better understanding of financial statements is achieved if the broad principles are known.

This book will undoubtedly go well beyond the expectations of its publishers. It is based around a series of lecture notes to students and yet it is a major contribution to practitioners in the valuation profession and most definitely "others".

Why is this such a good publication? Quite simply because it is both delightfully readable as well as educational. As stated at the commencement of this review, some of Mr Speedy's works have been more scholarly than many of us are prepared to cope with. Don't let that deter you from this one. Its strength is its plain simple language and no valuer should be without it. Make sure there is a place on your bookshelf for this.

New Zealand Institute of Valuers

Annual Seminar April 1982

SPEAKERS:

Mr R. P. YOUNG:-

Mr Peter Young graduated B. Comm, Dip. Urb. Val. in Auckland, is a Fellow of the New Zealand Institute of Valuers, practises in Auckland as a Partner in the Valuation and Consultancy partnership of Mahoney, Young & Gamby and is a Member of the Valuers' Registration Board.

Mr Young has presented papers on "Insurance Valuations" at past Seminars and on other occasions. He is fully conversant with this difficult and demanding aspect of the valuer's work. In his latest paper, he has worked through an exercise which covers many of the difficulties facing the Valuer when assessing properties for replacement insurance and indemnity valuation purposes.

Mr T. A. ROBERTS:-

Mr Roberts is the Executive Director of the Insurance Council of New Zealand. He graduated with a L.L.B. from Victoria University in 1963, was formerly a Partner of the legal firm of Messrs Hogg, Gillespie, Carter & Oakley, and was appointed the Executive Director of the Insurance Council of N.Z. Inc., on the 1st December 1977. He was also a member of the Commission of Enquiry into the Abbotsford Landslip Disaster.

In his paper, Mr Roberts has traversed the difficult area of Indemnity Value. He has referred to problems experienced by the Courts in defining the term "Indemnity Value" by relation to Court Decisions.

Mr E. J. BABE:-

Mr Ted Babe is the most recently elevated Life Member of the Institute, and is Secretary for Internal Affairs. He has had a distinguished Public Service career commencing as a Valuation Department cadet in 1944. He transferred to the State Advances Corporation as Deputy General Manager in 1968 and became the Director-General of the Housing Corporation and General Manager of the Royal Banking and Finance Corporation. His paper was presented at the Seminar by Mr R. J. Chappell, the Assistant Director of the Housing Corporation of N.Z.

The paper headed "Future Outlook for the Housing Industry" provides an outline of housing development in New Zealand since the Depression and World War II.

Mr K. R. CRONE:-

Mr Keith Crone, M.S., (U.C.) B.Hort. Sc. is the vineyard Development Manager of Cooks N.Z. Wine Company Limited. He holds a degree as Bachelor of Horticulture from Massey University and a further Degree from Davis University, United States of America. He is resident in Auckland.

Mr N. R. IBBOTSON:-

Mr Neal Ibbotson is a public valuer, farm management consultant and contract grape grower, residing in Blenheim. Mr Ibbotson holds a Diploma in Valuation and Farm Management, and is an Associate Member of the N.Z. Institute of Valuers and a member of the N.Z. Farm Management Society.

Mr Ibbotson's paper deals directly with establishment costs of vineyards and the factors affecting profitability including irrigation, varieties, soil types, pests and diseases, climatic factors and shelter. Questions directed to Mr Ibbotson were concerned in many respects with the possible importation of disease from the North to the South Island by the use of non disease-free root stocks.

Mr E. ROBERTSON:-

Mr Ewen Robertson is the General Manager of the Eastern and Central Savings Bank, Hastings and a member of the N.Z. Housing Commission. In 1978, he was awarded a Fellowship under the Winston Churchill Memorial Trust and studied housing development in Nordic countries,, The thrust of his paper is directed towards taxation in relation to housing with discussions centred around capital gains tax and interest rates.

Mr R. M. :–

Mr Dick White is the Managing Director of Neil Holdings, one of the largest building and housing development companies in New Zealand. He is a member of the N.Z. Housing Commission and presents strong views in his paper on the potential demand for housing and the type of housing required. He expresses doubt that a run-down housing industry will be capable of coping in the future with the demand for new housing units.

Mr J. M. KING:-

Mr John King is the Senior Advisory Officer, Economics Division, Ministry of Agriculture & Fisheries, Hastings. Mr King holds a Master of Agriculture Degree from Lincoln College. He is an acknowledged authority in his field and is the regional specialist in agriculture and horticulture economics. His paper deals with the profitability of viticulture and he makes comment on the well-known disease "phylloxera".

Mr J. K. BUCK:-

Mr John Buck is the Managing Director of the Te Mata Estate, Havelock North. He is an acknowledged national wine judge and a recognised authority on the production and marketing of wine. Mr Buck spoke from brief notes and did not provide a written paper. His presentation was in a lighter vein but still contained valuable comments on marketing. Unfortunately a transcript of his delivery is not available.

Membership

ADMITTED TO INTERMEDIATE:

Allcock, C. D.	Auckland.
Ansley, N. D.	Rotorua/Bay of Plenty.
Aston, P. D.	Rotorua/Bay of Plenty.
Banner, T. N.	Wellington.
Bertenshaw, G. J.	Canterbury/Westland.
Cairns, S. G.	Southland.
Cavanagh, S. M. (Mrs)	Southland.
Copp, S. R.......................	Northland.
Dooney, C. J.	Auckland.
Dryden, S. E. (Miss)	Canterbury/Westland.
Dunn, J. M. (Miss)	Wellington.
Faherty, M. P.	Wellington.
Grandiek, J. N.	Rotorua/Bay of Plenty.
Gunton, M. K.	Canterbury/Westland.
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McKeage, I. D.	Nelson/Marlborough.
McLay, B. J.	Gisborne.
Maples, J. F. D.	Canterbury/Westland.
Martin, A. B.	Canterbury/Westland.
Miller, G. D.	Nelson/Marlborough.
Miller, W. I.	Auckland.
Muskee, A. H.	Southland.
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Walker, T. M.	Rotorua/Bay of Plenty.
Watson, H. J.	Rotorua/Bay of Plenty.
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Duggan, J. B.	Hawke's Bay.
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Harris, D. W.	Northland.
Hiebendaal, R. O.	Auckland.
King. W. F.	Canterbury/Westland.
McCarthy, J	Nelson/Marlborough.
McPhail, D. K.	Central Districts.
Marshall, S. R.	Auckland.
Sadler, R. G.	Auckland.
Smith, P. J.	Canterbury/Westland.
Stewart, H. K. F.	Rotorua/Bay of Plenty.

REMOVED FROM ROLL OF MEMBERSHIP:

Loughlin, C. J.	Auckland.

RETIRED:

Elcock, A. C. R.	Canterbury/Westland - Rule 14 (1).
Morrell, I. H.	Auckland - Rule 14 (2).
Wallace, J. J.	Otago - Rule 14 (2).

RESIGNATIONS:

Hunt, D. J.	Overseas.
Parker, D. G.	Rotorua/Bay of Plenty as at 31/12/81.

MEMBERSHIP RE-INSTATED:

Hawkins, W. D.	Canterbury/Westland.
Roberts, J. B. .....-	Northland.

DECEASED:

Simmonds, M. D.	Auckland.

Valuers Registration Board

DISCIPLINARY DECISIONS: MAXIMUM PENALTY IMPOSED BY REGISTRATION BOARD

Seven disciplinary inquiries were held by tht Valuers Registration Board in the year ended 31 March, 1982, as a consequence of complaints against registered valuers. In two instances the charges which formed the basis of the inquiries were found "not proven". The Board's decisions in the remaining cases, in which penalties ranging from fines and reprimands to de-registration were imposed, will be published in the N.Z. Valuer when the appeal period is passed or any appeals are disposed of.

The first case, which resulted in the removal of the valuer concerned from the register, originated from a complaint laid by the N.Z. Institute of Valuers. The matter had been brought to the notice of a branch committee by a member of the Institute who had himself received a complaint from a finance house relating to a valuation of a commercial property.

The complaint drew attention to the wide discrepancy between the valuer's valuation and other valuations and sales on the same property and the inclusion of plant in both the valuation and mortgage recommendations. In addition it was suggested that the valuer had probably contravened the Institute's Code of Ethics concerning the acceptance of professional work on his own account by a member in employment without the knowledge and consent of his employer.

The Valuer General investigated the complaint and reported to the Board as required by Section 32 of the Valuers Act. The Board having considered the Valuer-General's report decided to proceed with an Inquiry and notice of the charges was duly served. The charges cited:

(1) Unethical conduct in the acceptance of professional work contrary to Article 20 of the Code of Ethics of the New Zealand Institute of Valuers (Section 31(1) (c) and Section 31(2) of the Valuers Act 1948.

(2) Incompetent conduct in the gross over-valuation of the property concerned (Section 31 (1) (c)).

(3) Incompetent conduct in making an excessive mortgage recommendation in respect of that property. (Section 31 (1) (c)).

Turning to Charge 1, the valuer, who was employed by a local authority at the relevant time, prepared a valuation report and made a loan recommendation on a shopping complex. A letter from his employer stated that no approval had been given to the valuer to accept valuation work on his own account.

It was clear to the Board that the acceptance of the valuation brief and the preparation of a report and loan recommendation were breaches of clause 10 of the Code of Ethics which states - "A member in employment shall not accept professional work on his own account unless with the knowledge and consent of his employer or unless his contract of service expressly authises him to do so".

Charge 2 alleged that the valuer was incompetent in the performance of his duties as a valuer and that he grossly over-valued the subject property. Having examined the report complained of, along with a valuation report prepared by the District Valuer with the Valuation Department, on the subject property as of the same date, the Board found this charge to be upheld on both counts. It was clear from the evidence brought forward in those reports and also from the valuer's handwritten letter of explanation to the Board that his level of competence in preparing the subject valuation was below that expected by the Board of a Registered Valuer. Specifically the Board noted the inclusion of an amount of $47,700 for chattels in the valuer's computation of the value of plant and equipment, being added in with other improvements to establish a replacement capital value and furthermore, when an investment analysis approach was made to assess the capital value, he had failed to isolate the rental which should have accrued to the plant. On that basis the valuer determined the gross rental income to be $39,230 while the District Valuer in his report after correctly making allowances for plant, assessed rents at $26,442. It was further noted with concern that the valuer's outgoings were calculated at $1,070 and the District Valuer's at $4,512. The valuer had made no allowance for bad debts and grossly inadequate allowances for insurance. On the basis of interpreting the results of an incorrect investment approach and also an incorrect replacement approach, he had arrived at capital value which the Board considered to represent a gross over-valuation.

Charge 3 alleged an excessive mortgage recommendation. This followed from the gross over-valuation as determined in Charge 2, when a maximum recommendation under the Trustee Act was recommended. The Board was most concerned to note that loan recommendation was based -

(i) Upon a valuation of $375,000 which included $47,700 worth of plant, plant not being deemed to be a security under the Act,

(ii) That the loan recommendation was set in numerals at $250,000 but following it was another recommendation in words for Two Hundred and Thirty Three Thousand Three Hundred Dollars which was a clear sign of carelessness which would cause confusion to a person reading the report.

The Board therefore found the valuer guilty as charged on all counts. In determining the penalty on these charges, the Board took cognisance of his letter of explanation where a plea for leniency was implied. Nevertheless, having regard to the gravity of the case and to the penalties which are provided for under the Valuers Act, the Board had no alternative but to cause the valuer's name to be removed from the Register in terms of Sec. 31 (1) (c). In the event of a re-application for registration at some future date the Board noted that it would consider an application on its merits at the time.

Extract from N.Z. Gazette, 27 May 1982, No. 56, page 1689.

Members of the Valuers Registration Board Appointed.

Pursuant to section 3 of the Valuers Act 1948, the Minister in Charge of the Valuation Department hereby appoints

Donn James Armstrong,
Malcolm Russell Hanna, and
Robert Peter Young

to be members of the Valuers Registration Board, to hold office for a term of 3 years, commencing on the 1st day of May 1982, and it is hereby notified that the said Robert Peter Young has been appointed on the recommendation of the New Zealand Institute of Valuers, as required by the said Act.

Dated at Wellington this 18th day of May 1982.

JONATHAN ELWORTHY,

Minister in Charge of the Valuation Department.

P. D. Hasselberg, Government Printer, Wellington, New Zealand - 1982.

The re-appointment of three members of the Valuers Registration Board, on the expiry of their previous appointments, was' Gazetted on 27 May 1982. Mr M. R. Hanna of Wellington is now serving his fourth term on the Board. Mr D. J. Armstrong of Pleasant Point, Timaru and Mr R. P. Young of Auckland are in their second term as is the fourth appointed member, Mr L. M. Sole of Rotorua, whose first term expired and was renewed in 1981. All appointments to the Board are for 3 year terms. Messrs Sole and Young are the Institute's nominees. The Valuer-General is a member and Chairman of the Board ex-officio.

The Public Works Act 1981

An address to the Auckland Branch N.Z. Institute of Valuers 27th May, 1982.

By P. M. Salmon of Auckland, Barrister.

Peter Salmon has lectured on this topic for the Law Society throughout New Zealand and is currently preparing a publication, which will include the subject matter of this address.

The inviolability of private property was one of the rights recognised in English law in the Magna Carta. There has however always been a second strand in English law recognising the sovereign right to take the property of an individual in certain circumstances.

In Britain the question of the compulsory acquisition of land did not assume great importance in the legal system until, as a result of the industrial revolution, it became necessary to facilitate the construction of canals and railways. Such works of necessity interfered with the property rights of large numbers of people. To facilitate these construction projects, legislation was passed, first in the form of an Act for each particular project, but later in the form of general legislation.

In New Zealand, a similar impetus to the passing of public works legislation was given by the development programme of Prime Minister Vogel. The philosophy upon which that 19th century legislation was based was repeated in subsequent Public Works Acts down to the Public Works Act 1928.

This act, like its predecessors, gave powers of compulsory acquisition to the government and to local authorities in respect of all public works. The term "public work" was widely defined to cover any work which a government or local authority had the power to undertake.

At the time of the first public works legislation in this country the powers of the government and of local authorities were limited. However, over the years since then, those powers have been substantially widened so that today, governments and local authorities have a very wide range of powers enabling them to engage in many activities, some of them of an entrepreneurial business nature. The powers of government and local authorities then have gone far beyond those which existed when the original public works legislation was passed but in each case the additional powers have been accompanied by the right to acquire land compulsorily.

There have been other major changes in society and in our economic system since the passing of the 19th century legislation including:

1. The trend to private ownership so that whereas originally the consequence of a taking was the replacement of an investment it is now very often the replacement of a home and property having a much greater value than that of a mere investment. Indeed the attachment of people to a property over which they have laboured may be judged by this statement by Machiavelli several hundred years ago: "But above all a prince must refrain from taking property, for men forget the death of a father more quickly than the loss of their property".
2. The effect of inflation which has meant delays in settling claims for compensation arising from compulsory acquisition can have serious consequences.

It is the case of course that over the years local authorities and government have acquired land by agreement rather than compulsorily. However, in the negotiations for the acquisition, the private landowner has always faced the spectre of compulsion if he fails to agree. Private landowners have not been able to say to the negotiating authority - "No, I do not want to sell my land."

On the other hand, most people would accept that governments must have the power to acquire land, and, if need be, compulsorily, for certain works which the community regards as essential and which often require to be sited in a particular location. No government could function in the way we expect it to, and provide the services which we require, without some compulsory powers. The Public Works Act 1981 attempts to strike a balance between the desire of the individual to sell his land when and to whom he wants and the necessity for government to have powers of compulsory acquisition.

The new Act has limited the right of compulsory acquisition to certain defined essential works. In respect of all other activities undertaken by the Crown or by local authorities, they must negotiate to purchase land in the same way as anyone else wishing to acquire land. It is important then, when advising anyone on a matter involving the acquisition of land by either local or central government to first ascertain whether or not the use to which that land is to be put comes within the definition of essential work.

A consequence of this change is that in the case of the acquisition of land the power to have compensation fixed by the Land Valuation Tribunal is now limited to the case where land is taken for essential works.

Other important changes made by the new legislation are:

1. A taking authority is now required to negotiate with the owner of the land before proceeding with compulsory acquisition.
2. There have been additional and useful rights included in the Act to bring about an acceleration of the taking and compensation procedures.
3. Provision has been made to introduce the concept of a house for a house.
4. The heads under which compensation may be claimed have been clarified and given a statutory basis.

5. At least so far as compulsory acquisition is concerned, there has been an alleviating of the problem of urban blight although this problem still exists in relation to the designation of land under the Town and Country Planning Act.

How does this new Act affect valuers?

Valuers will often be involved earlier in the taking procedures than has hitherto been the case. The first step in compulsory acquisition is the negotiations with the owner required by Section 18 of the Act. As part of that process the taking authority must have a valuation carried out by a registered valuer and must advise the owner of the estimated amount of compensation to which he would be entitled. Thus, so far as the taking authority is concerned, a registered valuer must be involved at this very early stage.

Section 82 of the Act requires that a claim for compensation be accompanied by a valuation report signed by a registered valuer.

Section 70 provides a procedure for requiring payment on account once the taking procedures have been commenced. The payment must be of an amount which the taking authority considers is adequate to fairly compensate the owner for his estate or interest. The assessment of this amount would require a valuation.

2. The rules as to the assessment of compensation are the same as those which previously applied but the entitlement under various heads is more precisely spelt out.

Section 60 sets out the basic entitlement for compensation under three heads.

(i) Compensation for land taken for an essential work.

(ii) Injurious affection as the result of an essential work.

(iii) Loss arising from damage to land.

3. Some new heads of compensation have been included in the Act. For example, Section 63 provides for the payment of compensation for injurious affection where no land has been taken. This right is very limited and applies only where substantial injurious affection to a person's land is caused by the construction (but not the maintenance or operation) of a public work. The Section contains other limitations on the right but at least it is a beginning.

Section 65 makes special provision for the assessment of compensation for land for which no general demand or market exists. In such cases compensation may be assessed on the basis of the reasonable cost of equivalent reinstatement in some other place.

Section 67 provides for payment of compensation for the loss incurred on the repayment of a mortgage and re-financing at a higher rate. In inflationary times this is particularly valuable. For example, the taking of land could necessitate repayment of a mortgage at a favourable rate of interest. In such circumstances the re-financing involved in the acquisition of a new property could create a liability for a much higher rate of interest.

Section 64 abrogates the anomalous rule set out in cases such as Edwards v. Minister of Transport. The Section now provides that where an essential work is constructed partly on the land of the person claiming and partly on other land, compensation for injurious affection of the land retained by the person claiming shall be assessed by reference to the effect of the whole of the essential work on the land so retained and not only to the part situated on the land taken or acquired from that person.

4. Section 66 gives statutory authority to the recovery of compensation for disturbance to land. The Section also sets out some of the specific circumstances which will attract disturbance payments. Included amongst these is an allowance for any improvements not readily removable from the land acquired which are of particular use to a disabled owner or a disabled member of an owner's family and which are not reflected in the market value of the land.

Section 68 sets out some of the disturbance payments which result when the land upon which a business is situated is compulsorily acquired.

5. Other provisions to which it is worth drawing attention, include the provisions of Section 73 and 74 relating to the provision of assistance to purchase a replacement property. This assistance is in the form of an advance of money by the taking authority.

Section 105 contains the provision which I have earlier described as "a home for a home". In fact, the section makes wider provision than that and applies in any case where the land contains a dwelling occupied by the owner as a private resident or is land used by the owner personally for any purpose. In such circumstances where land reasonably equivalent to that so taken or acquired is not readily available on the market the owner may ask the notifying authority to take all reasonable steps to grant to the owner in payment or satisfaction or part payment or satisfaction of the compensation to which the owner may otherwise be entitled, land owned or acquired by the authority.

6. The Act makes provision for the payment of interest on compensation money at such rate as the Land Valuation Tribunal thinks fit. This combined with the decisions of the Court in the cases of Coomber v. Birkenhead Borough Council 1980 NZLR 681 and Drower v. Minister of Works and Development 1980 NZLR 691 provide the opportunity for the inflation proofing of compensation awards.

Conclusion

In my view the 1981 Public Works Act is a very important piece of legislation which makes far reaching changes for the benefit of people whose land is required by Government and local authorities. It is essential that registered valuers be familiar with the new provisions of the legislation in order to properly advise those for whom they act.

Law Practitioners' Bill and Valuers

Address to the Auckland Branch of N.Z. Institute of Valuers.

By B. H. Slane, President, New Zealand Law Society.
Partner Cairns, Slane, Fitzgerald & Phillips, Auckland.

Introduced by Mr N. Dean, Auckland Branch Chairman.

After hearing that introduction you might be interested to know the stories told when I became President of the Law Society. It was said I received a number of messages from people. The Dean of the Faculty of Law at Auckland University, which I graced for a long period of my life - as a student I might say, not as a teacher - was said to have sent me a telegram:

> "Congratulations. Epoch-making event. First time non-lawyer elected president of Law Society."

A note from the Minister of Justice, Jim McLay, which said:

> "Congratulations. I hope I can look forward to dealing with you next year as well."

I wasn't sure if that was genuine because it didn't have the words "quite frankly" in it.

There was also, it was alleged, a mention from the Prime Minister at his press conference. He just said, in his usual quiet way, when asked to comment, that -

> "The Law Society usually elects competent people as President."

I want to talk to you about the Law Practitioners' Bill, which has just been reported back by the Statutes Revision Committee.

They have made a number of amendments to it, the most notable of which is to qualify lawyer members of Parliament for practising on their own account as lawyers. Solicitors are required to have three years' experience, working for a solicitor, or in a local authority, or in the Government before starting out in practice on their own account or in partnership. The Statute Revisions Committee thought that work in the Government or a local authority and companies or law offices was not really a wide enough class of experience. Therefore, in the future, solicitor members of Parliament with three years' experience would be entitled to start out on their own.

The Law Practitioners' Bill in some respects is the most far reaching piece of professional legislation that has been seen or may be seen for some considerable time. And I will tell you why. But we didn't get all we wanted.

The first thing we wanted to have was the power of the Law Society to impose compulsory education on the profession. That was thrown out by the members of the Statutes Revision Committee. They received a lot of opposing submissions. Some didn't believe in compulsion, some thought the Law schools were offended and therefore we shouldn't have the power, some thought it should be imposed by the Council for Legal Education, and the students thought that it was just making life difficult for young people. But we really did think it was important.

Our proposal was that people should have to attend a certain amount of continuing education during the first three years of their professional careers. We found that when people came out of the University and had started in an office, they needed the parallel course of practical experience matched with more formal education continuing.

No matter how much you can teach a student in theory how to deal with problems in practice and tell them what the practice is, until they start doing it the adrenalin doesn't run and the impact of the education is limited.

However, we lost that round. I think we will persist with what we call our "Lawprac" course - perhaps to give certificates to encourage people to undertake the courses. These days the young solicitor cannot get the time and wisdom of the older practitioner because of economic pressures yet he does need some formal study – an opportunity to go and sit around a table with others and go through some exercises which relate to the work he or she is doing.

So that was one thing. At the other end of the scale, the disciplinary sphere, we have introduced two or three changes.

There will be a lay observer or lay observers for N.Z. who will be available to anybody who has complained about a lawyer and is not satisfied as to what the District Law Society is doing about it. There will be also, at the Disciplinary Tribunal. two lay members. We said one - The committee has increased it to two - we won't be worried about that.

I have been concerned for years that disciplining people (and I am sure that this has occurred with valuers as well) isn't necessarily the best wav to achieve the highest professional standards. Besides education and discipline, you need somehow to make efforts to improve competence as you go along.

What we have done in that sphere is management advisory services which have started up in Auckland, where a practitioner can get somebody to come into his practice and spend a morning there, go through the figures, and come out at the end and tell him where he is going wrong or why he is not succeeding, and what is wrong with his work pattern or whatever it is about the way he organises himself.

The second part of maintaining competence is to use the disciplinary procedures to help people. What we have done is to make available a wide range of options to the disciplinary tribunals if a practitioner is charged before a tribunal. He can be struck off, can be suspended, can be ordered at present not to work on his own account. He must work with somebody else. We are going beyond those now and we have got a whole range of other choices which are available to the Tribunal.

For instance, the Committee will be able to order a practitioner to complete work at a certain fee for a client. He can be required to report to someone regularly on his practice. He can be required to take advice on management from someone and to make his practice available for inspection. He can be required to not hold himself out as competent in a particular field and not to undertake that kind of work. So we can say "Right, you can go on doing your Court work but you may not be involved in acting in the administration of a deceased estate". So we try to eliminate the risk from the weak points and make sure that the person is performing only in the area in which he is competent. With that, I hope there will be a Competency Committee set up so that people who are seen to be in need *of help can* be assisted.

All these new orders can be made by the Disciplinary Tribunal even if they find there has been no professional misconduct but simply that there was justification in bringing a charge.

Negligence. Before we did not have provision that negligence in itself was professional misconduct or conduct unbecoming a solicitor, or barrister. We now have a provision that says that negligence or incompetence to such a degree or so frequent as to reflect on the solicitor's fitness to practise or so as to bring the profession into disrepute is punishable.

So that's gone quite a long way further. I think it will occur in other professions, and I think that it has been necessary simply because people are dissatisfied these days if the professional body can't give them some remedy. Now while you can't possibly have a professional body having a go at people every time somebody is negligent, you can take the people who are consistently negligent, or who commit flagrant acts of negligence, and say - "This really does cast doubt as to whether that person is competent to practise professionally".

The outcome may not be to punish him, it may be simply to say - "That's the sort of work he's not allowed to do because he's proved to be unreliable or unfit to practise in that field".

Now, I just wanted to mention one other thing that I think arises out of this Bill. When you listened to the debate there was quite a lot of antagonism towards the legal profession. There was talk about taking some of their work away from them. Why should lawyers be the only ones to do conveyancing?

When you analysed the argument, it arose partly from the Consumers Institute and partly from a general movement within the National Party towards more market philosophy and more competition. And when you look at what they have said, what they are really objecting to is scale fees, and particularly scale fees that operate as a minimum. As you probably know the Commerce Act permits professional bodies to do that. But there is a surveillance of the level of charges. But that's not enough.

We find an increasing dissatisfaction in non-legal circles with minimum fees. People these days seem to want to be able to shop around. They want to get quotes. The position is quite developed in Australia.

In the State of Victoria the Law Institute has said that it will abandon its scale. In New South Wales the Law Society will permit lawyers to advertise that they do certain types of work, and that they charge an initial fee for an interview, whether they do legal aid, what languages are spoken, what hours they are open - these sorts of things - as often as they like in newspapers.

Some say that if they do that, if they have compulsory indemnity insurance and if people can shop around for price, there is no need to bring in some less qualified group to do conveyancing.

You can't stand off and look at what is happening to lawyers and say - "Oh well, it doesn't matter". You are going to find in New Zealand there is an increasing tendency to adopt an anti-professional viewpoint. It's going to be across the board politically. You are going to get a lot of dissatisfaction with professional people. Professional people are difficult. They are a nuisance for the pragmatic New Zealander who just wants what he wants to be done straight away, without any fuss. "Look - just give me a valuation and tell me that place is worth $20,000 - I want a letter tomorrow".

And that's the difficulty you're under. Valuers are a niusance when *they* are being difficult and saying - "it will actually take me several hours to do that work". Well, you can guess what they'll say. -

"Let's just have somebody who understands property. I mean, there are plenty of good honest, stout-hearted men who understand property, who know a decent farm when they see one. We don't need all these over-educated ponces who waste all those years at University and then sit around the Valuation Department doing a lot of work that doesn't bring any productivity to N.Z."

"It's about time we cut them in half and said - Look, a couple of years at A.T.I. and you should be able to go out and do simple valuations".

They won't know how to define a simple valuation, or how the fellow who had the simple education will know when it isn't a simple valuation.

But you see what we are up against.

We now hear the suggestion that you should just have some para-legals - people who work for lawyers at the moment perhaps - allowed to go out on their own and they can do the conveyancing. They'll just do the simple conveyancing. They'll do it cheap, and that sort of thing. They say it's done in one state or two states in Australia. The fact that their fees are about the same as the lawyer's fees and the fact that their offices are now as elaborate as lawyers' and they have had to take out compulsory negligence insurance just means you now have an "A" team and a "B" team.

But this sort of talk has quite a lot of appeal. The politician in this country wants to cut through all this nonsense. He doesn't want any difficulty over matters of principle or be told that there's more to a problem than can be debated in the House of Representatives late at night with little sleep.

So, there you are!

We're getting bashed a bit about the law because the law shouldn't stand in the way of 600 jobs. It's alright if the freezing works closing down stands in the way of 600 jobs - nothing much done about that. Jobs shouldn't stand in the way of the Clyde Dam.

The Law Society doesn't say that if the law is inadequate, too slow, improper or wrong in principle, that it shouldn't be changed. What we do say is that if the Government says - "We will make ourselves subject to this particular law" - then they should stick to that. And if they get themselves into a mess administratively, they shouldn't seek to use bad methods of law-making to overcome it. Because you can bet your bottom dollar that intervening in legal processes may be important for 600 jobs but in the future it may be used to save a member of a Government from embarrassment. And so our few safeguards for freedom and for the rule of law are whittled away.

I don't think for a minute that most lawyers would say that there's anything wrong with abridging rights or limiting them - in fact I believe one of the judges in the Planning Tribunal has publicly said he is concerned that the Planning Tribunal could be involved in looking at the end use of electricity. Is a Tribunal to look at water rights from the point of view of whether the water is going to irrigate plums or peaches?

In the world of the law, we are trying to communicate a little better. We are trying to turn out pamphlets which will be of use to people. I have brought along a few things like "Over the Fence", "How Your Lawyer Can Help You". What Happens When Your Marriage Breaks Up" and the most popular one - "Living Together". Family Law is increasingly important to lawyers. One day a little man came into the office. He wanted to see one of my family law partners. Both of them were out writing books - for separate publishers. The couple saw me. The woman was a fairly domineering sort and she stepped in and said - "He'll tell you the story" - and so this little man said - "Well - uh - we've decided that we're going to get divorced and - uh - my wife is going to get the house and she gets the beach place, and she gets my car - and actually she gets everything except my clothes and the bonus bond my aunt left me - and oh - I'm going to pay her $380 per week maintenance and - uh - she has the children, and - uh - the other thing was if I should remarry and have children, she gets them too."

You have probably been concerned about new legislation going through Parliament. We have too. For some years the Law Society has vetted every Act that has come in or Bill that has been introduced in Parliament. We have a look and decide whether or not we will make some submissions. Sometimes we just write a letter off saying we have seen a couple of errors in it - but usually we make submissions, and it takes a lot of voluntary time. It takes a lot of care and it's done by volunteers late at night, and we're always picking up mistakes, I might say. But then when we make mistakes immediately the Minister starts criticising us, saying the Law Society has made a lot of mistakes. They should take a lot more care in their submissions. We are doing it for nothing, on Bills we have no interest in personally, and doing what is clearly a public service.

Recently the Minister of Broadcasting said we'd made - and we admitted - some mistakes in a submission. But then he said the Law Society had raised some other points. So he had introduced 12 pages of amendment!

Today the face of the profession is changing. We have a lot more women coming in. About half the students are now women, and we expect that it won't be very long before half the intake of the profession will be female. There are two women District Court Judges now, Judy Potter is on the Council for the Auckland Society, and there is an increasing involvement. They've brought an added dimension to the profession.

There is an effort to try to put women on the bench.

In Australia, there is a story going around at the moment that the Attorney General Senator Durack, wanted to appoint a woman to the High Court of Australia. He thought of a State Supreme Court Judge, Justice Roma Mitchell. They looked her name up in "Who's Who" but she didn't put her age in. So he said to one of his staff - "Send a telegram off to the Attorney General for South Australia - `How old Roma Mitchell?" They did, and the reply came back "Old Roma Mitchell fine. How old you?"

QUESTIONS:

1. Bob McGough, Auckland - In the State of Victoria, professional negligence insurance for law practitioners is compulsory. Is insurance compulsory in N.Z. for law practitioners?

No. The proportion of lawyers insured is about 90%. which for voluntary schemes, is apparently very high. We did face a problem because I know of instances where a solicitor has been refused cover and has had trouble finding it - obviously for some reason that perhaps was justifiable. But it does raise the question that if you were claiming a sole right to practise in a field of endeavour such as law or valuing, whether if you make a mistake you should be prepared to stand by it through an insurance scheme. What the present situation in N.Z. is, is that we are preparing a report, and there is a survey of solicitors at the moment as to what they are paying. Rising claims have brought premiums up to $900, in most states in Australia, per annum for cover of about $700,000 or $800,000. They feel they have to do it for political reasons if no other, to provide that protection for the public. In Britain, they have got a compulsory scheme. The one thing that they have found overseas that is effective, is that with the bad risk, you increase the amount he has to pay. Instead of his paying only the first $1,000 of any claim you may make him pay the first $5,000. That would mean generally that clients will be covered, because most of the professional people would be worth $5,000, and that is some sort of control.

2. Peter Mahoney - You made reference to Parliament and Select Committees. Could you comment on the role of Select Committees and the notice taken of submissions made by the public? Is little notice taken of submissions?

That has not been our experience. I think it depends what sort of thing you are saying. If they are bringing in a Gas Council Bill and they've settled the policy, it's no good making submissions saying there shouldn't be a Gas Council. And so they're only interested in how it's going to work. Now when the Law Society makes a submission generally it doesn't enter into the policy of the bill. In other words it accepts the Government's right to introduce a bill on this matter. If you take something like the dogs. There is a Dogs Bill around at the moment. There is a Domestic Violence Bill. Now in both those cases we've made quite detailed submissions. In the case of the Domestic Violence one, the bill was brought back in another form with further submissions to be made. In other words, they changed the bill quite substantially as a result of a lot of submissions that they got. In the case of the Law Practitioners' Bill, they took a lot of notice of the submissions of the law students and the Faculty of Law who felt their territory was being trodden on and that's why we lost our Lawprac Scheme. I think a lot depends on the quality of the submissions and the quality of the committee of the House. If they are a bit tired and impatient and they're getting towards the end of the year you may not get much in the way of results.

When the Committee sits it has a departmental officer with it. Perhaps even the office solicitor for the department concerned, and then they have the Parliamentary counsel there who has drafted it. He would have a look at those things and if he saw errors I think he would say to the committee in private afterwards - "look, this is commonsense; we ought to change it." I think when it comes to matters which are matters of political principles, if the party has gone in on the basis that it is going to make compulsory acquisition of land more difficult - then going along to say we want to make it easier is not going to cut much ice with the Government majority on the committee. But if you say that this example is not a good one to bring under that section of the Act, I think that there would be a fairly good response. We have always had a fairly good hearing. Sometimes they have had confusing submissions in from other parties, and they ask if we are going to make a submission because they in fact value our help.

3. Derek Barratt-Boyes - You made mention that lay people are appointed to the Disciplinary Committee. How important do you think this is?

Legal practitioners appointed to the committees are liable to be seen as backing up the lawyer. A lay person on the committee establishes that there is nothing to hide.

I think that is not the only real advantage that they may bring. I think we can be a bit snobbish and underestimate the advantage of the layman on the committee. I think what he can do is require the professional to explain why. To think out what is professional conduct or misconduct. - What is the proper standard to adopt? And, the professional can't get away with saying - "Well, we always do this", or "We've always given this penalty for this offence".

But mainly, I think it is just a consumer representation. I think that they are capable of doing it. I don't think they should be a majority but I think their participation on the committee will, in the end, make not a great deal of difference to what those committees do.

4. Peter Young, Auckland - Also on the question of disciplinary procedures, where a complaint is lodged before the disciplinary committee. My question is in two parts. Do they have a right not to hear the complaint? And, does a complainant have a right of appeal?

We take it in a two-stage thing. Firstly, if you take the Disciplinary Tribunals, we've got two tiers, a national one for serious cases and a district one for lesser matters. At either level the only people who can bring charges before it are District Law Societies. In other words, the client has to go to a District Law Society and have the District Law Society investigate. They're the police, if you like. Then the police (the District Law Society) goes to the judiciary (the Disciplinary Committee) with the charge.

Unlike the position in the ordinary community, if the police don't prosecute you can in theory bring a private prosecution yourself. You can't against a lawyer. It has got to be made by the District Society. That is to provide some protection against the obsessed, of which we have a large number as clients. The client's right of appeal against a decision not to investigate is to go to the Lay Observer and say -

"I want you to examine, as a sort of ombudsman, how well the Law Society did its job."

He has their file, he talks to the solicitors. He will probably talk to the client and then he will say -

"I want it to be reconsidered by The Law Society" - or - "I am sending it back to them with a recommendation that they prosecute."

Or else he will explain to you that he is satisfied that they have made the right judgment.

It is a two-stage thing. A complaints stage and a disciplinary stage.

Reinstatement Insurance Valuations

By R. P. Young, B.Comm. Dip. U.V. F.N.Z.I.Y.

This subject has been covered in several previous seminars and in articles appearing in the New Zealand Valuer over the years. I do not propose to go over material already dealt with in published papers.

In order to make this paper as educational and enlightening as possible I have chosen to treat it as a type of "working paper" and present a report on a hypothetical property, dealing with problems which I have encountered in practice.

My hypothetical property contains three different buildings erected on land part of which is zoned for commercial/retail use and part of which is used for industrial/warehouse use. The property fronts onto "Commerce Street" where the land is zoned for general main street commercial functions including retail shops, offices, banks, licensed premises etc.; and backs onto "Industry Road" where land is zoned for general light industrial and warehouse functions of a non-noxious or non-offensive nature.

When valuing such property for replacement cost insurance purposes I use the standard "Certificate of Valuation for Insurance Purposes" form for reference purposes only, and deal with the various sections of that Certificate in a covering letter. The Certificate therefore contains only brief notes and references as shown in the example.

I usually describe the buildings in a "Schedule of Improvements" which is also attached to the covering letter. In brief, our hypothetical property comprises "Building No. 1", a three-storey building fronting Commerce Street, the ground floor of which is used as a large hardware shop with the first and second lfoors used as office accommodation. This is a seventy-year old building constructed with a heavy timber structural frame, unreinforced solid brick exterior sheathing and galvanised iron roof on timber trusses, with a mixture of wallboard and timber internal wall linings. The Industry Road land is occupied by two buildings, the main one being "Building No. 2", a ten-year old warehouse and the other, "Building No. 3", being a forty-year old dwelling currently occupied by the assistant manager of the retail shop.

My report would be in the following general form and terms:

17 March, 1982

The Manager,
Peter Out Insurance Brokers Ltd.,
Private Bag,
Townsville. Attention: Mr Out

Dear Sir,

Re: Townsville Building and Hardware Supplies Ltd. 10-12 Commerce Street and 15-21 Industry Road, Townsville.

In accordance with instructions contained in your letter of 10 January, 1982 we have inspected the above property in order to complete a Certificate of Valuation for Insurance Purposes. A copy of the Certificate is attached.

Because of inadequate space on the Certificate, our valuation figures are supplied in this letter and other notes contained in this letter should be read in conjunction with the Certificate.

Buildings are briefly described in the attached "Schedule of Improvements" and the following valuation figures apply to each building:

Building No. 1:

Indemnity Value	$100,000
Reinstatement estimate	$1,400,000
Demolition allowance	$55,000
Inflationary provision indemnity	nil
Inflationary provision - reinstatement	$350,000

Building No. 2:

Indemnity Value	$600,000
Reinstatement estimate	$800,000
Demolition allowance	$60,000
Inflationary provision - indemnity	$60,000
Inflationary provision - reinstatement	$200,000

Building No. 3:

Indemnity Value	$20,000
Reinstatement estimate	$45,000
Demolition allowance	$2,000
Inflationary provision - indemnity	$2,000
Inflationary provision - reinstatement	$9,000

The following comments should be read in conjunction with this Certificate:

Re Section B Note (i):

We are advised by the Townsville City Council Building Inspector that the property is situated within the Outer A Fire Risk area and is in Fire Risk Group D2. The Council has adopted the provisions of NZSS 1900 Chapter 5 (Fire resisting construction and means of egress). Building No. 1 (The Commerce Street three-storey retail/office building) does not comply with this model building by-law and in accordance with the requirements noted on the reverse side of the Certificate of Valuation for Insurance Purposes, we have assessed the cost of rebuilding this structure including the use of currently equivalent building materials and techniques. Accordingly, we have assumed a building having reinforced concrete floors, a reinforced concrete structural frame, concrete block perimeter walls having a four-hour fire resistance rating to side and rear walls, modern suspended tile ceilings with wallboard (gibraltar board) interior wall linings. We have assumed steel trusses or roof members with a galvanised iron roof. Since the ground floor retail portion has a floor area in excess of 929m2 (10,000 sq. ft.) in one fire compartment, sprinklers would be required in this area and we have allowed for their inclusion. (Reference Clause 5.52.1 of NZSS 1900 Chapter 5).

With reference to Building No. 2, this has a lfoor area of 3,160m2 (34,014 sq. ft.) and in the normal course of events would require the installation of sprinklers on reinstatement (reference Table 1 of NZSS 1900 Chapter 5). However, in terms of Clause 5.10.3.1 of NZSS 1900 Chapter 5 the floor area in one fire compartment can be increased by 20% on 30,000 sq. ft. where there are two remote outlets from exit ways from a fire compartment. Following discussions with the City Council Egress Inspector and with your company's architects, we are advised that two remote outlets could be provided and that the building could be reinstated to its existing size without the necessity to install sprinklers. Accordingly, our reinstatement cost estimate does not include an allowance for sprinklers.

Re Section B Note (ii):

In the event of total or substantial damage, it is obvious that Building No. I will be reinstated with the use of totally different materials to those contained in the existing structure. Since buildings are now very seldom constructed with heavy timber structural frames, timber floors and timber trusses, it is impossible to estimate the amount by which reinstatement with currently equivalent building materials will exceed the cost of reinstatement with existing material. Indeed, it may be just as expensive to reinstate with the existing construction method (in a manner complying with By-laws) as it is with currently equivalent building materials.

Reference Section B Note (iii):

Building No. 3 (the dwelling fronting Industry Road) is a non-conforming use in this zone and if it were totally destroyed then Town Planning difficulties may be encountered in the event of the owners wishing to reinstate the house. It may be possible to reinstate as of right in terms of Section 91 of the Town and Country Planning Act 1977, provided that reconstruction does not increase the "current market value" of the building by more than 60%. In order to avoid Town Planning difficulties in the event of a need to reinstate this building, we would recommend that the insurance policy allows for reinstatement on a suitable alternative site.

Following our discussions with the City Council Building Inspector, there appear to be no regulations which are likely to totally prevent reinstatement of Buildings 1 and 2. However, there are some matters which may cause delays to any reinstatement programme. These are summarised as follows:

(a) Off-street parking is now required at the rate of one space per X m2 of retail accommodation; one space for every Y m2 gross building area used for office purposes; one space for every Z m2 gross building area used for warehousing and one space for each residential unit. This would necessitate the provision of eighty off-street parking spaces for the subject property. We estimate that there is sufficient land to accommodate only forty off-street parking spaces. Again, some relief may be obtained in terms of Section 91 of the Town and Country Planning Act 1977 but this will depend on the extent of increase in current market value of the building resulting from reinstatement. The City Council has power to accept a cash contribution in lieu of off-street parking and if Council exercised its power in this direction, a levy would be made for the forty spaces which cannot be accommodated. At the present time this levy is at the rate of $3000 per space, but the amount is subject to amendment at any time and at Council's discretion. Please note that our reinstatement estimate does not include any allowance for this cash contribution. A further remedy would be to acquire additional land to satisfy off-street parking requirements or to reinstate on an alternative site. We would again recommend that the insurance policy allows for reinstatement on a suitable alternative site.

It should be noted that the inflationary provisions do not include an allowance for undue time delays which may be involved in obtaining Town Planning dispensations and approvals, or in acquiring an alternative site.

As far as we can ascertain the Economic Stabilisation (Building Registration and Construction) Regulations 1974 continue to apply. Reinstatement may be deferred in terms of these regulations but at the present time we consider that such deferment is unlikely. Our inflationary provisions do not include any allowance for deferment in terms of these regulations.

Further points which should be noted in association with the attached Certificate are as follows:

1. The replacement cost figures contained in the attached Certificate do not include any allowance for bridging finance interest during the course of reinstatement or reconstruction. In order to avoid the necessity to arrange for bridging finance we would recommend that the insurance policy allows for the reinstatement monies to be made available in progress payments during the course of reconstruction.
2. The attached Certificate makes no provision for an allowance for car park sealing, site improvements, driveways etc. which may be damaged in the course of a fire or in the course of reinstatement works. If you wish to cover these items then we would recommend an allowance of an additional amount of say $20,000 in order to allow for reinstatement of such damage.
3. The indemnity value figure shown for the dwelling erected on industrial land fronting Industry Road, has been calculated by using the formula stated in the Certificate - i.e. present reinstatement cost after allowing for normal physical depreciation.

The resultant "indemnity value" bears no relationship to the market value of this building or to the true insurable "indemnity value" as that term has been defined in several Court decisions.

4. Building No. 1 comes within the scope of Section 624 of the Local Government Act 1974, dealing with powers of Council with respect to buildings likely to be dangerous in a moderate earthquake. We understand that your company has received a notice from the City Council in terms of Section 624, requiring this building to be strengthened within the next ten years. You should note that in the event of this building being partially damaged, the City Council will probably require you to strengthen the undamaged portion when you apply for a building permit to reinstate the partial damage. It is unlikely that your reinstatement cost insurance policy will cover the cost of structural work required by the Council to that portion of the building which is undamaged by the fire or other peril against which the insurance policy is taken out.

In accordance with your instructions this report has been prepared in order to supply valuation ifgures for replacement cost and indemnity insurance purposes only. No responsibility is accepted in the event of these valuation figures being used for any other purpose.

Yours faithfully,

XYZ

Registered Valuer

Attached to this letter will be a "Schedule of Buildings" which supplies a description of each of the buildings including age, size, construction details and current use.

Additional general and background information useful to valuers undertaking this type of work is available in the following publications:

1. "Insurance for Commercial Buildings" compiled by the Building Owners and Managers Association of New Zealand (Boma) in January 1982. This publication is available from the Building Owners and Managers Association at a cost of $8.00.
2. Standards Association of New Zealand publication "Fire Properties of Building Materials and Elements of Structure" known as MP9: 1980. This is available from the Standards Association of New Zealand, Private Bag, Wellington.
3. All valuers undertaking this type of work should of course have a current copy of NZSS 1900 Chapter 5.

NOTES: 1. FEES

These are to include Architects', Surveyors', Consulting Engineers' and other fees for estimates, plans, specifications, quantities and tenders and supervision necessarily incurred in the reinstatement consequent on destruction of or damage to the property insured (not exceeding the Scale of Fees laid down by the N.Z. Institute of Architects and the N.Z. Institution of Engineers current at the time) but not such fees for preparing any claim under the Policy.

2. EARTHQUAKE AND WAR DAMAGE ACT

Under a Reinstatement, Replacement or an Extra Cost Reinstatement policy the Earthquake and War Damage Amendment Act 1951 provides a means whereby the Earthquake and War Damage premium may be charged on the certified indemnity value only which then becomes the maximum liability of the Commission.

In order to receive this concession the following procedure must be followed:

At the commencement of each period of insurance a certificate stating the indemnity value must be submitted to the Commission. This certificate is to be furnished by a valuer approved by the Commission and who must be a registered Architect or a Valuer registered under the Valuers Act 1948, or an Engineer registered under the Engineers' Registration Act 1924.

3. "REINSTATEMENT" SHALL MEAN BUILDINGS

(a) Where destroyed, the rebuilding of the property including the use of currently equivalent building materials and techniques and such additional costs necessary to comply with any Act of Parliament or any Regulations under or framed in pursuance of any such Act or with By-laws of any Municipal or Local Authority.

(b) Where damaged, the restoration of the damaged portion of the property to a condition substantially the same as but not better or more extensive than its condition when new but including such additional costs necessary to comply with any act of Parliament or any Regulations under or framed in pursuance of any such Act or with By-laws of any Municipal or Local Authority.

PROPERTY OTHER THAN BUILDINGS

The restoration of the damaged property to a condition substantially the same as but not better or more extensive than' its condition when new or if destroyed its replacement by similar property in a condition substantially the same as but not better than the condition of the insured property when new.

NEW ZEALAND INSTITUTE OF VALUERS

CERTIFICATE OF VALUATION FOR INSURANCE PURPOSES
(Buildings)

1. Name of Insured: TOWNSVILLE BUILDING & HARDWARE SUPPLIES LTD.

(include street number)

2. Address of Buildings to be insured: 10-12 COMMERCE STREET and 15-21 INDUSTRY ROAD, TOWNS-VILLE.

3. Type of Occupancy: See attached letter.

4. Brief Details of Construction: See attached letter.

5. Approximate Age of Building: See attached letter.

A. CERTIFICATE OF INDEMNITY VALUE: See, attached letter.
In compliance with the requirements of the Earthquake and War Damage Act I hereby certify that the "INDEMNITY VALUE" of the Insured Building expressed as depreciated cost (i.e. its present reinstatement

cost after allowing for normal physical depreciation) is .... $
(Important - before applying depreciation the Valuer should include all fees as defined on reverse hereof.)

Valuer's Signature.. Qualification: Registered Valuer.

Date: 17 March, 1982.

Name of Valuer and Firm: XYZ Registered Valuers.,..

Name of Insurance Company ....

Policy No .... Period of Policy is from...

to..

B. REINSTATEMENT ESTIMATE: See attached letter.
The estimated cost of rebuilding the property at the level of costs applying at the inception of the current period of insurance ignoring the inflationary factors which may operate subsequent thereto including the use of currently equivalent building materials and techniques and such additional costs as necessary to comply with any Act of Parliament or any Regulation under or framed in pursuance of any such Act or with By-laws of any Municipal or Local Authority (inclusive of all fees as defined on the reverse hereof)

S

Note (i) If the reinstatement estimate is based upon the use of different materials and/or additional services

from those existing, briefly describe them
See attached letter.

Note (ii) By what amounts do the considerations referred to in Note (i) increase the Reinstatement Cost?
See attached letter. $

Note (iii) Are there any Regulations preventing reinstatement wholly or in part? If so give brief details

See attached letter.

C. DEMOLITION See attached letter
What is the estimated amount required to cover the cost of any Demolition Shoring up or Propping of the building damaged or destroyed and the Removal of Debris including Contents whether damaged or not.....................

$

D. INFLATIONARY PROVISION See attached letter.
(i) Indemnity (as defined in A above): The estimated amount of inflation in "INDEMNITY VALUE" anticipated

during the period of insurance only is .... $

(ii) Reinstatement (as defined in B above): The estimated amount of inflation in costs anticipated during both the period of insurance and the estimated reinstatement period taking into consideration time required for damage inspections, demolition, preparation of new preliminary proposals and their approval, preparation of working drawings and specifications, schedule of quantities, obtaining City Council approval tenders etc. is

Estimates under B, C and D are given without prejudice.

SIGNATURE .... DATE: 17 March, 1982.
Name of Valuer and Firm: XYZ Registered Valuer.

The Assessment of Indemnity Value for Insurance Purposes

By T. A. Roberts, The Insurance Council of New Zealand Inc.

1. Introduction

1.1 I am grateful and flattered to have the opportunity to present a paper to your Conference upon this subject. I suspect that the invitation stems from a perception on the part of your Institute that these days, anybody remotely connected with the business of insurance is a masochist, and that masochism is the prime qualification for attempting to comment upon a legal and practical problem of very considerable significance which is at present as confused as any area of the law.

1.2 The law is unclear, a matter which must give all concerned cause for reflection in view of the way in which the subject matter of this paper impinges on the lives of many ordinary citizens, and probably at a time when they are very very vulnerable indeed, for it is trite to say that the problem only arises when somebody has suffered a loss with its attendant stress and personal distress.

1.3 The subject of the paper when analysed really distils down to two simple questions:-

(a) What do we mean when we talk about "indemnity value"?

(b) Do those words "indemnity value" have different meanings in different legal circumstances?

1.4 Generally speaking, the concept of "replacement value" in an insurance context does not give rise to any great problem until circumstances arise which suggest that the words are synonymous with "indemnity value" or that replacement value may be one of the measures of "indemnity value". In most instances the words will be used in the context of a contract of insurance where the contractual liability of the insurer is defined in terms other than purely to indemnify and the calculation of quantum is thus contractually determined. They will have a meaning defined and described by the contract in respect of which the loss arises, and of course different contracts will produce different meanings and results. The trick then, is simply to deal with each individual contract on its specific language. The problem arises where in whole or in part the assessment of the loss requires an answer to the ifrst question, "What do we mean by indemnity value?"

1.5 In New Zealand we also have the additional problem that the need to consider what the law means arises not only in the context of insurance law and the measure of damages but also as a matter of statutory interpretation due to the incorporation of the concept of indemnity value into our system of statutory insurance against catastrophic or extraordinary loss through natural disaster embodied in the Earthquake and War Damage Act 1944.

1.6 We will consider the general law in general terms first, and then move to the problems that arise under the Earthquake and War Damage Act 1944, and thus look at the case law in some detail as it affects both the general insurance law and the interpretation of the Act.

2. The Concept of "Indemnity" in Insurance Law

2.1 The textbooks are, as is often the case, somewhat unhelpful. The Fourth Edition of Colinvaux's "The Law of Insurance" at page 130 puts the matter this way:-

> "A claim under a policy of indemnity is a claim for unliquidated damages. Where the policy is a valued one the measure of indemnity is the agreed value, and in no case can the indemnity exceed the sum insured, or, where the policy is "subject to average," the part of the sum insured applicable to the loss. The general rule is that the measure of indemnity in respect of the loss of any property is determined not by its cost, but by its value at the date and at the place of the loss."

This statement is useful until the next obvious question is asked, namely, "On what basis is value to be determined?" At this point the text is notable for its silence.

2.2 The matter is carried a little further by the statements in the Second Edition of Hardv Ivamy's "General Principles of Insurance Law" at page 378.

> "A calculation of the amount recoverable
>
> The object of calculating the amount recoverable is to ascertain the pecuniary value of the loss, since the obligation of the insurers is to make good the loss by a payment of money.
>
> 1 Valued Policies
>
> Where the policy under which the claim of the assured arises is a valued policy, the valuation placed upon the subject-matter in the policy except in the case of fraud or mistake, conclusively establishes the sum required for the purpose of a full indemnity. The assured is therefore dispensed from the necessity of dealing with questions of amount, and is entitled, on proving the fact of his loss, to recover the full amount insured upon the subject-matter of insurance. Thus, a personal accident policy usually specifies the various sums payable according to the nature and effect of the injury sustained. A liability policy of whatever kind binds the insurers to pay any sum

for which, in the event insured against, the assured shall become legally liable, the amount of his liability being a matter of calculation in proceedings to which they are not parties, and their obligation being to pay him the amount when calculated, subject to the limits of the policy. Similarly, solvency policies of all kinds and fidelity policies relate to pecuniary losses in the first instance.

As far as marine insurance is concerned, the Marine Insurance Act 1906, s. 27 (3), provides:

"Subject to the provisions of this Act, and in the absence of fraud, the value fixed by the policy is, as between the insurer and assured, conclusive of the insurable value of the subject intended to be insured, whether the loss be total or partial."

2 Unvalued Policies

Where the policy is an unvalued one, the amount of insurance specified in the policy does not necessarily represent the measure of indemnity. It may, therefore, be disregarded in this connection, except as fixing the maximum sum for which the insurers may be held liable. The assured must prove the extent and value of his loss, and the amount recoverable will be calculated accordingly. The amount thus calculated may correspond with the amount of insurance, but it is recoverable not as being the sum specified in the policy, but as being the sum which has been proved to be required for a full indemnity.

As far as marine insurance is concerned, the Marine Insurance Act 1906, s. 28, states:

"An unvalued policy is a policy which does not specify the value of the subject-matter insured, but, subject to the limit of the sum insured, leaves the insurable value to be subsequently ascertained, in the manner hereinbefore specified."

In the case of certain classes of property insurance, e.g. insurance against burglary or damage, it may, and usually does, become necessary to measure the value of the loss and to consider on what basis the value is to be calculated."

2.3 It is also possible to attempt to resolve the problem by reference to basic principles and practice. I am indebted to Mr Eric Sherburd, a Chartered Loss Adjuster of Wellington, who in an excellent short paper presented to a conference of the Institute of Loss Adjusters at Christchurch in 1981, set the position out as follows:-

"The traditional practice of establishing indemnity value has been to take the replacement cost of the property concerned, estimate its economic life and create a formula taking into consideration the age and general condition of the property concerned, limited of course to the sum insured.

Indemnity Value =

$$\frac{\text{Cost of Replacement}}{1} \times \frac{\text{Age}}{\text{Economic Life}} = \text{Amount of Claim}$$

Example

Indemnity Value =

$$\frac{\$20{,}000}{1} \times \frac{5 \text{ Years}}{10 \text{ Years}} = \$10{,}000$$

Although this simplistic calculation may generally be satisfactory for chattels losses, it is no longer an acceptable formula for all situations under a Houseowners Policy."

2.4 The law is also stated in general terms in Halsbury's "Laws of England", Second Edition, Volume 18 at page 496 as follows:-

"The assured is not fully indemnified unless, so far as money can do it, he is restored to the position existing at the time of the fire. The amount recoverable must therefore be measured by the amount of his loss, that is to say, by the value which the fire has taken away from his property.

In the case of a total loss, the measure of indemnity must necessarily be the value of the property destroyed, up to the limit of the sum insured. For the purpose of ascertaining this value, the following rules may be applied, namely:-

(1) The value to be taken is the value of the physical property destroyed: no allowance is to be made for loss of prospective profits or consequential loss.

(2) The value is the intrinsic value of the property, its real and actual value: no allowances to be made for mere sentimental value.

(3) The value is the value at the time of the ifre. This is in accordance with the express undertaking of the insurers in the policy. Hence, if the value has increased during the period of insurance, and thus exceeds at the time of the fire the value at the commencement of the risk, the assured is entitled to recover on the basis of the increased value.

(4) The value is the value at the place of the ifre.

(5) Prima facie the value is to be measured on the basis of market value. This clearly represents an adequate indemnity where, as in the case of merchandise or stock-in-trade, the property destroyed is a marketable commodity, since payment of the market value will enable the assured to go into the market place and, by the purchase of similar property, be restored to his original position. The basis of market value cannot, however, be applied in every case: the market value does not necessarily represent the real value of the property, and payment of the market value may not adequately indemnify the assured for what he has lost. This is particularly the case where the property was held by the assured, not for the purpose of placing it on the market, but for his own use or enjoyment or for the purpose of carrying on his business. The assured cannot continue the use or enjoyment or carry on his business unless the property is reinstated, and the cost of

reinstatement may be considerably in excess of the market value. There are also cases in which property, such as, for example, a church, has no market value at all, and where there can be no restoration to the original position unless the property is reinstated. In cases such as these the amount recoverable is based on the cost of reinstatement.

Where the loss is partial only, it can usually be made good by repairing the damage to the property, and the amount recoverable therefore is based on the cost of repairs."

2.5 There are other ways of endeavouring to measure indemnity value. The measure of the potential problem and confusion is succinctly set forth in Mr Sherburd's paper and I take the liberty of again quoting from it.

"The insured is entitled to the value of the affected property, but cannot receive more than its value to him at the time of the loss. Indemnity may in the circumstances of a particular claim be any one or a combination of different values. I have discarded many adjectives such as real, intrinsic, actual, and full, as being incapable of precise definition and limited my comments to the following:

1.Physical	6.Book
2.Market	7.Repair
3.Rental	8.Functional
4.Special	9.Indemnity
5.Sentimental	10.Salvage"

2.6 The calculation of an indemnity is then not an exact science. In Maurice v. Goidsborough, Mort & Co. Ltd. [19391, 3 All England Law Reports 63, Lord Wright put the matter succinctly:-"Insurance does not necessarily give perfect indemnity but gives sometimes more and sometimes less."

2.7 There is some similarity between "indemnity" and "compensation" and the court has regard to the principles of indemnity when for instance it awards compensation to a third party in a liability claim. However, some items of compensation would not be payable as part of an indemnity under a material loss policy, for instance, foreseeable pecuniary loss over and above the value of the destroyed or damaged property. There are also restrictions to compensation which do not apply to the amount of an indemnity payable under an insurance on property, for instance, limitations imposed by statute and contributory negligence by the claimant.

2.8 There has been much recent development in the development and marketing of insurance. A simple example would be the so-called "new for old" houseowners policies. This class of policy is still a contract of indemnity even though it may require that the insurer will not deduct any allowance for prior wear and tear on certain classes of article. It is merely defining the amount payable as an indemnity. The operative clause usually mentions the word "indemnify" and in this respect it may be different from the standard fire policy which is also a contract of indemnity but which may not specifically refer to that fact in its operative clause.

2.9 A consequential loss or business interruption policy should show exactly how the amount payable under the policy is to be calculated. It is unlikely that the insureds' accountant would calculate their loss in a similar manner if the policy merely stated that it was a contract of indemnity (which in fact it usually does as well showing a formula for calculation of losses). It is equally unlikely that the court would accept the formula shown in the policy when awarding a subrogated recovery, although the court would have to accept the formula in any action by the insured for a payment under the policy.

2.10 A fire policy is often extended to include a reinstatement memorandum which requires the insurer to pay the cost of reinstatement when it is incurred. But even if the memorandum is not on the policy, the operative clause provides the insurer with the option of giving an indemnity by reinstatement. If the insurer carries out that reinstatement to provide indemnity, he must do so completely and he cannot require the insured to contribute towards the cost regardless of any prior wear and tear which would have caused a cash settlement to be for a lower amount. A policy condition may limit the cost of reinstatement to the sum insured, but if the insurer takes the policy option to provide an indemnity by reinstatement of partial destruction or damage, it would seem that not even the average clause can be applied to reduce the liability of the insurer, let alone any deduction for prior wear and tear.

2.11 There is ample precedent then for "new for old" insurance, or insurance which provides how an indemnity is to be calculated or for reinstatement in one form or another, and indeed some policies now do not even provide a limit to the reinstatement value. There are many cases where insurers have to pay claims far in excess of what we have been brought up to believe is a true indemnity.

2.12 However the indemnity concept remains. often in a climate in which expectation exceeds contractual rights. It may be that the expectation is translated in reality, not by the process of the law but into the process of calculation or valuation and the temptation must be avoided of adopting methods of valuation which affect level of expectation rather than level of loss. The significance of this comment will emerge later in this paper.

3. Statutory Insurance - The Earthquake and War Damage Act 1944

3.1 That New Zealand is a country subject to considerable risk of major loss through natural disaster cannot be doubted. New Zealand has suffered a number of substantial earthquakes since the time of European settlement, particulars of which are well documented and recorded. Threat of loss from volcanic activity is always present and our history is of course littered with examples of other natural disasters arising from flood, landslip, storm, and the like. The organising of seminars on the subject of natural disasters has of late become something of a growth industry, with everyone affected or likely to be affected, in on the act. Not unnaturally, New Zealand's propensity for natural disaster has produced a demand for protection from, or indemnity against, the consequences of the natural phenomena we have to live with, and the minds of the public of course turn at once to insurance. However, the ability and willingness of the insurance industry to provide cover against some forms of natural disaster is limited.

3.2 The problems arising from this fact have been recognised in the legislation originally enacted in 1944 as the Earthquake and War Damage Act 1944. The Act, as a result of public demand, has been progressively expanded to cover other forms of natural disaster, so the Act is now somewhat misnamed.

3.3 The following events may give rise to cover under the Earthquake and War Damage Act 1944:-

(a) Earthquake damage as defined by Section 2 of the Earthquake and War Damage Act 1944 which includes damage occurring as a direct result of earthquake or of fire following earthquake and damage occurring as the direct result of measures taken under proper authority to avoid the spreading of damage or to mitigate the consequences of direct earthquake damage or earthquake ifre damage.

(b) War damage as defined under Section 2 of the Earthquake and War Damage Act.

(c) Disaster damage as defined in the Earthquake and War Damage Regulations 1956, which includes storm damage, flood damage, or volcanic eruption, excluding damage caused by landslip, subsidence, or erosion, which gives rise to the possibility of voluntary cover under Section 15 of the Act.

(d) Extraordinary disaster damage as defined in the Regulations.

(e) Landslip damage as defined in the Earthquake and War Damage Regulations as amended.

(f) Geothermal activity damage as covered in terms of Regulation 17A of the Earthquake and War Damage Regulations 1956 Amendment No. 2.

3.4 The Commission of Inquiry into the Abbotsford Landslip Disaster, which reported in November 1980, had this to say about the legislation at page 155 of the report:-

"6.9.4.2 The present legislation does not fully meet either the needs or the expectation of the public nor has it been entirely responsive to and compatible with developments in insurance practice over the past 20 years. The following sections of the report suggest the matters which this commission considers require legislative alteration and makes some suggestions as to how the review of the Act and Regulations should proceed. Some of these matters arise directly from the Abbotsford experience and are based upon the evidence of the experiences and performance of those people and organisations involved in the events and their aftermath. Some matters arise from evidence and submissions as to deficiencies in the legislation presented to this commission in response to paragraph (d) (iv) of its terms of reference, a paragraph which because of its very wide scope places a very onerous responsibility upon us.

6.9.4.3 We record that we accept, as we believe the community generally accepts, the basic philosophy upon which the Earthquake and War Damage Act 1944 grew. It may be instructive in this regard to quote from the Parliamentary Debate in 1944 which accompanied the introduction of the legislation. The then Minister of Finance, Hon. Walter Nash had this to say:

"What has actuated the writing of the measure is the unpredictable nature of earthquake losses, and the injuries that might come to a few of the people. The endeavour has been to work out a principle under which the whole loss is deemed to be a national loss, and under which those people who might be affected will subscribe towards a fund to meet losses which may come to any of them. It is not exactly the same as a fire-insurance premium"."

3.5 The Commission of Inquiry was also at pains to analyse the logical basis underlying the Act. It put the matter this way:-

"The present act has we think two important legal premises derived in part from insurance law:

(a) It is based on the concept of cover for indemnity value.

(b) It provides for cover in respect of specified risks or perils."

3.6 The important section of the Act for our purposes is Section 14 (2A) which provides as follows:-

"Where the contract of fire insurance provides for settlement of any claim for damage to or destruction of the property upon a basis more favourable to the insured person than its indemnity value,-

(a) The property shall be deemed to be insured under this section to the amount of indemnity value only:

(b) The earthquake and war damage premium in respect of each period of the insurance shall be computed on the amount of the indemnity value of the property as approved by the Commission after being certified at the commencement of that period by a valuer approved by the Commission, being a registered architect or by a valuer registered under the Valuers Act 1948 or an engineer registered under the Engineers Registration Act 1924:

Provided that if no such certificate is approved by the Commission in respect of any period the premium shall be computed on the amount to which the property is insured under the contract."

3.7 There is no definition of the term "indemnity value" in the Act and the meaning of the term must be ascertained from consideration of the general insurance law. The Abbotsford Commission of Inquiry observed that the prevailing practice of the Earthquake and War Damage Commission was " . . to calculate indemnity value and offer claim settlement on the basis of a valuation provided by a Registered Public Valuer. This procedure is not unreasonable provided that the valuer values the property concerned on a correct basis." The Commission noted the growing volume of case law arising out of interpretation of insurance contracts concerning the meaning of indemnity value and observed that there were difficulties in defining the term which reflect in the case law. The Commission alluded to some inconsistency in the methods of valuation and observed, for instance, that it had heard in evidence that valuers employed by the Earthquake and War Damage Commission took into account the effect on value of the very circumstances that gave rise to the event of loss, and remarked that they did not consider such a procedure appropriate. The matter was important because of the divergence between the cover provided by the Commission and current insurance practice. It is increasingly the practice to insure property on so called "replacement" conditions, or something closely akin thereto, so that the amount of cover afforded against the peril of fire greatly exceeds the amount of cover afforded against the specified natural disasters appearing in the Act and Regulations, which is based on indemnity value only. In some instances the gap is bridged by the provision of excess of indemnity cover in respect of the perils covered by the Act. In other cases the gap is not bridged or is only partially bridged by the provisions of cover in respect of some only of the perils concerned. The real issue is the width of the gap and the only way to determine this is to consider the meaning in law of the term "indemnity value".

3.8 The Earthquake and War Damage Commission's present legislation and policy require that where a building is insured upon replacement terms it must be valued every year to support an assessment of the indemnity value and a premium calculation based on indemnity value. As the practice of obtaining replacement insurance becomes more widespread, the cost of the present procedures to the public, and the amount of paper work generated for the Earthquake and War Damage Commission must make the position intolerable and it seems that already this point is close to being reached. In addition, it is also evident that many insured persons are paying premiums based on an assessment of replacement value but are receiving cover only based on an assessment of indemnity value. Any comment on the justice or otherwise of this state of affairs would be superfluous.

3.9 The difficulties may be highlighted by citing some specific examples of problems that may arise when traditional methods of valuation are applied or in some cases not applied. For instance, do two identical houses in similar condition, one erected at Box Hill, Khandallah, and the other at Warspite Avenue, Porirua East, have a similar indemnity value? Secondly, would the indemnity value of the Box Hill house be reduced if the Mongrel Mob established its gang headquarters next door? Thirdly, would the indemnity value of the Box Hill property be reduced if there were an Abbotsford style landslip 100 yards down the road with the possibility of the slip area extending to the Box Hill property? Now extend the arguments to special purpose buildings. What else can you do with small suburban petrol stations or a Kentucky Fried Chicken outlet? Does the limited use of the building affect value? Now make the matter really complicated and impose zoning considerations, assume that the buildings are nonconforming uses within the zones or are subject to major restrictions as to location or choice of materials in the event of destruction and rebuilding.

3.10 Having said all that we really need to go back even further to basic principles and ask ourselves what the legislation was trying to do and within what legal and logical framework it was trying to do it. There are really two possible philosophical bases:-

(a) The legislation can be regarded as a form of insurance extension to cover events of loss in respect of which insurance is not normally or readily available.

(b) The legislation can be regarded as a sort of social security system covering material damage.

The history and scheme of the Act and Regulations demonstrate that the former is the philosophical basis for the Act, so that it pro. vides "insurance" not "social security". Indemnity value then could be expected to have its ordinary insurance law meaning for the purposes of the Act. The fact that the scheme of the Act is to engraft onto insurance contracts additional cover for additional events of loss reinforces this conclusion.

4. The Case Law

4.1 The difficulties or anomalies are well illustrated by the cases which have considered the meaning and calculation of indemnity value. The first case we need to consider is Reynolds and Anderson v. Phoenix Assurance Co. Ltd. and Others [1978], 2 Lloyd's Law Reports 440. This case involved a building in Stowmarket, Suffolk, known as the Stonham Parva Maltings. The building concerned was a very typical special purpose building known as a "floor maltings", being originally used for malting barley in a process which included spreading the barley to a shallow depth across the floor of the building. The buildings are described in the case as of massive construction, brick built with a slate roof, having been built towards the end of the Victorian era. In the 1960s a new malting process was developed which did not involve spreading barley on the floor in the old fashion, and consequently many maltings outlived their original purpose and new uses were sought for them. In 1969 the plaintiffs, Reynolds and Anderson, bought the premises and insured them with frve insurance companies for 18,000 pounds in all. In August 1972 the insurance on the buildings was increased to 500,000 pounds and in August 1973, on the advice of insurance brokers, a new insurance policy was taken out, the total sum insured being 628,000 pounds, covering the buildings for 550,000 pounds and machinery and stock for the balance. In November 1973 a ifre occurred which destroyed about 7/10ths of the buildings. The plaintiffs claimed under the insurance policies and the loss was adjusted at a figure of 243,000 pounds, taking into account a deduction of 37,240 pounds for betterment. In June 1974 the insurance adjusters wrote conifrming that their principals had instructed that they agree to the assessment of 243,000 pounds on an indemnity basis, subject to the work of rebuilding being put in hand. The defendants' solicitors then wrote stating that the figure of 243,000 was acceptable provided that the buildings were to be reinstated; if they were not then a lesser figure would be payable as "it by no means follows that the plaintiffs can claim that the loss which they have suffered . . . is anything of the order of 243,000 pounds when one bears in mind the initial cost of the building of only 16,000." The plaintiffs refused to reinstate, settlement fell through, and the plaintiffs brought action under the policies claiming an indemnity which amounted to the total cost of reinstatement of the building.

4.2 In looking at the question of the extent of "indemnity" provided, the Judge stated that there were three possible *ways* of evaluating the loss.

(a) Market value

(b) Equivalent modern replacement

(c) Reinstatement.

4.3 Market value was described as the value which the premises would have fetched if sold in the open market immediately before the fire. Equivalent modern replacement was described as a method of arriving at a valuation of premises where no other suitable method of valuation is available. The rationale behind its use is that at any rate in cases of commercial interests the building does not exist merely as a collection of bricks and mortar, it exists to be used for a purpose and in commercial cases for a commercial purpose. Reinstatement, the third alternative, was said to be the replacement of like with like. The Judge rejected the argument that in the circumstances indemnity really meant replacement. The Judge quoted what he described as the classic statement of the basis of the insureds' right to indemnity as set forth in Castellain v. Preston [1883], 11 QBD 380 at page 386.

> "The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified but shall never be more than fully indemnified. That is the fundamental principle of insurance, and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the assured from obtaining a full indemnity or which will give to the assured more than a full indemnity, that proposition must certainly be wrong."

4.4 It was further held that in some cases the cost of reinstatement might be a possible means of measuring indemnity, but in this particular case market forces provided a solution and the true view was "would the owner for any reason that would appeal to an ordinary man in his position, rebuild if he got replacement damages, or was his claim for damages a mere pretence?" On the facts the plaintiffs did have the genuine intention to reinstate if given the insurance moneys and this wasn't a mere eccentricity but arose from the fact that they would not be properly indemnified unless they were given the means to reinstate the building substantially as it was before the fire. The Judge also decided that if he was wrong, then the true test was what a sensible commercial person using his own money would do in the circumstances, and the modern replacement value provided the safest test of market value. The Judge's reasoning is underpinned by the assumption that what needs to be found is the market value arrived at as between willing buyer and willing seller dealing at arms length.

4.5 The second case, Leppard v. Excess Insurance Co. Ltd. [1979], 2 All England Law Reports 668, is fortunately somewhat more helpful. To begin with it is a decision of the Court of Appeal, the factual circumstances are somewhat simpler, and the case is rather better argued. The plaintiff purchased a cottage from his father-in-law with the purpose of selling it and dividing the proceeds between himself and his father-in-law. At first his asking price was 12,500 pounds for the cottage, but eventually he reduced the asking price to a more realistic 4,250 pounds, and he would have been willing to sell it for 4,000 pounds. He insured the cottage under a policy of insurance against fire and other risks. The proposal form stated that the sum insured was 10,000 pounds and on renewal the sum insured was increased to 14,000 pounds. Before any sale took place the property was totally destroyed by fire. The insurer accepted liability but contested the amount payable under the policy. The plaintiff contended that the amount payable was the cost of reinstatement, because having regard to the wording of the policy and the declaration incorporated in it, the full value of the property was deemed to be the cost of reinstatement, even though it exceeded the amount of the actual loss suffered. The insurer contended that the plaintiff was entitled only to the market value of the cottage at the time of the fire, which was agreed at 3,000 pounds, that is the price at which the plaintiff was willing to self less the site value of the land, since that was the value of the actual loss suffered.

4.6 The court supported the contention of the insurer on the basis that under an indemnity insurance policy the insured could not recover more than the actual loss suffered. Since the policy in question was an ordinary indemnity only contract, on its true construction the insurer had undertaken on the occurrence of total loss by fire to pay only the actual loss suffered by the plaintiff and had not expressly or impliedly agreed to pay a greater sum than the actual loss.

4.7 The measure of indemnity value would appear to be determined by a subjective judgment, on the facts, of the extent of the real loss of the insured, and to differ depending on whether there is a total loss or a partial loss. The insureds' intentions will also count. The ultimate test in some cases would appear to be market value, and market value would have to be calculated at the last appropriate time before the circumstances which gave rise to the loss. In other cases the test is based on a judgment of the assumed loss of the insured based on his activities and his intentions. It is also clear that indemnity value can be affected by circumstances quite unconnected with the loss and quite extraneous to the valuation of the property on a strict "bricks and mortar" basis. Thus, market factors and purely local environmental factors may influence the calculation of indemnity value. This of course produces some totally unsatisfactory consequences. In short "it all depends on the circumstances" which isn't really a very helpful statement, but then neither is the present state of the law very helpful.

4.8 The proposition that replacement less depreciation is not always the correct measure of indemnity value is graphically and simply illustrated by the New Zealand decision, Falcon Investments Corporation (N.Z.) Ltd. v. State Insurance General Manager [1975], 1 NZLR 520. This was a case where a redevelopment property incapable of renovation was destroyed prior to redevelopment but at a time when some income could have been derived from the property. Mr Justice O'Regan in a very vigorous and very simple judgment sets the position out with admirable clarity, and despite its length I think it appropriate again to quote in full from the relevant portion of the judgment, starting at page 523.

> "I do not find it necessary to consider in detail the data tendered by either valuer. They were valuing realty and their evidence is as to their reasons for the conclusions they reached. My task is to ascertain the loss resulting from the fire sustained by the plaintiff, which I apprehend to be a very different exercise. The policy provides that the defendant "in the event of any of the contingencies hereinafter described . . . will by payment, reinstatement or repair indemnify the Insured as hereinafter provided." The first of the contingencies described is "loss or damage to property described in the Schedule caused by . fire." Reinstatement or repair, it is agreed, are not for consideration. The question, therefore, is what payment should the defendant make to indemnify the plaintiff for the loss or damage to the property by the fire. Such loss is the loss to the insured whereas the opinions offered by the valuers is as to the intrinsic value of the property destroyed. The distinction between the two situations has been considered and made in a series of Canadian cases. In Canadian National Fire Insurance Co. v. Colonsay Hotel Co. [1923] 3 DLR 1001, the insured property was a large hotel built in 1910 and sold in 1912 for $20,000. It was subsequently deprived of a licence by the introduction of prohibition. After having been occupied by a Chinaman for a time, it, along with its contents, was acquired by the respondent in October 1920 - some eight months prior to its destruction by fire - for $3,950. For the six months prior to the fire, the hotel was run by the respondent at a substantial loss. The trial Judge directed the jury that the basis of indemnity was the replacement value of the property insured. The jury returned a verdict estimating the value of the hotel at $16,500 and the contents at $3,500. On appeal, the Saskatchewan Court of Appeal affirmed the judgment but the Supreme Court of Canada reversed it. Duff J had this to say:
>
> "The jury ought to have been told that the pecuniary loss suffered by the insured in the destruction of the hotel was the true and only measure of the indemnity to which it was entitled. It seems to be quite clear that the loss could in the circumstances be measured by the value of the property - not necessarily the selling value, if the insured could establish a value in use greater than the selling value - but I can entertain no doubt whatever that the point upon which a jury should have been told to apply their minds was that of ascertaining the value to the insured of the property destroyed" (ibid, 1005).
>
> This decision was applied in Vanierburgh v. Oneida Farmers' Mutual Fire Insurance Co. [1935] 1 DLR 257 where Davis J A said:
>
> "There are, of course, many cases where replacement cost less depreciation is obviously no measure of loss. Old buildings are not infrequently a detriment, or at least of little value, in the sale of land. and it would be wrong to estimate loss in such cases by ascertaining replacement cost. One of such cases was Canadian National Fire Insurance Co. v. Colonsa 3 v Hotel Co. [1923] DLR 1001. It is in every case the actual loss that is to be ascertained though different methods of arriving at that loss may be appropriate in different cases" (ibid, 258).
>
> In Scott v. Canadian Mercantile Insurance Co. [1965] 49 DLR (2d) 601, the plaintiff claimed indemnity for the collapse of a portion of his five-storey chicken house due to a windstorm, basing his loss on replacement less depreciation. The policies in question limited

indemnity to the actual cash value of the property at the time of destruction. The building was 5,1 years old when it collapsed. Because of adverse economic conditions in the egg production business in which he was engaged, it was clear that the plaintiff could not have continued operating for more than 11 years even if the building had not collapsed. The original cost of the building was $67,000. The award in favour of the plaintiff was calculated at its depreciated value after 52 years based on full depreciation for 7 years. In reaching its decision the Court, therefore, took account of circumstances peculiar to the plaintiff and the property in determining "the pecuniary loss suffered by the insured" and, in so doing, followed Canadian National Fire Insurance Co. v. Colonsay Hotel Co. (supra).

In Burnand v. Rodocanachi [1882] 7 App Cas 333 Lord Blackburn stated the principle involved in these words:

> "The general rule of law (and it is obvious justice) is that where there is a contract of indemnity . . . and a loss happens, anything which reduces or diminishes that loss reduces or diminishes the amount which the indemnifier is bound to pay . . . " (ibid, 339).

This passage was cited with approval by Cotton LJ in Castellain v. Preston [1883] II QBD 380, 394.

In the present case, the land was about to be developed when the loss happened and that development involved the demolition of the house. In my view, the only loss accruing to the plaintiff was the rent revenue for a year beyond the date of the fire. He would have, however, had to spend $500 in making good the depredations of the vandals before it could be revenue producing. The fire resulted in a saving in demolition costs. The cost of demolition of the house, as it was before the fire, I accept to have been $650. The cost of demolition of what was left after the fire was $312. The saving then was $338 and I think the defendant should have credit for that. The defendant has already paid $312 under the policy and must have credit for that amount also. The defendant's net loss resultant upon the fire is accordingly:

Loss of 1 year' s rental		$2,600.00
Cost of reparation to render it tenantable	$500.00	
Saving on demolition costs	338.00	838.00
		$1,762.00
Less amount already paid		312.00
		$1,450.00

Judgment for the plaintiff for $1,450."

4.9 It would be impossible to deal with a matter of this interest and complexity without running across Lord Justice Denning, who manages to have something to say on most subjects of legal interest and controversy, and to say them with admirable clarity and vigour, even if the House of Lords sometimes takes the view that his clarity and vigour might sometimes be tempered with a more accurate view of the law. In this case however, I do not think there can be any doubt that he is right, and again we come to the old maxim that it "all depends on the circumstances". The principles governing how you arrive at an assessment of the circumstances are more nearly expressed in this than in any other case. The case is Harbutt's Plasticine Ltd. v. Wayne Tank and Pump Co. Ltd. [1970], 2 W.L.R. 198.

4.10 The relevant part of the judgment deals with the measure of damages. The case arose where a plasticine factory in an old mill burnt down. There was no possibility of alternative accommodation, the factory had to be rebuilt, the policy was a policy of indemnity, and the court had to decide what the measure of indemnity was. The Judge sets the situation out under the heading "Replacement or indemnity" and I quote from page 212 of the decision.

> "A question was raised on the measure of damages. The plasticine company were not allowed to rebuild the old mill (which was ifve storeys high) for use as a factory. They had to put up a new factory of two storeys. But it had no more accommodation. Are they entitled to the actual cost of replacement? or are they limited to the difference in value of the old mill before and after the fire?
>
> The figures were agreed:
>
> | | Cost of Reinstatement Pounds | Difference in Value Pounds |
> |---|---|---|
> | Buildings | 67,973 | 42,538 |
> | Stock | 17,324 | 17,324 |
> | Loss of Profit | 21,000 | 21,000 |
> | Plant and Machinery | 40,284 | 35,923 |
> | | 146,581 | 116,785 |
>
> The defendants.said it should be the difference in value before and after the fire, relying on Philips v. Ward [1956] 1 W.L.R. 471. The plaintiffs said it should be the cost of replacement, relying on Hollebone v. Midhurst & Fernhurst Builders Ltd. [1968] 1 Lloyd's Rep. 38.
>
> The destruction of a building is different from the destruction of a chattel. If a secondhand car is destroyed, the owner only gets its value: because he can go into the market and get another secondhand car to replace it. He cannot charge the other party with the cost of replacing it with a new car. But when this mill was destroyed, the plasticine company had no choice. They were bound to replace it as soon as they could, not only to keep their business going, but also to mitigate the loss of profit (for which they would be able to charge the defendants). They replaced it in the only possible way, without adding any extras. I

think they should be allowed the cost of replacement. True it is that they got new for old; but I do not think the wrongdoer can diminish the claim on that account. If they had added extra accommodation or made extra improvements, they would have to give credit. But that is not this case. I think the judge was right on this point."

4.11 The view that all of the relevant circumstances must be taken into account as a matter of law, and that there is really no general rule with universal application, is further supported by the cases on the measure of damages in tort. There are a vast number of them and I will quote only from one because it does canvass most of the leading old authorities and its facts and the principles that arise from those facts are fairly simply and fairly memorably expressed. The case is Hollebone and Others v. Midhurst and Fernhurst Builders Ltd. and Another [1968], 1 Lloyd's Law Reports 38. In that case the plaintiffs' house was damaged by fire due to the admitted negligence of workmen. Liability was admitted but there was a dispute as to the quantum of damages. The defendants took the position that damages should be based on differential value, that is the difference between value before the fire and value after the fire. The plaintiffs claimed that the principle of "restitutio in integrum" should apply and the proper measure of damages was the cost of repair which exceeded the differential in value by some 4,000 pounds. There was also a claim in respect of betterment. I quote at length from the relevant portion of the judgment.

"In these circumstances and in the light of the ownership and occupation of the property by the Hollebone family, it is clear that Mrs Hollebone acted reasonably in having the damage made good and the amount of the cost of these repairs is the measure of damage which provides restitutio in integrum and the ifgure I would award unless I am bound to assess damages on the differential basis.

In support of his argument that the figure based on differential value is the correct one, Mr Kidwell, on behalf of the defendants, relies on the observations of the authors of a number of textbooks and on the decisions quoted by them as supporting their conclusions in a number of decided cases.

Before examining them, I should refer to what was said on the subject of the measure of damage in two cases in the House of Lords.

In The Susquehanna, [1926] A.C. 655; (1926) 25 L1.L.Rep. 205, Viscount Dunedin states that no rigid rule or rules that apply to all cases can be laid down, but one must consider all the relevant circumstances.

In The Chekiang, [1926] A.C. 637, at p. 643; (1926) 25 L1.L. Rep. 173, at p. 175, the proposition is put by Lord Sumner in these words:

" . . . The measure of damages ought never to be governed by mere rules of practice, nor can such rules override the principles of the law on this subject.........."

The relevant circumstances must clearly depend on such matters as the interest which the injured party has in what is damaged: whether it be a chattel or realty the principle is equally applicable.

In the case of realty he may be owner-occupier, or tenant with or without liability to repair, or reversioner. The property may be used as a private house, or guesthouse, or market garden, or investment, its life may be short or long and perhaps subject to the likelihood of compulsory purchase. Again the relevant circumstances applicable in the last century may be wholly different to those obtaining today, as is evidenced by the scarcity of homes today and the restrictions imposed by town planning and other legislation in regard to building and conversion as against the situation in the past when alternative accommodation was readily available and there was no restriction on building.

I now turn to the observations in the textbooks. In Salmond on Torts, 11th ed. (1953), at p. 240, it is stated that where trespass has caused physical damage to land - and there is no difference whether the tort be in trespass, nuisance, or negligence - the measure of damage is not the cost of reinstatement. In Mayne and McGregor on Damages, 12th ed. (1961), at p. 635, it is stated that in torts affecting land, the normal measure of damages is the amount of the diminution of the value of the land, and in Street on Damages, at p. 201, the author states that in actions relating to loss and damage to land and structures, the Courts are reluctant to apply the test of replacement.

For these propositions reliance is placed on a number of cases to which I have been referred, namely: Jones v. Gooday, (1841) 8 M. & W. 146; 151 E.R. 985; Hosking v. Philips, (1848) 3 Ex. 168; 154 E.R. 801; Moss v. Christchurch Rural District Council, [1925] 2 K.B., 750; and Spicer v. Smee, [1946] 1 All E.R. 489.

All these cases can I think be distinguished on their facts in that the circumstances were different to those relevant in this case.

In the case of Jones, sup., the damage to the land was minimal and did not affect the full enjoyment of the undamaged residue, in Hosking's case, sup., the plaintiff was a reversioner and the house was due for demolition in the immediate future, in the case of Moss, sup., the plaintiff was a reversioner, the premises being held under a tenancy protected by the Rent Restriction Acts - and the differential value basis was conceded. See Lord Moncrieff in Hutchison and Another v. Davidson, [1945] S.C. 395.

In Spicer's case, sup., rebuilding was not possible due to by-law restriction nor was any evidence called or argument addressed on differential values, and in fact the damages were assessed on a third basis, namely the value of the building destroyed.

If the reasons I have suggested as distinguishing those facts from the present case are not well founded, then in so far that these cases purport to lay down a hard and fast rule or principle or practice they must be rejected not only because they conflict with other cases which in my judgment are to be preferred where the cost of repair or replacement was held to be the proper measure of damage (see: Duke of Newcastle v. Hundred of Broxlowe, (1832) 4 B. & Ad. 273; 110 E.R. 458; Murphy v. County Council of Wexford, [1921] 2 I.R. 23; Nitro-phosphate and Odam's Chemical Manure Company v. London and St. Katharine Docks Company, (1878) 9 Ch. D. 503; and Hutchison v. Davidson, sup.) but also because they run counter to the speeches of Viscount Dunedin and Lord Sumner, to which I have referred."

5. Where the Valuer Stands

5.1 That there are considerable practical difficulties for valuers cannot be doubted, and the extent of these practical difficulties can be quite simply illustrated by reference to the standard form of certificate of valuation for insurance purposes, used by the Institute of Valuers itself. A copy of this certificate in blank form is attached to this paper, though all valuers will of course be familiar with it.

5.2 The certificate states "In compliance with the requirements of the Earthquake and War Damage Act I hereby certify that the indemnity value of the insured building expressed as depreciated cost (i.e. its present reinstatement cost after allowing for normal physical depreciation) is $." This is followed by the slightly intriguing note, "(Important - before applying depreciation the valuer should include all fees as defined on reverse hereof)". There is no substitute for dealing immediately, bluntly and vigorously with fundamental and important problems like professional fees.

5.3 The difficulty is that all of this, (and especially the fees bit) has nothing whatever to do with the meaning of indemnity value as a matter of law, and this point is illustrated by a practical example. Assume that Section D of the valuation certificate shows an inflationary provision of $50,000 and a reinstatement value of $60,000. Assume also that the building is a brand new building and that the indemnity value is said to be $4 million. In these circumstances, the Earthquake and War Damage Commission has adopted the practice of requiring that as the building is a new building, there is no depreciation and that Earthquake and War Damage premium should be charged on the full amount to which the building is insured under the contract of fire insurance, and on the basis that for the first 12 months at least of the building's life it is presumed reinstatement value and indemnity value are one and the same thing. If they are, it is purely co-incidental. It may well be that circumstances produce the situation that a building which was built for $250,000 and will cost $375,000 to replace has an indemnity value of $150,000 or $500,000. As the Bishop is alleged to have said to the actress, "It all depends on the circumstances," to which I would have to add, that if the Bishop was a valuer, he would have to say, "It all depends on all of the circumstances." The difficulty is further compounded by a ruling of the Earthquake and War Damage Commission embodied in its Circular 1978/1 that calculations of indemnity value are to include an allowance for inflation during the period of cover. This ruling is quite unsupported by either the Act or the general law and is in my view incorrect as a matter of law.

5.4 It has become the custom to value properties for the purpose of the Earthquake and War Damage Act by calculating the indemnity value on the basis of depreciated costs, that is present estimated reinstatement cost after allowing for normal physical depreciation, and the valuation form used by the New Zealand Institute of Valuers also directs valuers before applying depreciation to include fees as defined on the reverse of the form. This method of valuation may be customary but it is simply not warranted by the law. As I have said, indemnity value is not defined in the Act but has a meaning at law and that meaning is not replacement less depreciation, whatever the established custom is. I observe that some valuers have adopted the practice of "tagging" their valuations with a statement such as "this estimate of indemnity has been prepared in strict conformity with the specific wording of the certificate of valuation form hereunder and does not necessarily represent an indemnity value in terms of a market value loss." This statement, which is something like the valuers' equivalent of a tagged auditors report, really highlights the difficulties of the matter. Valuers are aware that indemnity value has a specific meaning and must be sensitive to the fact that the present method of calculation adopted for the purposes of calculating premium, may produce grave difficulties in the event of a claim. It is open to the Earthquake and War Damage Commission to collect its premium on the basis of a replacement less depreciation formula and then pay the claims on the basis of market value, which in some cases will be very much less than replacement less depreciation. There is an urgent need for some clarity in the legislation.

6. Conclusion

6.1 Where does all this lead us? First, it is suggested that valuers may need to look hard and long at the methods which they use to determine indemnity value. The law simply does not support the traditional "intrinsic value" method of valuation when replacement cost, economic life and depreciation, and age and general conditions are reduced to a formula, nor is simple market value necessarily the measure of indemnity. Nor will replacement value less depreciation necessarily be the measure.

6.2 Each case will turn on its own particular facts, but it is possible to distil from the texts and the cases some general principles:-

(a) Insurance is a contract of indemnity and the purpose of indemnity is to place the party indemnified as nearly as possible in the position he or she was in immediately before the event of loss.

(b) Circumstances will alter cases and the position in the event of partial loss may be different to the circumstances in the event of total loss. In such factors the intentions of the insured will be relevant.

(c) The question that the valuer must ask is what must be paid to the insured or what must be done for him to put him in the same position he was in immediately before the event of loss.

(d) This being the case, location factors, and such matters as zoning will be taken into account in arriving at the indemnity value.

6.3 Secondly, it is clear that there is a need for amendment to the Earthquake and War Damage Act 1944 to remove some of the difficulties and uncertainties. The problem and a possible solution may again be illustrated by quoting from the report of the Abbotsford Commission:-

"6.9.5.2.5 The only simple and practical solution would seem to be for premiums to be assessed on a "declaration of value" basis as is already the case with the motor vehicle insurance cover afforded under the Act. In our view the quantum of cover afforded under the Act should follow the cover afforded under the insurance policy. Where a maximum limit of cover is specified, this would provide the basis of the premium calculation. Where no limit of cover is specified, then the insured should be required to make a declaration as to the maximum foreseeable insured loss under the policy. The premium should be calculated on the basis of the declared amount which would also provide the maximum limit of cover. This latter step should eliminate the risk that false or careless declarations are made to reduce premiums, such a step of course carrying with it the risk that in the event of loss the property will be left substantially under-insured."

Questions and Answers

R. P. Young and T. A. Roberts

S. Speedy, Auckland

Q. At the 1978 Conference there was an Insurance Representative and I said insurance is what you think you have until you try to claim. And today after listening to that very worthwhile amazing address I am more convinced than ever that there is one big `con' going on and I am quite serious now if what you say is correct and I think it is, because this is my view and we are merely doing figuring to produce a form of indemnity to fit the form and to satisfy the lack of ability of surveyors at least Architects and Engineers to be able to give true indemnity when millions of dollars in premiums are being paid quite unjustifiably without any hope of actually the Insurance Company paying out on those figures. And this is a very deplorable situation if that is what you have been saying to us. Now, can you, say have I received that message, that what we are doing at the moment has been taking a special hypothetical situation of replacement cost and working out a few bits of depreciation saying this makes the insurance people happy, now this is the way we will do it. Because it goes against our grain, whereas we know that true indemnity from an added value point of view if you know what we are talking about will make a different figure? And you say, okay for the form we pay a premium amount but then we find we go back to the old principles again. I don't think this is good enough and if that is the situation then something will have to be done about it.

T. Roberts

A. Yes, that makes clear the situation under the Earthquake and War Damage Act in many instances. And the practice has arisen where many people are paying their premiums on the basis of replacement value and are receiving in fact cover on the basis of indemnity value. This is a matter which was again criticised by the Abbotsford Commission and has been the subject in some fairly trenchant discussions between the Insurance Industry and the Earthquake and War Damage Commission and is going to require a legislative change to sort the situation out. Now, looking at the position with regard to the Insurance companies as distinct from the Earthquake and War Damage Commission, what you have is a situation where you have got to ask yourself that fundamental question which with respect many of you don't, and that is: What is the contract between the Insurer and the Insured? If the contract is a contract by way of indemnity only, and many policies are, then the position is perfectly clear and all that the Insured is entitled to is indemnity whatever the use at the time of the event of loss. And that may very well be a movable feast. It may well be that the premium is calculated on the basis that the indemnity value of the property is likely to be $10,000 but a special circumstance will arise in which the indemnity value of the property increases tremendously or circumstances may arise in which the indemnity value of the property reduces dramatically. What you are insuring is the contingent loss up to a maximum sum insured. No more, no less. You are not insuring depreciation and you are not participating in a lottery. You are indemnifying. Now when you get to the situation of replacement insurance, again you have got to look at the contractual terms. Some covers are genuine like for like replacement. Others are loosely described as replacement insurance but in fact they are indemnity insurance with various add ons for things like Architects' fees, cost of demolition and the like. So it's a matter of getting what you pay for and you need to look very carefully at the contractual terms. The difficulty, and you put your finger on it particularly with regard to the Earthquake and War Damage situation is that there is now a huge divergence between insurance practice and the cover provided under the Earthquake and War Damage Act which was never intended to be any more than a partial cover anyway. But the difficulty is that the practice of the Commission in many instances means that they are collecting their premiums on one basis and paying on another. And I personally don't think that is on.

Nigel Dean, Auckland

Q. I have a question for each of the speakers, Peter Young firstly. If we acecpt all that has gone before why does he not take the insurance certificate and rule out the section that said `Indemnity value expressed as depreciated cost' and simply say what the indemnity value is and certify it accordingly? And for Mr Roberts: Why did the insurance company still insist on this extremely unusual and apparently improper definition of indemnity value depreciated cost, depreciated replacement cost?

Peter Young

A. Why don't I amend the form was Nigel Dean's question. This form I believe or the predecessor of this form came out in 1967. It was produced by a committee which was one of the reasons why it is so unadequate- That committee comprised from memory one Registered Valuer, Malcolm Hanna from Wellington. With him I have had several arguments about this form. There were about four insurance council representatives, a couple of architects, a couple of engineers and various other people. I think the form was produced in that way because Malcolm Hanna was probably the only one on that committee who realised that indemnity value was not replacement cost after allowing for normal physical depreciation. Whether that's a reason why I don't amend the form or not I don't know but I am not sort of big enough to buck the system to that extent. When the form came out I wrote an article for the Auckland Branch newsletter which Jack Gellatly in Wellington (who was very active at the time) took me up on, and wrote to me personally explaining various things, and almost as the elder statesman of the Institute telling me to shut up I think, but it's very encouraging to me to hear that Trevor supports what I said in that article which was written about 15 years ago. I think the main reason though is that we have got to realise the indemnity value as shown on these forms as far as I am aware is used for two purposes only. The ifrst is that it's the basis on which the Earthquake and War Damage Commission levies its dollar and the second is that if the insured chooses not to reinstate and take the cash he get only that figure. Now I always in my letter (in my covering letter) where there is a big discrepancy between replacement cost less depreciation and the true indemnity value as I understand it, and I think as Trevor has explained it, I always state in my letter that this discrepancy exists and that I followed the form purely because it's in the form. I would be very happy if the form was amended to exclude those words.

T. Roberts

A. There's not much I would like to add to that, except to say that in our experience the form works relatively well for the purposes of companies. It works extremely badly fur the purposes of assessing premiums as far as the Earthquake and War Damage Act is concerned and again to sort that out there is only one way to do it. The Act and Regulations are going to have to be amended.

John Fletcher, Otago

Q. Having been involved very considerably in the Abbotsford slip we as valuers in Otago, are concerned at the criticism in the Commission Enquiry report regarding valuers and their methods of computation of value that has been suggested of replacement cost less depreciation. I think that Mr Roberts could probably clarify this one in that all the valuations that were submitted to the Commission by the valuers for them were on the basis in fact of a market depreciation with the added value of the improvement to the land setting the indemnity value. Also to both Mr Roberts and Mr Young the question of extra cost. Indeed we find the provision for extra cost in many instances unnecessary. Particularly so if we have gone to the trouble, as Peter has, in detailing fairly carefully what we envisage the reinstated structure to be, and in discussing this recently last Thursday with a very substantial insurance broker in the City both he and we were of the opinion that at least the figure so far as extra cost is concerned could be deleted but I think it is necessary still to, if not on the certificate certainly in your letter, put down the basis on which the reinstated building has been assessed.

Peter Young

A. On that extra cost, that Section B Note 2 on the form: I can't really add anything to what I said in my paper. I have never been able to find out why it is required and in the numerous instances where I haven't given a figure I have never had an enquiry as to why a figure wasn't given or that one was required. I don't think that it is required and in most cases it defies assessment. That's about all I can say.

Trevor Roberts

A. I have to be a little careful so far as commenting on the work of the Abbotsford Commission- is concerned for obvious reasons but I think there are a couple of comments that I can make. The ifrst is, that I think the Commission would have found it very helpful indeed to have had some pretty specific submissions from the Institute of Valuers. The second comment I would make is that in some instances I think there was a considerable divergence between the valuations that were provided and the situation which would have arisen if those valuations had been provided strictly on the basis of the legal situation. The Commission wasn't too disturbed by that fact because of the fortuities of the situation. Opposed divergences in that particular instance operated to the benefit of the people at Abbotsford who were affected by the disaster rather than to their detriment. That might not always be the situation and legislation is clearly required to correct that position. To give you some idea of the difficulties that might potentially arise let's switch from Abbotsford and move to another part of Otago, Kelsow. And can I repay the compliment of the question by asking you how you would cope with that type of situation, where you get what I think were two or was it three hundred year floods within a very short period where from a practical point of view the remaining properties at Kelsow became virtually valueless. Where the way in which those properties were valued for the purposes of calculating indemnity value had to take into account the existence of the potential disaster circumstances and on any reasonable reading of the law I would think that you would have to downgrade the value of the properties rather than upgrade them. Then extend that sort of problem back into Abbotsford and ask yourself the situaticn how do you now value for the purposes of calculating indemnity value a property on the edge of the ground at Abbotsford. If you take into account the possibiliy are we going to get another bedding plain slide at Abbotsford, what happens if you get the first signs of another graubin at the top of Abbotsford Hill. We don't know whether there is going to be a bedding plain slide but there's the possibility. Does that immediately mean that for the purposes of calculating indemnity value the value of every property in Abbotsford is zilch, from the point of time that the first crack appears. Then translate that problem across Green Island to the area behind the Green Island School and ask yourself what the situation is over there. Well I have reversed the compliment. Have a go. Let's see where we get to

Bob Gardiner, Auckland

Q. Following on Mr Speedy's question, I would ask Mr Roberts when we might perhaps expect amending legislation to cure this indemnity problem? Because I can think of one incident of a property, which I was involved in, where the current indemnity value by depreciated replacement value is 6.8 million whereas its true indemnity value is 2.3 million. Now you have got a difference there of 42 million dollars on which the insured is paying a premium for no possible benefit. Secondly, has he any thoughts as to how the legislation could be properly amended?

T. Roberts

A. Well as to when, with an ounce of luck we may see some legislation before the House this year. The Government has allowed some time in the legislative programme but whether we will be able to prise legislation loose through the Department of Internal Affairs and through the Law Drafting offices is anybody's guess. The second question that you pose. With the huge divergence between indemnity value and the replacement value. That difficulty can be overcome in terms of the legislation and you should not, if you are getting proper insurance advice on a commercial property of that size, be in the situation where you are paying your insurance premium on the full replacement value. If you are going through that procedure there is something wrong with the insurance advice you are getting or the practices of the insured. You can as you all know have that property valued on the basis of its indemnity value and have your premium calculated on the 2.8 million. I would however say that the legislation when its comes is likely to close some of the other loop holes in the Act to the detriment of the insured and in my view quite properly so. I am for instance aware of one case which arose not too far from here, where a briSht insurance broker suggested to the owners of a concrete products factory that they ought to get fire insurance on their stacks of finished products which were concrete blocks, which were stacked in a river bed over the wrong side of the stop bank on the basis that having got the fire insurance cover, they would also get automatic earthquake and war damage cover which would automatically give them flood cover at a rate of a lot less than they would get from the insurance industry, which was not a piece of advice which actually overjoyed the Earthquake and War Damage Commission. That sort of practice, and also it had a number of other undesirable side affects as well, is in my view totally reprehensible and the legislation when it comes I hope will block that sort of loop hole as well. It can be a bit of a two-way street. This year with luck. The shape of the legislation is anybody's guess. We are still locked in mortal combat with Government Departments.

Stuart Morice, Napier

Q. It seems to me, especially in the first paper, there are quite a few points that you have put in your covering letter which I have taken note of and in which I think there is a tremendous amount of merit. I am just wondering why a simple statement couldn't be put in that letter to the effect that the indemnity value has been calculated on the cost less physical depreciation method and that it's suggested that the insured makes sure that that is the arrangement that he makes in his contract of insurance with his company? That, that is the amount we pay, not the calculation in the correct manner?

Peter Young

A. That sort of statement I don't think would have any point because if it came to a claim then the Earthquake and War Damage Commission need only pay out on the indemnity value as that term is defined in the case law. So it doesn't matter what ifgure a valuer put in. You see the indemnity value ifgure in that Certificate is only to be used by the Earthquake and War Damage Commission for a claim. It's not going to be used by the insurance company covering the property for reinstatement or replacement cost. I think it would be very foolish not to reinstate because the gentleman from the Insurance Council who spoke to us four years ago made the statement, which surprised me but which I believe now is true, that if you were covering a dairy factory out on the plains somewhere and the company had a total rightoff it could reinstate with a department store in town. In other words he doesn't have to reinstate the same building on the same site, he can reinstate a different building on a different site. He could build a motel like this if he wanted to. This is the statement that was made by the Insurance Council representative who spoke to us four years ago. So to take $60,000 when you could get a building reinstatement for two million would be quite pointless. And I don't know of any incidences where people have taken the money rather than the reinstatement.

John Fletcher (To reply to T. Roberts' earlier question)

Firstly I would like to say that there were no valuers called before the Commission enquiring into Abbotsford, and certainly I would hope and I understand in the future there will be some opportunity to make submissions to a working group that's been set up to have a look at disaster valuations. Secondly, in Abbotsford in the matter of assessing value probably we are in a very fortunate position at the moment in that property sales are being transacted of homes in proximity to the slip, so we are looking at market transactions then assessing indemnity values accordingly. For the likes of the Green Island slip we have been requested by representatives to date to assess a value in line with market conditions as No. 1, to assess a value with the effect of that slip as No. 2 and I believe that it will probably be ultimately for the Courts to decide at least on some of these settlements that will take place. But thank you for the opportunity of speaking again.

Neil Darroch, Auckland

Q. It seems that in most cases fires are partial destruction jobs and this is the area that concerns me mostly. I wonder if you could confirm that Peter? But I believe that where there is partial destruction and a building has to be upgraded for other purposes, e.g. in respect of fire requirements, that neither would that be taken into account and paid for so an owner could be caught for that additional cost. I think that is correct, could you confirm?

Peter Young

A. That could be likely as I understand it only where the owner has had notice of those extra requirements. If an owner has had notice from the City Council for instance that he has to upgrade his fire rating and egress provisions in a building then he would have to face the cost of that part in the undamaged part of the building. What the situation is where he had not had that notice I am not too sure. Trevor might know, but certainly you are correct where the owner has had notice that that work is required prior to the fire.

Trevor Roberts

A. If the policy is properly drawn you're correct in that additional cos, should be excluded so that the company should not be called upon to pick up the costs which don't arise directly from the event of loss but arise as a result of the Local Body requirement that follows on consequently in the undamaged portion of the building. It will depend on whether the policy is properly drawn and in some cases those additional costs may sneak through. If the underwriter is half awake they shouldn't. As far as the owner/client is concerned he may be able to persuade an underwriter to pick up that cost. But the problem is of course that the cost arises not out of the event of loss that he is being indemnified against but out of requirements of the Local Authority against which he can't insure. It's an uninsurable event if you sit down and analyse it. The fact that he's perhaps having to do it a little earlier is I suppose awkward as far as he is concerned, but in theory anyway it should be an uninsurable loss. The basis of insurance being, that you're insuring against contingencies and not certainties and that you are not providing a fund to cover his depreciation or his maintenance or to protect him against statutory events that fall on the whole community.

Future Outlook For Housing Industry

By E. J. Babe, B. Comm., Dip. U.V., Life Member delivered by R. Chappell.

Before looking to the future it may be as well to briefly review the past and endeavour to get the present into perspective. These hold the key to the future. If there is one thing that characterises New Zealand's development, it is the gradual evolution of progress - rarely do we witness a sudden and dramatic change of direction. So it has been with housing.

The Great Depression and World War II coming so shortly thereafter left New Zealand with both a severe shortage in the numbers of houses and a housing stock that was in poor condition with heavy obsolescence. The Government's response was to place strong emphasis on increasing the numbers of houses, leaving the improvement of the existing housing stock to be looked after elsewhere as a lower priority. Much was done in the "fifties" and "sixties" to encourage the building of new houses and the ideal of home ownership was made attractive and attainable by a great variety of Government incentives. There was the population pressure to give importance to increasing the housing stock and improving economic conditions to give the resources to translate this pressure into effective demand for new construction.

As the absolute shortage was overcome, and people generally were decently housed, we became more aware of some of the less desirable social consequences of the emphasis on new construction. Policies came to be seen as pushing young couples to live in new areas, occupied by people with uniformly low incomes and with most of the inhabitants in the same age group and family type (young married couples with children). There were problems with lack of shopping, facilities, transport and various social and cultural amenities. Meanwhile, older established areas with a wider variety of incomes, ages and family types were inaccessible to most young families looking for their first home, while appearing to many people to offer equally good, if not better, value for money. Policies which had started as helping people to attain their first house were now closing off a choice that many would have wished to make. Because much new housing was directly or indirectly financed by Government, its loan and cost limits gave great uniformity to the size and quality of new houses to their detriment. Demand for new housing dropped, but all this was soon to change.

In the early seventies, a high level of immigration coincided with strong liquidity in the economy. The consequence was a massive increase in the construction of new houses, combined with very high turnover in existing properti.es. Even then, the building industry was ,anable to expand fast enough from the declining levels of the late sixties to meet the increased demand for houses, so the value of existing houses rose faster than the cost of new construction. For example, in the six months ended June 1971, the average new house cost 32 percent more than the average sale price for an existing house. This dropped in relative terms to. 9 percent for 1974 and 11 percent for the ifrst six months of 1975, as the prices of existing houses rose.

The boom conditions of this period saw record peaks in the numbers of houses built. Whereas in the previous decade New Zealand built on average 23,000 dwelling units a year, in the seventies it was an average of 26,000 a year. The staggering peaks of house construction in the period 1974 to 1977 were not sustained by demand, hence the equally staggering troughs of 1979 to 1981, and the cautious mild recovery in recent months. It will be some time yet before we need to consider large scale additions to the housing stock to meet the shelter needs of a community.

In the early seventies, Government's response was to emphasise new housing construction to cope with the pressure from high immigration levels. Once the "oil shock" and its various economic consequences were felt, there was continued help to the building industry, whose stability or viability were seen as vital to the provision of adequate housing in the future.

In the second half of the decade, the Government was trying to reduce its direct influence on the housing market, which was increasingly seen as a source of distortion. The Government also tried to increase the freedom of choice for its clients by reducing the emphasis on the finance restricted to new housing. At the same time, however, the plight of the building industry was a limiting factor, so some encouragement to build rather than buy remained in the Government's lending policies.

Part of the Government's strategy for helping the building industry, which was also aimed at conservation of an important resource, has been the encouragement of the rehabilitation of older houses and sometimes of whole areas through Home Improvement Loans and Neighbourhood Improvement Areas - the CHIP programme. This has further encouraged a significant contemporary trend towards interest in the renovation and preservation of older houses.

In spite of all the problems of the seventies, Government policy has given some stability to a very unstable situation. There is little doubt that without the support given to the building industry through various Government policies during the second half of the seventies, the industry would be in a very much worse situation than it is now. Government housing finance policies still favour the erection of a new house, just as they have done since the War. The deposit requirements through the Housing Corporation for loans for new houses is 12½ percent compared to 20 percent for existing houses; the income limit for applicants is $250 per week for new houses, $200 per week for existing houses (though the single-income family has a special limit), the loan amount is $25,000 for new houses and only $18,500 for existing houses. If the applicant raises the necessary finance from the private sector rather than from the Housing Corporation, then there is a $4,000 interest-free suspensory loan available for new houses only.

The one big change in recent years is that an applicant on low income can now choose between buying a new house or buying an existing house and today most prefer to buy an existing house. No longer are they directed solely to the new house market.

There are good reasons for this. You are well aware of the considerable price difference between otherwise comparable new and existing houses. Given such market circumstances a Government cannot, in all equity, continue a policy of directing low income first home seekers to new housing when existing housing is available at much less capital cost. I see nothing wrong with subsidising the building industry in the general interests of community development, but it is hard to accept that the subsidies be paid by the section of the community least able to afford them. Forcible incentives to applicants to take new houses mean that they need to accept bigger mortgages for longer periods and, in effect, be saddled with the additional cost for the entire life of the mortgage. A concealed subsidy today could mean a 30-year impost on the homeowner. It could mean much more, of course. In the event of sale of the property it could mean a loss of the equity contribution of the owner. In the part of the market that Housing Corporation clients operate in, a vendor of a nearly new house cannot always recover the capital cost of that house to him when he tries to sell it.

For all that, to 31 March, 1982 the Housing Corporation will make loans to assist in the erection of over 3,000 new dwelling units. Though this is small by the measure of former years, it is still a significant contribution to the housing industry. It is, in practical terms an injection of $75 million, and is only one of the several Housing Corporation policies that relate almost directly to the building industry.

At present, the housing industry is becoming gradually more exposed to free market forces and less sheltered from them by Government action. This means that as time goes on we may hope that distortions of the market (such as people buying a small new house when they would prefer to buy a large old one) will be reduced.

There are still serious distortions in the market, with the average new house costing half as much again as the average existing house (though it should be noted that the average size of new houses is at a historically high level). The problem for the Government is how quickly it can reasonably withdraw its present level of support for the house-building industry so as to reduce the distortions in the market without doing undue damage to the building industry.

One of the greatest difficulties at present is to determine where the problems are. We know that there are increasing numbers of people who are finding themselves in need of emergency accommodation because they have become homeless. What is very difficult to tell is how much this is a housing problem as such, and how much it is some wider sort of problem, for example, of welfare or personal economics. Some people even suggest it is just a sort of log-jam caused by the now fading boom of 1981, when the exceptionally high number of sales that took place removed many properties from temporary occupation, and that dropping to a more normal turnover will help to alleviate the problem.

It is also apparent that our cities are experiencing changes in occupation patterns and internal migration flows that are different from past movements, and we have yet to grapple with the consequences of them.

Thus, there are indications that it is once again time to take a new look at our housing scene. All housing policy is a matter of choosing between a number of competing goals, and in trying to achieve one goal we may do harm to another. To keep things in reasonable balance, constant adjustment of policies is necessary. In this the house construction industry is but one element - albeit a very important element.

It must be remembered that all this is said against a background of having one of the best housed countries in the world, whatever may be the claims to the contrary. Our problems are neither unique to New Zealand, nor as bad as those experienced by almost every other country.

Where do we go to from here? The present and recent past give us our indications. The building industry and real estate markets have adjusted to the disruption caused by the boom of the early seventies and the subsequent fall-off in activity. The stock of houses, both new and used, received a further economic adjustment and shake-down in the 1980-1981 property boom which saw a record turnover of properties with prices rising significantly for certain selected areas of the market only. Most prices did, indeed, rise but the extent of the increase hardly compensated for the static state of the market through the late seventies and the annual rates of inflation experienced. The cost of building, on the other hand, moved and continues to move faster than the trend of the used property market.

The 1980-1981 boom is also of interest in that it was largely financed by the private sector. Previous movements in the rationalisation of building societies and the growth of savings banks and other financial organisations produced institutions of size and confidence to marshal savings and provide the great bulk of the finance required.

Thus, we have a situation of roughly one million dwelling units for an almost static population of three million. We have the institutions and Government policies to encourage savings. We have policies attuned to the better utilisation of the houses we already have. We can be pardoned for thinking that we have no overall housing problem. What, then, is the future of the housing industry?

I do not see the need to be pessimistic in this. We do not need the high volumes of construction of the past, but we do need a viable building industry to meet the pressure points as progress continues. For the 1980-81 year, total new houses completed were 14,200; 1981-82 should see around 16,000 built. A significant proportion of these dwellings is in the middle- to high-cost range, bringing into the stock a greater variety of housing types. Permits for new houses and lfats in the last year showed a healthy increase over the previous year, so completions for 1982-83 should be at least as good as 1981-82. This, for the immediate future, is a reasonable level.

There are problems in the major cities brought about by the owner-utilisation and modernisation of inner city properties, and the displacement of former tenants, but such problems cannot be solved by the wholesale construction of houses out at the perimeter of the city.

The cost of building is, in itself, a problem. In many facets of it, it is rising faster than the inflation rate. Many have been the calculations of what a house may cost in five years' time, and the horrendous total has had its share of publicity. But when has it been easy to build or buy a house? Prices have risen, and so have wages. Before the War houses cost around $2,500 to $2,750 to build, and few could afford them. Even when they could be bought in the sixties with $200 deposit, a failure rate was present because of the higher monthly charges involved with larger mortgages, rent for leasehold sites, and so on. Though the capital to borrow was available, the family income to meet the charges was inadequate. That situation is basically the problem today. A sacrifice has always been required. The rewards, monetary and social, attaching to home ownership have made the sacrifices worthwhile and they will continue to do so.

Every Government has attached high priority to housing. Even in this period of great stringency the Housing Corporation placed in the 1981-82 financial year over $400 million directly into housing. If, to this, is added the many indirect incentives through taxation relief and the like, aimed largely at the first-home buyer, the total contribution is enormous.

We must not equate the housing problems of New Zealand with the house-building industry. It is but one of the many ways available to Government to meet the needs of the community for shelter. The housing industry has a fundamental and vital role to play in any housing policy, but its significance clearly will vary according to the balance of requirement at any time. Prudence demands that there be no violent swings in the use of its services, but history has its own judgement on success in that! The housing industry has adjusted to economic imperatives and relies much less today than formerly on Government support. It shows its awareness that its future depends upon its ability to satisfy its clients as to quality, variety, and price within the competitive nature of the property market. It is making its contribution to housing and will be required to continue in this way. The problems of the present always crowd our attention and colour our conclusions, but the long view shows the necessity to have an adequate building force, and what the community needs, it ultimately gets.

`Future Outlook for the Housing Industry'

By R. M. White, Managing Director Neil Holdings Limited, Auckland.

1: Introduction

In almost any developed country the outlook for the housing industry is a function of three main variables:

A. The formation of households.
B. The strength of the economy.
C. The Government's attitude to housing as a social welfare priority.

In New Zealand, in the past, A, B and C have all combined very favourably to indicate an extremely buoyant future for the housing industry. Since the mid seventies, however, there have been some dramatic changes.

Although the formation of households has taken place at an increased rate, the economy has weakened and the Government has not continued to place a high priority on housing. The result has been a reduction in permit numbers of approximately 25,000 dwelling units per annum.

The drop is, perhaps, seen in truer perspective if we look at house building as a percentage of Gross Domestic Product which shows an alarming decline from 5.96% to 2.18%.

March Year End	G.D.P. $	New Housing By Permits $	°J0
1974	9,135M	544.7M	5.96
1975	10,028M	546.6M	5.45
1976	11,484M	593.4M	5.17
1977	13,792M	634.4M	4.59
1978	15,217M	503.7M	3.31
1979	17,504M	498.9M	2.85
1980	20,908M	462.2M	2.21
1981	23,920M	521.OM	2.18

Source: Government Statistician.

We can ask ourselves whether or not it is reasonable to extrapolate this downward trend. Will the economic and political factors continue to outweigh a growing demand? In the short-term, say two years, the answer is probably and regrettably - "yes". In the longer term, however, the economy is likely to improve and the Government would be well aware of the political implications of suppressing real demand any further. The problem will be restoring a shattered industry to cope with this situation.

2. What is the Future Demand (or Need)

I am always irritated somewhat to hear 'experts' say that the real demand is dropping off because the population rate of increase has slowed. This is a very glib over-simplification which could lead to serious planning errors. The demand for houses at any time is not simply proportional to population increase. It is more accurately related to the formation of households and this in turn is largely related to the current age distribution of our population. The Demographic Studies Section of the Department of Statistics tells us that Auckland's 20-29 year olds will increase in numbers by over 40% in the period 1976 to 1991. We are presently meeting the housing demand of the high birth rate of the 50s and 60s when for a period of twenty years children were being born at the rate of 60,000 per annum. They are now forming households at the rate of 30,000 per annum! The same population bulge that overtaxed our primary schools, secondary schools, universities and job opportunities has now hit the housing market. Let us make no mistake about that.

It may well be nonsense but we keep hearing superficial assertions about nett migration losses. For the year ended 31 March, 1981 departures exceeded arrivals by only 16,209 or 1.7%. The nett figure is, of course, the difference between nearly a million people leaving and nearly a million people arriving. We need to look very closely at the housing associations and needs of these two groups. Some 60% of those leaving are under the age of 24 and may well only vacate a bedroom and leave no accommodation for those coming in. Much more investigation is needed in this area.

In any case, the past has shown a cyclical pattern of large emigration losses being followed a few years later by massive immigration gains. (See table 1.) The low gains of 1960 and 1961 were followed by massive gains of 12-18,000 for six years. Then the record losses of 8-10,000 in 1968 and 1969 were followed by record gains of 25-33,000 for 1973, 1974 and 1975. The fact is, young New Zealanders do return home eventually and often with a husband or wife from another country. Perhaps this explains the larger subsequent immigration gains. I am sure that once again they will return to create new record immigration gains. The gains of the last few months may well be the start of a new trend to return. (See table 2.) It is frightening to consider the accommodation problems that will arise when they do return.

We cannot overlook the trend that the head of household rate is significantly increasing and the average persons per dwelling figure is decreasing. It decreased from 3.61 in 1951 to 3.52 in 1966. Remarkably, it then dropped over four times faster to 3.38 in 1971 and six times faster to 3.19 in 1976. I believe the persons per dwelling figure is continuing to decrease. Economist Goran Runeson showed that the United Kingdom and the United States of America have approximately 36 houses for every 100 people. Australia has approximately 34. New Zealand by contrast has barely 30! Clearly, while our housing stock is of high quality we fall well behind on dwelling quantity.

All the social trends which occurred in Los Angeles - smaller families, teenage flatting, high divorce rates, the elderly living alone, etc. - are happening here. Los Angeles, however, has 50 dwellings per 100 people while Auckland, our largest city, has only 28!

EXTERNAL PASSENGER MIGRATION

TABLE 1

(Excluding Short Stay Visitors and Crews)

Number (000)

Number (000)

40 r---

1 40

EXCESS OF ARRIVALS

30 30

20 20

10 10

0

10 10

20 20

EXCESS OF DEPARTURES

30 30

Ot0 O N M -.1 C) LO N co P O N M V L0)C N Cp piO .- N M -1 C1 I0 N O, O
tD C0 I0 ID LO p 10 N N N C., N N) cbcO 10 c0 W a0 co C) m 01
nr M T C1 N0))C Cn Q1 0 Q1 CT ` C) D Q C) OtC 0) M 01 T O CT [b CT C) 01)C T rn

YEAR ENDED 31 MARCH

PERMANENT AND LONG TERM MONTHLY NETT MIGRATION

TABLE 2

2000

NETT GAIN

1000

1980 1981

0 J F M A M J J A S 0 N D J F M A M J J A S O N D

-1000

NETT LOSS

-2000

-3000

V

-4000

-3320

--6000

To sum up, it would appear that future demand will continue very strongly for at least ten years. Beyond that date we are guessing because the range of assumptions is so broad.

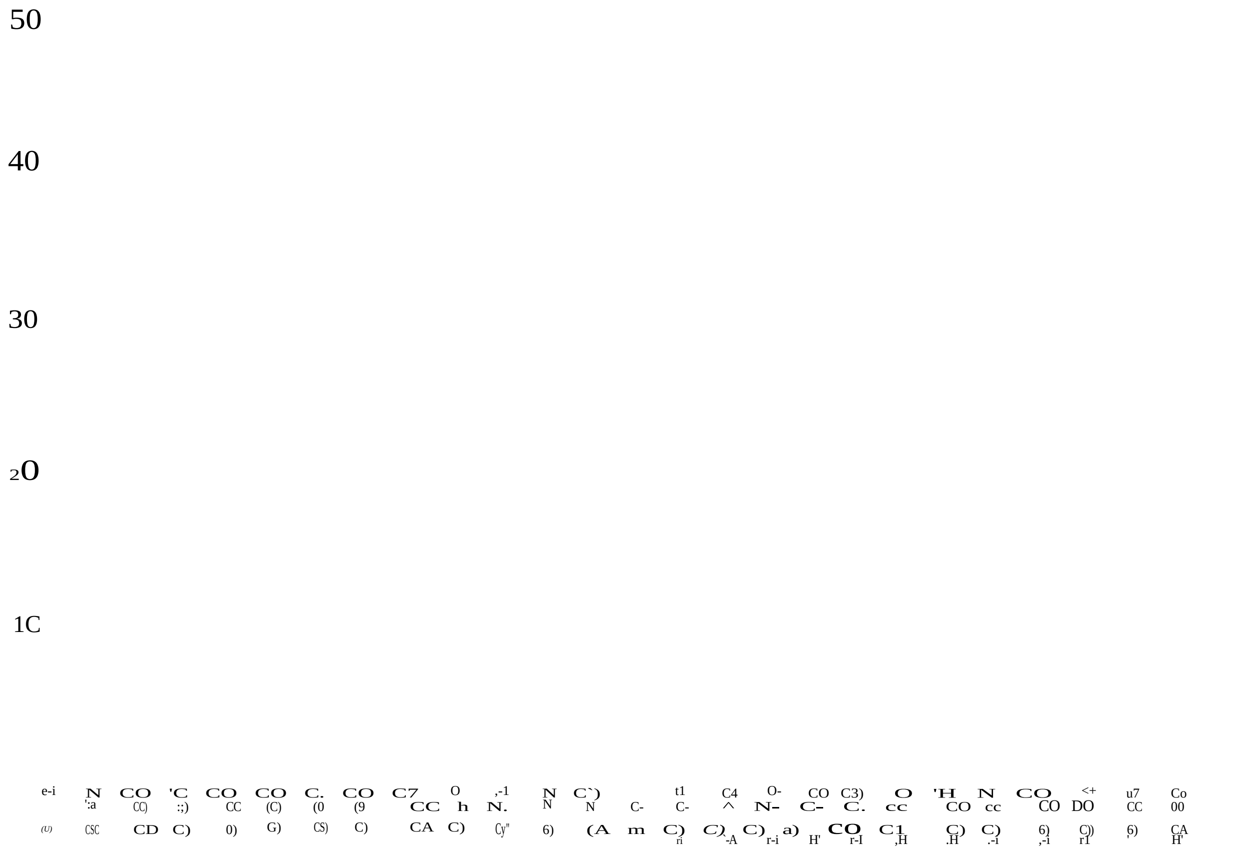
3. Will People Become Flat Dwellers?

There can be no doubt that the large and increasing numbers of flats built over the last twenty years have reflected a growing public demand for this type of accommodation. It can be argued that many people are living in flats because it is the only accommodation available to them. There is a lot of truth in this comment but at the same time there are many people buying flats because they prefer this life style. The current demand for luxury flats and town-houses will, I am sure, continue as older and more affluent people change their housing life style.

The table below shows national permit figures for the last twenty one years for houses and flats and the flat permits expressed as a percentage of total. (See also table 3 Graph.)

March Years	Total Units	Houses	Flats	Flats %p Total
1961	24,397	23,050	1,347	5.5
1962	22,394	20,817	1,577	7.0
1963	20,636	18,624	2,012	9.7
1964	21,763	18,388	3,375	15.5
1965	25,357	19,895	5,462	21.5
1966	25,932	20,257	5,675	21.9
1967	24,046	18,777	5,269	21.9
1968	21,635	17,049	4,586	21.2
1969	22,317	17,421	4,896	21.9
1970	23,084	16,990	6,094	26.4
1971	23,679	16,230	7,449	31.4
1972	24,331	15,578	8,753	35.9
1973	32,770	19,913	12,857	39.2
1974	39,734	23,582	16,152	40.7
1975	33,101	21,436	11,665	35.3
1976	32,181	20,931	11,250	34.9
1977	30,070	19,094	10,976	36.5
1978	21,205	14,358	6,847	32.3
1979	19,050	13,670	5,380	28.2
1980	15,197	11,687	3,510	23.1
1981	14,447	11,108	3,334	23.1

FLATS AS %age TOTAL DWELLING PERMITS TABLE 3



The rapid early growth of flats as a percentage of total permits was no doubt partly the result of a new social need to house the new phenomena of fragmented families. Flats, home units, townhouses, or semi-detacheds were simply a relatively new thing, meeting a large but sudden need. A lot of catching up was necessary.

The percentage figures for the last eight years seem to indicate that the catching up period is over, and that possibly the demand for flats has stabilised or even fallen off over this period.

The National Housing Commission Study `Housing Preferences in New Zealand' produced the startling survey information that an overwhelming 87% of a sample of 2,000 people prefer a detached house lifestyle. If, in fact, only 13% of our population now prefers flats (or higher density living) it follows that approximately one third of the people now living in flats would prefer a detached dwelling. It would appear that particularly in the lower cost area, growing disenchantment is creating a very strong counter effect. This is only partly offset by the increased demands in the higher price or luxury market.

To sum up, it is now clear that there is not unlimited scope for flat building. There are already signs of market resistance becoming apparent. Some areas may well be approaching saturation point and developers and planners would be well advised to carry out appropriate market research in specific localities before embarking upon large scale low-rise high density housing projects. Some of the critics of suburbia and urban growth have the persuasion or the planning powers to impose various forms of medium or high density development upon the community. Such ill-considered moves would temporarily create an artificial situation until public outcry demanded change.

4: Will Sections (or Titles) Become Smaller?

In my experience most people are happy with section sizes of 500-1,000 sq. m or one-eighth to one-quarter acre. Most purchasers are generally unhappy with a smaller section because it will not enable them to fully enjoy their aspired life style. This may well be because of the need for play space, garden space, privacy, outdoor entertaining, keeping pets, building or keeping a boat, parking the firm's truck, a tradesman's workshop or a variety of other needs. It may simply be claustrophobia that makes them want space.

Dr Halkett of the Australian Institute of Urban Studies found in Adelaide that 85% of his sampled households used their gardens or yards for at least one type of recreation activity, not including gardening or strolling around. He also found that 57% of the adults and 51% of the children spent more than half their outdoor recreation time in their gardens. I would be surprised if New Zealand was very different.

The National Housing Commission found in its survey `Housing Preferences in New Zealand' that only 16% of the respondents would prefer less than 500 sq. m of unshared or private land.

However, an elite group of professional critics of suburbia keep saying "we must reduce section sizes to conserve farm land and prevent urban sprawl" despite the fact that residential land is only about one-third of the gross area of cities. The same bureaucrats who set minimum section sizes a few years ago may soon be setting maximum section sizes and trying to enforce the type of subdivision they previously banned.

There could be new social recreational amenity problems with any such approach. It is to be hoped that a more enlightened attitude will provide greater flexibility to achieve what various people actually want. Most trends today point to a generous section size preference - outdoor living and entertaining, more leisure time, physical fitness awareness, the gardening boom, cost and hassle of travelling, home pools, parents' fear for their children in public places - all indicate a continuing need for adequate private space and little likelihood of section sizes being significantly reduced.

5: Will We Stop Urban Sprawl?

In view of the answers to the last three questions which show continuing demand, resistance to higher density and little chance of sections being reduced in size, it is extremely likely that peripheral urban expansion will continue albeit on a reduced scale and in a more controlled manner. I believe some of the problems of urban expansion have been considerably over stated while many of the problems of discontinuing such expansion have not yet been perceived.

While it is true that higher density will go some way towards reducing urban sprawl, there are, however, a mass of associated problems, some of which are probably more serious than urban sprawl. A large part of New Zealand building takes place in relatively small cities, towns or districts where urban sprawl presents no problem whatsoever. In the larger cities such as Auckland, controlling urban sprawl by forcing higher density development can produce many other problems, most of which are being conveniently overlooked by a variety of spokesmen on this subject.

In Auckland City it is becoming clear that employment opportunities are now shifting to the perimeter. Higher inner city development would thus introduce an enormous radial transport problem for perimeter workers. It would appear that the general trend is for white collar workers to move back into the inner city area nearer their work and for blue collar workers to move to outer suburbs nearer to their place of work.

The social problems of high or medium density living are well known to everyone and no comment is required except that in New Zealand this problem is compounded with the high Polynesian population.

It is interesting to note that in North America people are clamouring for the housing lifestyle that we currently enjoy in New Zealand. Recent United States surveys indicate something like 90% preference for single detached dwellings.

Over the last couple of years our Company has endeavoured to move into urban renewal and inner city medium density development. After considerable market research and the building of a variety of pleasing, well located medium density developments, we are a little disillusioned. It would seem that inner city medium density is neither suitable nor within the means of most low income purchasers. The costs are considerably-higher - often 50-100% higher than traditional peripheral development. Clearly there is need to combine inner medium density with peripheral lower density development.

6: How Will Houses Change?

A senior housing official recently commented that the three bedroomed detached dwelling is the most versatile accommodation ever devised. It can cope with the demands of a young couple, a family of five or six persons, an elderly couple and even one person.

During lower occupancy the extra bedrooms cater for sewing room, study, guest room, storage space etc. It can be added to or lifted to provide extra bedrooms, living space, rumpus or workshop.

It is no fortuitous accident that houses throughout New Zealand, Australia, North America and all over the world have evolved to this form. There is little, if any, prospect of major changes here in New Zealand where our home purchasers are notoriously conservative.

The energy crisis will require better insulation, more efficient and possibly solar heating. Solid fuel burners and open fires are not only cheap to run, but aesthetically pleasing and trendy and will become more common.

As travel becomes more costly and difficult, people will tend to stay at home more. Television has already created this situation to some extent. This will cause them to put greater emphasis on home recreation amenities such as games rooms, television rooms, hobby areas etc. It could see an upsurge of cottage industry and offices at home. Such a trend would probably have developed years ago if we had not devised such inflexible town planning codes and labour employment regulations. Such industries would be very efficient and do in fact form a very large part of some overseas countries' production effort.

7: How Will Houses Be Built?

Ever since man first moved out of his cave to the then revolutionary new building system of light timber framing and animal skin sheathing, someone has said "there must be a better way of building houses".

However, the basic principle of sheathing a timber frame has never been seriously challenged anywhere that timber was readily available.

It would be stupid to say that it never will be seriously challenged because `never' is such a long time. Present trends seem unlikely to produce marked changes in our lifetime. Currently, somewhere in excess of 95% of our New Zealand houses are built in traditional light frame timber construction. As we were building in solid brick and other means one hundred years ago, it does not look as though there has been any real trend away from the timber frame. Predicted yields from exotic forests projected at present annual planting rates will increase from 8.5 million M3 currently to 30.8 million M3 by the year 2,000. Timber will remain the obvious building resource. The main alternative methods of construction are as follows:

(a) Solid Timber Construction.
(b) Systems based on reconstituted wood products without a timber frame.
(c) Systems based on composite panels including non forest materials such as aluminium, plastic, asbestos cement etc.
(d) Ceramic, reinforced concrete, masonry or brick type panels.
(e) Steel studs and framing.
(f) Concrete block.
(g) Solid brickwork.
(h) Ferro-cement.
(i) Other systems.
(j) Trailer homes.

Systems (a) to (d) are modular or panel systems and are aimed at reducing labour or skilled labour on the ultimate dwelling site and using less skilled labour under factory conditions to do a greater portion of the job. These considerations may or may not be relevant and I would suspect that many people have not perceived that this can be so.

Outside an urban building programme or for export, panel systems have an obvious advantage and they will continue in this field. However, we must not forget that the bulk of building in this country is in, or near, urban areas where light frame timber systems suffer no such disadvantage and will continue as the main method of house construction for the foreseeable future.

8: Will Houses Be Built in Factories?

Leading Australian housing official, Dr Frank Blakely, has said "Factory built houses will never be cheaper than conventional ones. The concept of producing houses like cars in a factory still has its starry-eyed enthusiasts, in spite of the fact that in the history of industrialised housing the failures outnumber the successes by perhaps 100 to 1. Claims that factory built houses were cheaper had never been substantiated, and work done by Australian Government scientists showed that it was highly unlikely that they ever would be".

I am in total agreement with Dr Blakely.

9: Will New Homes Become Less Affordable?

We keep hearing the comment that building costs have risen more than wages and hence the public's ability to purchase. This is not strictly correct. In real terms the cost of a house bears much the same relationship to the average gross wage as it always did. In fact, more efficient methods have improved this relationship slightly.

While the cost of a house rises roughly in accordance with the average gross income the public's ability to save and service mortgages increases only in accordance with the average nett income after tax! We all know that a 20% wage increase may well only give a 14% increase in the pay packet, but it does give a 20% increase in building costs. Tax reforms could ultimately arrest this widening gap.

More efficient construction will continue to improve the situation provided we keep a very close eye on our many building controls.

In general, I believe new houses will get cheaper in real terms. They may not, however, become more affordable.

In the short term, high income tax rates coupled with high mortgage interest rates will continue to suppress affordability.

10: How Will Houses Be Financed?

A very difficult question to answer with any optimism in view of the present tight situation. It is my view that New Zealand is already committed to a high element of social welfare in housing and that Government involvement will eventually resume at a high level. Any dramatic change from public sector support must create serious hardship and social injustice. There is already ample evidence of this. More enlightened Government policies, may eventually provide incentives for more and cheaper private sector participation.

Our New Zealand home finance and mortgage scene is relatively unsophisticated by overseas standards and it is reasonable to expect proven overseas systems of finance to gain local acceptance. Our legislators and financial institutions will need to co-operate.

Equal pay, double income families will continue to have an enormous advantage over the single income family, both in bridging the deposit gap and also in their ability to service mortgage outgoings. Single income families will clearly need more assistance if they are not to become the `new poor' for whom ownership is quite an impossible dream.

11: Conclusion

I am sorry that I can neither paint a rosy picture nor amaze you all with mind boggling, space-age housing predictions. The demand for housing over this decade will be enormous but in the short term the constraining influences of the economy and Government attitude will prove stronger. In the long term possibly the only constraint will be a run-down industry's ability to cope. Changes will, however, be slow and more evolutionary than revolutionary.

Questions and Answers

R. Chappell, R. M. White and E. Robertson

P. Mahoney, Auckland

Q. I wonder if Mr White would expand a little on his comment that we have a national housing problem, where this is, in effect to say a housing problem peculiar to the major metropolitan areas, which is not necessarily reflected to the same degree in provincial centres or smaller Towns.

R. M. White

A. Well of course we have a problem if we have a need for one house in Auckland and we have one vacant house in shall we say the West Coast. In aggregate you could say we have got a vacant house in Westport and the demand for one in Auckland but in aggregate also we have one demand that cannot be satisfied so I would agree with you the thing varies from place to place. But I think that some of the people who are complacently thinking they do not have a housing problem at the moment may be about to encounter one because of this formation of households thing. There is a very delicate balance between supply and demand in anything, as we all know, and at the moment it's weighted, I believe, on the demand side. The demand side is greater and I think it's increasing, for the reason that I mention; the formation of households through the 50's and 60's. Just think about that for a moment. That high birth rate took place from the 50's through to the end of the 60's. The children that were born at the start of the fifties are now 30 years old. The ones that were born at the end of the fifties are now 20 years old. So for that decade we have got a group of young people in the community at the moment that are between 20 and 30. But right through the 60's the same birthrate took place. So we have got another echelon coming on for the next 10 years and I think some of the people who think they have got a satisfactory level of housing at the moment may find the situation change; even although they may have a net loss of young people looking for job opportunities and so on, but I still believe it is a national problem even if isolated areas are okay.

R. Chappell

A. I would just like to make a comment additional to what Mr White said. He is quite right about the growth of the households. There is also another problem that is very real in every community and this is the disillusion of the households. In Auckland one Real Estate agent told me very recently that the sales that have been taking place have been caused by marital split ups. At one time when there was a breakup in a marriage quite often one partner finished up with the children. Today we are noticing more and more in our workers that we are having demands from both partners for housing. One is taking some of the children, the other one is trying to retain the family home with two or three children in that, so it's not only a question of household formation, there is a problem there with household disillusion also.

E. Robertson

A. Mr Chairman, just one other comment on the change in household formation there is today. I've seen it change dramatically over the years. The ability of the spinster or bachelor to borrow in their own right. The girls have done well I think. But there is a large number of purchasers. Where it is a single person, either a spinster or a bachelor going back 15 years in the bank or 20 years or even 10, A woman couldn't borrow for herself very readily unless it was guaranteed by father or grandfather or brother, and also a bachelor wasn't looked upon as a great risk. It was more difficult for him to get money but this household formation situation Mr White raised again is one of the sort of puzzles at the moment I think on the supply and demand but there are a whole lot of factors coming forward. Last of all there are those spinster and bachelor situations.

N. Dean, Auckland

Q. One aspect that has troubled a lot of us over the last few years is the margin between the ability to purchase an existing house, compared to the cost of buying a new one. The cost increases in Auckland at the moment at something like 26% per year. I was intrigued therefore with one of the comments in Mr White's paper when he said that wage increases will give somebody (or 20�% wage increase will give somebody) a 14% increase in their salary, yet it will cause a 20% increase in the cost of the house. I am intrigued as to why it should do that. Is all the cost of the house labour?

R. Whyte

A. Yes, I made that point using the perhaps rather loose phrase that the house is just a great big stack of wages. And it literally is. We have done our costing exercises in great detail over the last 20 years with every general wage order that has ever taken place and we find that when there is a general wage order; right immediately we pick up about a third of it and that is right immediately, next week. Over a period of about three months we pick up another third of it and then over a period of about 5-6 months we have got every last cent of it. And you know it just all stacks up. There is no other ingredient. All of the money that is paid out to buy one of our houses goes out totally, almost totally in wages. There's a very small quantum goes to our shareholders but I suppose you could philosophically call that wages also in different form. But I can see no change from the situation that a house price will always move exactly in relation to wages. I know there is a perhaps social credit philosophy that there is a gap there somewhere, but I am unable to see it.

B. Beggs, Napier

Q. I address this question to Mr Chappell. We have at page six of your address, (bottom of page six) where you are saying; the boom was financed by the private sector. But there is a question here. Really was it financed or caused by the private sector or was it really basically caused by the Government, because if you look at the Reserve bank figures in August the domestic credit expansion showed approximately 32% which was far in excess of inflation, which was an obvious target to hit back at and which is usually a triennial hic cup. So basically it was caused not by the institutions but by Government increasing the credit expansion which they have never chopped back. Usually they allow for about 2% of inflation.

R. Chappell

A. Yes I see that "the 1980-81 boom is also of interest in that it was largely financed by the private sector." While I agree with your comment the point that was being made here was that it had not been financed by the Housing Corporation. The turnover of houses was largely financed by the private sector. I accept the fact that more money was made available in the private sector by shifting the reserve ratio of the trading banks just like they have been recently tightened. But it was private sector finance all the same.

Boswell, Auckland

Q. Mr White indicated that the future of housing wouldn't utilise good agricultural or horticultural land near the cities. I was wondering where he is going to be more selective? I am just wondering where he's going to get the land if he is not going to use that sort of land to expand?

R. White

A. Well, as a lot of valuers, particularly rural valuers would know, not all land that grows green grass is in fact prime horticultural land and if we take Auckland, that I am so familiar with, the land on the North Shore is literally goat country. The land in the west, despite the fact that it grows grapes and orchards, is not really good horticultural land You could find land that is every bit as good all over N.Z. But certainly there is good land in South Auckland and I am sure the opening address this morning referred to the prime land between Napier and Hastings and I think I would agree with that speaker, that it would be a tragedy if given other options we covered prime horticultural land with group houses or any other form of urban development. I think it's a matter of being selective about it. Clearly there are areas on which any city could expand, which minimised the expansion onto good land and I think it would just be a matter of intelligent planning and already most planning authorities are pretty conscious of this. But I do notice that they are not really prepared to turn the clock back. Those people that have zoned prime horticultural land in the past are not really un-zoning it. They are still sticking with those decisions maybe because of the enormous capital they have put into servicing in the mean time. Perhaps it would throw their whole plan out if they were to do that. But they are all very conscious of it and I am sure we will see much more emphasis on this aspect.

P. Mahoney, Auckland

Q. I wonder if Mr White would care to comment on the interest component on the housing cost and the cost to the development companies meeting the shortfall between the current first mortgage limits, to finance purchasers into these houses. Are you in a position to expand on that as a component of current cost of housing?

R. M. White

A. Well first of all the interest money available to the company which forms part of the company's own cost structure has doubled over the last decade or so. I well remember thinking our throats were cut in the days when we were paying 12% for ifnance company money; today we are paying 22-,',% for it. By contrast many of our clients are paying 26% for their first mortgage, others again are paying 26% for their second mortgage to finance companies. It's only a very short time ago that our clients were borrowing a lower total percentage of the house because most of them were able to capitalise the family benefit. The low interest mortgages that they were able to get were a higher percentage of the total proposition than they are today. Their Housing Corporation loan interest in those days were 3%. The second mortgages that they got were anything from 6-9%. I am not talking about a long time ago really. Today those same people paying 9% are trebling the interest rate if they are lucky. They have got to be under $250 a week to qualify for that. All the people who are over $250 don't qualify, they are out looking for mortgage finance at all sorts of other interest rates varying from perhaps 14-26% for their first mortgage. Now the cost element of this is simply astronomical. Companies such as our own are not really any longer in the field of second mortgage finance, because we find that we just cannot raise the money cheaply enough ourselves to lend on, and the degree of risk is such that we are not prepared to do it. It would change our proprietary equity so greatly and give us such an enormous contingent risk, that we would start to be even more suspect as a public listed company than we are today.

Future Outlook For Housing Industry

Taxation In Relation To Housing

By E. Robertson.

Until very recently the private home in New Zealand has not been subject to taxation, except possibly for Death Duties in certain instances and local authority rates.

With the introduction last year of a tax rebate for first home owners on interest paid of up to $1,000 on mortgages, I believe we will witness in New Zealand a dramatic change in the years ahead, on taxation and housing.

This major and, I believe, dramatic change will have a marked effect on the question of home-ownership in the future and no doubt will have a bearing on Registered Valuers' Reports and market values as this taxation question develops further.

There is no doubt in my mind that this recent move is only the thin edge of major changes yet to come.

It has amazed me how little publicity this taxation legislation move engendered, the lack of understanding and complacency from institutions such as yours and the public at large.

However, before making further comments on the New Zealand scene, I would like to cover some of the developments that have taken place in the Nordic Countries which I believe is a clear case study for the New Zealand scene.

In 1978 I was fortunate in being awarded a fellowship under the Winston Churchill Memorial Trust, which enabled me to spend some two months in the Nordic Countries researching housing developments and I spent a considerable time looking at the development of taxation on housing.

There were small variations in taxation laws between say Denmark, Norway, Sweden and Finland, but the following points are developments of similar nature that have taken place in these countries.

Taxation on private home ownership developed from the problems of inflation, high interest rates, and the politicians, seeking public favour, by seeking re-election and offering, as a bait, tax deduction for interest paid on home mortgages.

From this modest beginning successive Governments continued to expand this area, until today the "home" has become a major taxable item with far reaching social implications.

The major developments are briefly:

1. Tax deduction of interest is not equitable to all citizens and has led to extensive subsidies, rent controls and subsidies also on rental flats as an equaliser.

   Already in New Zealand we have heard rumbles for the consideration of rental subsidies.

   The situation arises with a home owner comparing his situation with a person on the same income who is renting - the home owner is ahead in many ways.

   (a) Net income is greater. Take home pay, with interest deduction ahead of neighbour who rents.

   (b) Capital gain.

   (c) The renter has no tax deductions for rent.

   (d) Rent increasing with inflation. These factors led to rent subsidies. I think you can see a comparable situation developing in New Zealand.

2. Capital gains tax on dwellings has been introduced as a natural follow on.

   This has, as expected, led to a black market situation with an "official price" for taxation purposes and cash under the table for the difference between official price and market value.

   I found in Norway this was freely discussed by their Ministry of Housing officials, solicitors, and bankers as an almost normal operation.

   With taxation rates up to 86%, it becomes difficult to remain an honest law abiding citizen.

   Another important factor that has developed is a form of "wealth tax". In a world where there is a wish for all to be equal, individuals with "above average" homes have been taxed on their equity.

   In other words effort and enterprise to obtain an above the average residence has been discouraged to curtail so called social inequities.

   A point we could debate for some time.

3. Interest rates tend to become academic.

   In Denmark where all interest paid by the private citizen is now a tax deductible item, interest rates have increased rapidly. Housing is between 19% and 20%.

   The more you can borrow in an inflationary climate with large capital appreciation on buildings, the better you are off in real income.

   As mentioned previously the "renter" found himself severely disadvantaged and this prompted an equaliser of rent subsidies in the private and public sector.

4. With the multiplicity of subsidies and taxation laws in Sweden, today the house regulations covering some 17,000 pages in publications cover all aspects of subsidies. For example room sizes are limited, bathrooms cannot exceed a certain size, lounges and bedrooms cannot exceed a certain measurement.

5. Tax deductible interest on home mortgages with no time limits does not encourage repayment and the overall "pool" for home ifnance is accordingly limited.

6. Tax deduction of interest, as it develops, breeds a generation of spenders - not savers.

Savings are still a necessary attribute in our society to provide a mortgage pool for on lending and provide society with funds for local and national development of resources.

7. It is often mooted, and particularly by real estate people, that home mortgages should be transferable with the property.

I personally oppose this concept.

In the countries where this has developed, along with interest being tax deductible, houses have sold above market values, and believe me, causes a considerable problem in assessing a registered value.

8. Once tax deduction of interest is introduced, it is impossible, yes totally impossible, to retract.

Political pressure on elected members stops the politician from making a change.

However, the main point is that the mortgagor has budgeted on a tax deductible basis and usually could not balance his budget should it be taken away.

Last year in Norway the Government attempted to modify this type of legislation, but there was such an uproar it had to back off.

Once introduced, it is impossible to retract.

I could report many other problems, but I have covered the main points.

The question I ask myself is what are the likely further developments on the New Zealand scene and likely effects on housing, and in particular, valuations of the private home.

Our homes now are under the attention of the Inland Revenue Department and I forecast that with future political campaigns the family home will be open for bids and open to political gain and abuse.

To you people gathered here today, I suggest that changing tax laws must have some bearing in the future on valuations of real estate.

Mr Chairman, that concludes my paper.

Vineyard Appraisal and Establishment Costs

By N. R. Ibbotson, Marlborough.

This paper deals with the development costs, expected returns, and factors affecting those returns, and subsequent value, of vineyards.

It is based on the limited experience of the writer, who has established grape vines on his own account, and has been involved in the ifnancial planning, management advising, and to a lesser extent valuing of vineyards, in the Marlborough area.

The points that follow relate directly to the Marlborough area, however a considerable amount is probably relevant to other areas of New Zealand.

As you may be aware Montana first planted grapes in Marlborough in 1974, with contract growers' first plantings being established in 1978.

There are now three large wine companies in the district with a total area planted including contract growers, of 1,100 hectares. This area is still expanding.

1. Contracts:

Virtually all growers in Marlborough are on a contract basis to a wine company. The term varies from 10 to 15 years with some having rights of transfer, others no such rights.

The contract basically is an agreement for the grower to supply and the company to accept. It does not guarantee price and is in effect only as good as the company. If the company goes out of business obviously the contract is of limited value.

2. Price Paid For Grapes:

1981 harvest prices varied for Riesling Sylvaner variety between $370 and $490 per tonne, with a net of harvesting average return of $420/tonne.

Price paid is negotiated annually between growers and companies, normally with the right to go to arbitration if agreement is not reached.

Negotiations are based on cost of production and price to the grower has increased by an average of 8%/annum since 1971. In the last two years increases of approximately 1211% have been paid.

Prices paid on other varieties of grapes are related to Riesling Sylvaner with the companies' stated intention being to give growers a similar return as from Riesling Sylvaner.

It appears that very low yields from some varieties in Marlborough may make this difficult.

3. Development Period:

Full production is likely in the fourth year providing irrigation is used. First returns can be achieved at 20 months provided management is good and irrigation available. (This has the effect of substantially reducing development cost.) Development costs are fully tax deductible, apart from plants, which vary in price from no charge to 45 cents/vine, dependent on company.

4. Yields:

It is difficult to assess full yields in Marlborough from contract growers, as the oldest contract vines are only four years old.

Montana have vines seven years old however, and these plus yields achieved by contract growers with Riesling Sylvaner at two and three years old, do however give an indication.

Yield Achieved by Contract Growers from Riesling ,Sylvaner in Marlborough:

	Tonnes/Hectare		
	Low	Average	High
Second Year:	Nil	.3	7.4
Third Year:	2.0	5.5	13.0

Estimate of Yield at Full Production:

Tonnes/hectare :	7.0	12.	22.0

As can be seen the variation is substantial.

5. Development Cost:

The following schedule is based on effective planted hectares and it should be noted that approximately 10% of the total area is normally required for headlands. This nonproductive area is obviously higher in an irregular shaped block.

6. Variables:

(a) If an opportunity cost of $175/ha./annum was taken into account, total cost is increased to $14,803/ha.

(b) If interest is compounded at *15%* on development cost of $14,803, then total cost is increased to $21,051/ha.

(c) If a marginal tax rate of 60 cents in the $ is being paid, this cost is effectively reduced to $6,845/ha.

(d) If a crop can be obtained from two year vines, this $6,845 could be reduced to $5,361/ha.

Note:

Interest rate on development monies is calculated at 15%; those persons developing with Rural Bank interest at 7% over the development period are fortunate indeed.

VINEYARD ESTABLISHMENT COSTS PER EFFECTIVE HECTARE AS AT 20/2/82

	Year 1	Year 2	Year 3
Land Preparation:			
Contract deep ripping @ $55/hour: .5/ha/hour	110		
Lime - 22 tonne/ha. @ $20 tonne	50		
Superphosphate - 250 kg/ha @ $15c/kg	38		
8 man tractor hours cultivation @ $25	200		
Planting:			
Layout and Marking - 15 man hours @ $4.50/hour	68		
Hole Digging - 7 man and tractor hours @ $25/hour	175		
Planting - 35 man hours @ $4.50	158		
Plants - 1794/ha. @ 45 cents/plant	807		
Weed and Pest Control:			
3 sprays, disease materials	30	145	430
Contract @ 8.50/ha. x 3	55	111	148
(Year 2 - 6 sprays; Year 3 - 8 sprays)	30	30	30
2 weed sprays - materials; Row strips			
Contract $18.50/ha. x 2	37	37	37
7 cultivations - man and tractor hours - 102 hours @ $25	263	263	263
Hand hoeing man hours - 24 @ $4	96	96	
Trellis Construction:			
Strainer Assemblies - 30/ha. @ $14.50	420		
Posts - 440/ha. @ $3.30	1,452		
Wire - 122 gauge - 40 coils @ $33.50/coil. (7 wires)	1,340		
Wire strainers and nails and training cord	74		
Driving posts - tractor and man hours - 9 @ $30	270		
Assembling and wiring - tractor man hours - 20 @ $25	500		
Man hours - 10 @ $4.50	45		
Training, Tying and Pruning			
Training and tying - 130 @ $4.50 (Year 2 and 3 - 75 hours)	585	337	337
Pruning - 50 hours @ $4.50 (Year 2 - 60: Year 3 - 100 hours)	225	270	450
Sundry Labour - 30 hours @ $4.50 (Year 2 - 40 hours: Year 3 - 50 hours:)	135	180	225
Sundry tractor hours - 20 hours @ $20	400	400	400
Shredding	10	18	18
Trickle Irrigation:			
Materials	1,140		
Installation - 50 hours @ $4.50	225	30	30
Well pump and ditching and electrical	550		
Total Direct Cost/Hectars	9,488	1,917	2,368
Administration and Standing Charges			
Rates, Insurance, Telephone, Accountancy, Subscriptions, etc.	140	165	200
Total	$9,628	$2,082	$2,568

Summary:

Year 1:		$9,628/ha.	/acre $3,886
	Labour Hours/ha.	409	
	Tractor Hours/ha.	75	
Year 2:		$2,082/ha.	/acre $842
	Labour Hours/ha.	214	
	Tractor Hours/ha.	30	
Year 3:		$2568/ha,	/acre $1039,
	Labour Hours/ha.	240	
	Tractor Hours/ha.	30	
Three Year Development Total:		$14,278/ha.	$5,778/acre

7. Capital Cost:

(a) Land:

At present suitable bare land in Marlborough being used for grapes has a capital value of between $10,000/ha. and $20,000/ha. The latter price reflecting deeper silt loam soils closer to Blenheim with added proximity value.

(b) Plant:

The value of plant on grower vineyards varies from $2,500 to $30,000 giving a per hectare figure of between $250 and $3,000 on a 10 hectare vineyard.

8. Profitability:

Using the above calculations we arrive at the following levels of profitability/ha. at full production.

	Low	Average	High
Yield tonnes/ha	7	12	22
$420/tonne net of harvesting	$2,940	$5,040	$9,240
Annual costs including administration and depreciation	$2,848	$2,848	$2,848
Net Return/planted hectare	$92	$2,192	$6,392
Return/total ha. 90% of above	$83	$1,973	$5,752

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9.Capital Involved:

	Low	Average	High
Land and Buildings: (Not Dwelling)	$10,000	$15,000	$20,000
Plant	$250	$1,625	$3,000
Development Cost	$5,361	$15,000	$21,051
Total Capital Involved	$15,611	$31,625	$44,051
Low Net Return/ha.	$83	$83	$83
Expressed as a % Return on Total Capital Involved	0.53%	0.26%	0.18%
Average Net Return/ha	$1,973	$1,973	$1,973
% on Total Capital Involved	12.6%	6.2%	4.5%
High Net Return/ha	$5,752	$5,752	$5,752
% on Total Capital Involved	36%	18%	13%

These returns highlight the variation in return on total capital involved from 0.18% to 36%.

There are no growers receiving this 36% as it requires the correct combination of the above factors; that is, low land, plant and development cost and top yields. There are growers however who are achieving very little more than 0.18% who have expensive land, plant, and low yields.

Cost of production is basically the same at high or low levels of production, and at low production returns barely cover costs.

10. Factors Affecting Profitability:

(a) Management:

In the vineyard the management factor is of prime importance. A good manager acts before the need is apparent and before the problem occurs.

Casual labour is employed in most vineyards and correct early training, and subsequent pruning of vines is imperative; poor labour supervision by management is disastrous.

(b) Irrigation:

The Marlborough climate is dry, 600mm rainfall annually, the evaporation rate is high, and many of the soils are light and free-draining with silt on a shingle base. Trickle irrigation is making the growing of vines profitable, without it yields are low and profitability almost non-existent.

Contract vineyards that have had irrigation from the outset have averaged 4 tonne/hectare in the second year and 10 tonne/hectare in the third year.

Without irrigation there has been no harvest in the second year and an average of 5.3 tonne/hectare in the third year.

Converting these tonnages to income gives the irrigated vines after two harvests a return of $5,880 net of harvest, and the non irrigated vines a return of $1,680 - a difference of $4,200/hectare.

Even on the deeper silt loam soils and the wetter clay based soils, irrigation is required.

(c) Varieties:

To date there are no contract growers cropping anything other than Riesling Sylvaner, although there are a considerable number of other varieties planted.

Varieties which appear to be shy bearers and of doubtful viability based on present prices, and on the experience of one company, include Rhine Riesling and Gewurz Traminer, with a question mark on Pinot Chardenay.

(d) Soil Types:

It appears that the best yields are being achieved on the free-draining silt loams, and there is some evidence suggesting that stones to the surface are giving added warmth which is promoting additional growth and yield.

Trickle irrigation is of course a necessity on these soils.

The heavier soils, especially those with a clay base, create slower growth in the spring and can dry out rock hard in the summer, effectively stopping growth. There have been instances of vines actually being `drowned out' on poorly drained clay soils.

(e) Pests and Diseases:

The grape vine is susceptible to a number of diseases often influenced by weather condition, especially humidity.

A well managed spray programme can minimise the effect of most pests and diseases. Phylloxera is an aphid pest which attacks the roots of grape vines causing considerable loss of production and on occasions death. There is no known viable cure, however prevention is achieved by establishing vines on resistant root stock rather than on their own roots, which has been normal practice in the past. To date there has been no phylloxera found in Marlborough, it is however causing considerable damage in many North Island areas; and will no doubt be found in Marlborough in due course.

(f) Climatic Factors:

Late frosts can cause damage (although this is normally minimal), but areas that are frost prone should be avoided.

Warmth and especially high sunshine hours are beneficial, effectively making northerly aspect land desirable and southerly aspect less desirable.

Excessive slope causes higher running costs and possible difficulties with machine harvesting.

Hail can cause considerable damage to leaves and grape bunches, with subsequent reduction in yield. Hail belt areas are hence less attractive.

(g) Shelter:

Although shelter is necessary for most horticultural crops, it appears to be more of a hindrance for grape vines, in that it competes for nutrients, restricts sunshine, and accentuates any frost risk.

Wind damage is minimal in most vineyards, provided management with tucking of vines is up to date.

11. Risk Factors:

(a) Oversupply has occurred in the past and will no doubt occur in the future. The restriction on the amount;of water permitted in wines has created a greater demand for grapes, and the present effect of phylloxera is reducing yields, especially I understand in the Gisborne area.

One local company which has been talking oversupply is now understood to be looking for new contracts.

(b) Varieties may change in the future with present preferred varieties losing favour, and subsequently profitability.

(c) Contracts with the companies are only as good as the company itself, and whilst better in this respect than most horticultural crops, price or profitability is not guaranteed.

(d) Phylloxera as mentioned earlier is one of the greatest risks.

(e) Development Capital is at risk in the event of an unprofitable vineyard, although the structural portions being posts, wire and trickle irrigation, are recoverable.

12. Effect on Value:

The afore-mentioned factors and their effect on profitability influence what buyers are prepared to pay and hence vineyard values.

Questions and Answers (All questions answered by N. R. Ibbotson)

G. Townsend, Waikato

Q. From the table of returns, there is a theoretical return of 36% which nobody is getting. How many are getting 18%? How many are getting 15% in round figures? Would that be information available? Obviously some are only getting 2-3%.

A. Putting it into numbers of growers involved I would have difficulty doing that. I think probably it would best be related back to the average return of the average grower. So we are saying that the average grower is getting a return of 6.2%. I would think that probably only 5% of growers would be above the 18% figure.

G. Hilton, Auckland

What are opportunity costs for a start?

Looking at the opportunity cost of the use of the land what it may have earned in another crop during the period that the grapes are growing. So we are saying that during the first year it could have earned a return of $175 per hectare in another crop.

G. Hilton, Auckland

Q. I do occasional valuations in the Auckland region on lesser areas than you are involved with. We have smaller vineyards, some of them are to fairly well known companies, but they do grow a bigger variety of grapes. More so than you mention here, and I have at varying times in the course of my valuations tried to relate a value to the actual production per hectare and also the return per hectare. Have you tried this before?

A. No. The Marlborough situation is such that at this stage the vines that are planted by contract growers are only just starting to yield now, so we are in a situation where apart from one large company we haven't got private blocks that are actually yielding at this stage.

R. Frizell, Bay of Plenty

Q. I was wondering Neil, if you could tell me why you took the opportunity cost based on the production you could expect from the land rather than upon the capital that you propose to invest in the land.

A. The reason why I did it that way was to bring it back to then look at the return expressed as a percentage of the total capital that the block was going to show.

R. Speedy, Napier

Q. On Page 5 of your paper on the Capital involved; I must have missed something but I didn't get why there was such a wide variation in development costs between the low of $5,361 and the high of $21,051. Could you answer that one please?

A. The $21,000 is taking the extreme high situation, where full costs are taken including I think it is 15% on the money outlaid, whereas the low situation is looking at the position where the developer involved has a 60c in the dollar tax rate and also is able to achieve production at the 18 month stage as opposed to the 22 year stage.

G. Hilton, Auckland

Q. When you are doing a valuation on vineyards do you have regard to the potential return that the vineyard provides or do you look at it on just a straight summation basis? And the second part to the question - if you are making a loan recommendation on that property do you take the vines into account?

A. In answering the first part of that question, yes, I do make allowance for the potential income. The second part of the question with a loan recommendation. Yes I do take the value of the plants into account in looking at that loan recommendation. The recommendation for the percentage to be lent would depend substantially on the stage that the block was at, the management of it and all the other factors involved, so I can't put a specific figure on that percentage because it varies substantially from case to case.

K. Tremain, Napier

Q• On the basis that you say you pay 45c for vines when you plant them or $2.50 for the phylloxera tested vines. What value do you put on them at say 2, 3 or 5 years, in relating the value of that stock to the value of that property.

A. At that stage if they are getting close to full production (and as I said earlier, the only blocks we have in Marlborough that I have valued have been blocks on the development way through so we haven't got anything at full production and I understand that buyers have in other areas paid full value for improvements on fully developed vineyards). So in that situation if the buyers are paying full value for the plants then I think that would be the basis of the valuation. I think that the trend is for the buyers to take account of the cash return position in those early years. They are paying less for the vines in a purchase situation because the vines are further away from profit.

K. Tremain, Napier

Q. Have there been any vineyards sold in Marlborough?

A; No. The only vineyards that have been sold in the Marlborough area have been vineyards with vines on at one of two years old.

K. Tremain, Napier

Q. What difference in price does that make above the bare land price?

A. It's difficult to know exactly on the vine situation because we are looking at trellising as well, but it appears that buyers are paying somewhere in the vicinity of 50% of the value of improvements at that early stage.

Carter, Auckland

Q. I was wondering how you took into account the availability of water in your valuations?

A. Again, we are in the situation where we haven't had the comparison of sales with or without water. I would expect the buyers as they become more informed will make a substantial difference for irrigation and especially as vines get to the full production stage. I think we will find that irrigation will be given full value for the money that is being spent on it.

K. Parker, Napier

Q. In view of the fact that there have been very few sales of grape blocks isn't it then really very difficult to arrive at a value of these properties? In other words you really haven't got anything to go on have you to arrive at a value of a fully developed block. Isn't it a little hypothetical in view of the lack of sales evidence?

A. Yes, this would be very true. We haven't got sales of fully developed blocks so we are looking at a hypothetical situation in the Marlborough area when we talk on values of improvements to fully developed blocks.

A Ford, Palmerston North

Q. Just as a matter of interest what was the land being used for. This is quite a large area in Marlborough? And could you comment on what it is going to do for Marlborough in various ways?

A. A considerable area of the land that is being used for grapes was running sheep. When Montana ifrst bought it was probably running 3-4 sheep to the acre and at that stage its value was approximately $300 per acre. The effect of it on Marlborough is substantial. It has brought a lot of business to the town, a lot of money to the town, so Blenheim is growing because of it. It has probably also had to spin off by encouraging other horticultural crops because of the high land values. Other crops are being planted so it is having that spin off affect as well.

R. Frizell, Bay of Plenty

Q. I was wondering could you give, or have you, any impression of what the marginal tax rate is of the people who are entering the development of this land into vines, or the purchase of partly developed properties.

A. The trend seems to be for the development to be attracting those people with the high tax rate. There are, of course, exceptions to this. Traditional farmers that have moved into it, that haven't had the high level but they tend to be smaller block sizes whereas the larger blocks do tend to be either professional money from the towns or in some cases very well established farmers with the same high rate of taxation.

S. S. Morice, Napier

Q. With the problems that phylloxera has caused in the North Island, are there any moves by the growers in the Blenheim area to not allow planting of non-resistant stock or are they planting stock that is not resistant?

A. Virtually all the planting that has taken place in Marlborough has been on vines on their own roots as there hasn't been the resistant rootstock available. The Blenheim growers are attempting to prevent phylloxera coming into the South Island. One of the difficulties that they have is that two of the companies who have nurseries in the North Island are very keen to bring in the rooted plants which they are growing in their nurseries, and this makes it very difficult because of company attitude wanting to get established. I understand in South Australia high quarantine measures there have prevented phylloxera getting into South Australia so we are hopeful that a similar situation can be achieved in Marlborough but it's very difficult because of the reaction of two of the companies to it. The companies (being fair to them) do dip all plants that come into the district both when they leave and again when they arrive and this dipping will kill the phylloxera pest. But the risk is that somebody doesn't do the job properly and it comes in because of the plants not being dipped properly.

I. Burgess, Wanganui

Q. I wonder if you could tell us how sensitive is the profitability of the grapes to the annual sunshine hours. I mean does a year of low sunshine make the difference between a profit or loss on an average sort of property or is it not that sensitive?

A. No it appears to be not that sensitive. The Marlborough people would like to say that the higher sunshine hours we get there produce higher quality wines. The winemakers certainly do not agree with that when we are negotiating a price. So I don't think it is really a critical factor and it's interesting in that this year which has been a good one for the Marlborough area and its autumn as far as sunshine is concerned, we are seeing a relatively low level of sugar when we would have expected it would have been higher.

Continued in page 162.

Production and Planning in a New Zealand Wine Company

By K. Crone, Vineyard Development Manager, Cooks New Zealand Wine Co. Ltd.

The objective of this talk will be to shed a little light on the problems of planning and implementing production in the wine industry.

The last few years have seen an explosion in the planting of grapes, the making of wine and the levels of wine consumption in New Zealand. Overseas, similar trends have occurred in both North America and Australia. Although wine consumption presently shows signs of levelling in New Zealand, over the last few years growth of the medium white wine segment of the market has been increasing at the rate of up to 20 percent per annum.

This rate of increase has been responsible for the dramatic acceleration of grape plantings over the last few years. Grapes planted predominantly have been those varieties which will make medium white table wine. The problem facing wine companies during this period has been in judging the rate at which to plant more vines. There is a lag of three to four years between planting and consumption of the bottled product.

Most of the grapes planted in recent years are being grown under contract to a winery by farmers. The winery is obliged to buy the grapes and the farmer or other individual must sell them to the winery. This contrasts with Australia where a large portion of the grapes may be uncontracted. Although the grower is assured a market for his product, there is some degree of risk involved for both parties, since growers' prosperity ultimately depends on the individual wine companies' success in marketing their product. There is no Government support for wine companies if sales decline. The problems in estimating future grape requirements and the size of a particular company's market are even greater in exporting since sizable volumes of wine will be required to be supplied consistently.

Once the relevant marketing decisions have been made, and the wine styles and types to be produced determined, it becomes a question of planting the relevant grape varieties in the best location and either building a new winery or enlarging an existing one.

All these decisions involve large sums of money. Wineries cost up to $1.5 million per 1,000 tonnes of grapes or 75,000 cases of wine. Grape production currently is even more expensive. A winery contemplating growing its own grapes would need to make an investment in land, vineyard development and machinery even greater than in a winery. In Hawke's Bay at current land prices of say $25,000 per ha. plus development costs of the land, a wine company would have to spend up to $2.5 million per 1,000 tonnes of grapes, depending on variety. For example, Chardonnay may yield about eight tonnes per ha., whereas Riesling Sylvaner may yield about 16-20 tonnes per ha. The total investment required by the winery in order to make 75,000 cases of wine is up to $4 million. In addition, the investment in vineyards is made well before wine sales occur.

As a consequence of the huge investment necessary in wineries and vineyards most wine companies find it prudent to contract with farmers and other individuals to supply grapes, allowing the company to conserve its resources on winery development.

The contract growers often are in a position from their cash flow situation to be able to develop vineyards more economically than wine companies.

Farmers already own land at historical prices, quite often it is freehold or has been inherited. The land may have been used for grazing or annual crops prior to grape growing. Grape growing is far more profitable per hectare than these activities. The development of vineyards is tax deductible. This is a good method of saving tax and developing an asset which becomes a non taxed capital gain.

The current gross return for grapes is in the vicinity of $8,500 per hectare. If a farmer has a total investment in his hectare of grapes of around $37-38,000 on paper, his return on that investment looks poor. If one of the two factors just mentioned is not operating, clearly it is difficult for people without substantial assets or cash flows to enter into grape growing, but for persons in these categories, grape growing can be very profitable, in comparison to traditional land usage.

At this point it is pertinent to note that although land value is a basic cost in grape production, the price paid for land reflects not only its productive value but also other expectations, such as land values rising or non taxable capital gains accruing. Providing the owner picks a usage for his land with a viable future, not only will he gain from increased land values, but also from an increased value of his development, with time.

Should any of you be concerned about what I've said and that grape growers are poor then I would suggest a visit to their properties may rapidly dispel that view.

One of the relevant factors in favour of grapes as opposed to other perennial fruit crops which show much higher returns per hectare, is the relatively large area an owner/operator or syndicate can successfully manage. This is due to mechanisation.

If acquiring as much land as possible is important, or if you already own large amounts of land, grapes are a good crop to consider. This is especially true for those contemplating changing from grazing or an annual crop to a perennial one. Because of potential management difficulties it would be a brave person to plant 20 or 30 hectares of, say, kiwifruit. The success of the New Zealand apple industry is firmly based on owner/operator principles and kiwifruit is likely to be the same.

Each wine company chooses for itself where to grow grapes. The areas chosen in New Zealand range from Auckland to Te Kauwhata to Poverty Bay to Hawke's Bay and down to Marlborough.

In the case of Cooks Wines, although we own two vineyards up north, we are growing contract grapes exclusively in Poverty Bay and Hawke's Bay. Despite high land prices, these two regions offer us the best compromise regarding quantity and quality of grapes plus allowing us to process the grapes in a remote location, namely, Te Kauwhata.

In Poverty Bay we tend to concentrate on early season varieties while in Hawke's Bay a complete range of the varieties we require is grown. Compared to Poverty Bay there is less rainfall in Hawke's Bay plus a far greater range of soil types available, enabling us to grow a greater range of varieties of grapes. You will all be well aware that Hastings is called the fruit bowl of New Zealand and I believe that that title is well and truly justified. For Cooks, Hawke's Bay is the region where most of our future grape growing will occur, although we will continue to grow grapes in Poverty Bay as well.

Our continued large scale involvement in Hawke's Bay means that inevitably we will build a winery here once we have fully utilised the capacity of the Te Kauwhata winery.

We are currently in the process of acquiring a block of land for a winery and hopefully if our exporting efforts are successful, one of the larger New Zealand wineries will one day occupy the site. Curiously, during our search for a suitable winery site, we found very few acceptable locations. We needed a site big enough to expand indefinitely into the future since duplication of wineries in a given district is economically unsound. We had to be able to be connected to a sewer because of the nature of winery wastes and we wanted to be isolated from a residential area because of 24 hour operation at various times of the year. We would also have liked to be close to a railhead.

With the increasing land use for horticulture in Hawke's Bay, it is probable that other processing industries will develop and the provision of suitable sites with requirements similar to ours and Grower Canneries will be necessary.

At present we process all grapes at our winery at Te Kauwhata. We have encountered no problems with wine quality or moving that volume of grapes by truck, however it requires a lot more planning and is not as convenient as a local winery. The founders of Cooks never envisaged the company growing to its present size. Grape growing started at Te Kauwhata, and shortly after we purchased our first contract grapes from Poverty Bay, once the wine boom started.

The decision to build a winery in Hawke's Bay is linked directly to our commitment to the region and our confidence that we can grow both the quantity and quality of grapes we require here. At present although we are able to cope with our current production at Te Kauwhata, our future development will be here, but it will be ifrmly linked with development of export markets for our wine.

Questions and Answers.

Concluded from page 160.

J. Charters, Auckland

Q. Who determines the price that the contract grower receives?

A. This is determined annually by negotiation between the Companies involved and the contract growers. In the Blenheim district we've adopted the Gisborne pricing method which has been prepared on a cost of production basis. We use that as a base and then negotiate from there. The interesting thing with the pricing is although cost of production has been used as a method for fixing it the companies haven't accepted, and are not prepared to put in writing, that it will continue to he the method for assessing the price, and one wonders what will happen in a period of over-supply. In that from a company's angle accepting a cost of production basis in a period of under supply as we have had is probably reasonably satisfactory but there has got to be the probability that given a period of over-supply the price to the grower could drop substantially.

Judy Lenart, Wellington

Q. I take it that irrigation is an allowable deductible expense in a development cost. Fertiliser you mentioned briefly, something about phosphate being shown to be not effective. Is there any role in the nitrogenous fertilisers in viticulture?

A. The local Ministry of Agriculture have taken trials on some of the Montana blocks which have been down for some time. The results from those trials have indicated no response whatsoever to any fertilisers and I think in one of the trials actually indicated a depression in yield. However, there are growers that are using both phosphate and nitrogen fertilisers and I think getting some responses on different soil types. I do understand that the vine is not a high fertiliser feeder but on soils especially that have been cropped substantially, responses do seem to be obtained, especially nitrogen on young plants when they are growing quickly.

Judy Lenart, Wellington

Q. Just one other thing, on Page 3 Total Direct Cost per Hectare. If you were to deal with disease resistant stock you would be talking about $13,000. Is that right?

A. Yes, that would be right.

Viticulture Viability

By John M. King, Advisory Officer (Economics), Ministry of Agriculture and Fisheries, Hastings.

This afternoon I have been asked to address you on the viability of the wine-grape producing industry. In recent months, grape growing and its perils and pitfalls have received almost as much media time as potential tax reform and cricket matches. I speak, of course, of the disease Phylloxera, and the ramifications of its spread on growing areas in the eastern North Island.

I wish to begin with a short review of grape production in New Zealand before analysing the viability of producing grapes for the wine industry. In the years from 1975 to 1980, the total area of wine grapes increased from 2350 hectares to 4785 hectares - this being a doubling of area over 5 years. The volume of grapes produced over the same period has increased by 53% to a 1980 total of 36,700 tonnes. However, it is noted that at 1980, nearly half of the wine grapes in the ground were two years old or less, and contributed very little to the total production. And following 1981 plantings, there is still at least 1,000 hectares of wine grapes planted but yet to produce. The large increase in the rate of plantings in the last five to six years has coincided with and been encouraged by several factors. The first is the industry move towards using 100% grape juice in table wine making - an objective which has required several years to achieve due to a shortfall in supply of suitable grapes from domestic production.

The second is the Government's benevolent attitude towards the New Zealand wine making industry, which has protected the industry well by regulations which have included:-

- more than favourable treatment in regard to excise duties compared with other alcoholic beverages.
- relatively strong tariff and import restrictions on the import of foreign wine.
- prohibition of grape juice importation.
- licensing of restaurants.
- wine shop regulations which until recently allowed only New Zealand wine to be sold from these outlets.

Over the period, a more aggressive marketing approach to New Zealand wines has occurred, and this combined with an increasing acceptance of table wine consumption by the New Zealand populace has encouraged greatly increased plantings, enticed, of course, by the rising price being paid for grapes. A further factor providing some encouragement for the industry is in the potential export earnings from quality wines. But volumes exported to date have been small.

In 1981, exports accounted for little more than 1% of the volume put down in any of the years 1978 to 1981, and represented less than 25% of the wine imported into New Zealand. So, in short, New Zealand has more than 5000 hectares of wine grapes, of which an estimated 25% or more is still less than two years old. Consumption in New Zealand has risen rapidly from 4 litres per head in 1967 to 12.3 litres per head in 1980. Exports to date are an insignificant proportion of the total produced annually, and to my mind, are partly bolstered by Government export incentives associated with taxation. A rapid rise in the tonnage of grapes produced will occur in the next three years - phylloxera allowing. Given present market conditions, price and consumption levels, an oversupply is likely to result - particularly in the white varieties. Unless an aggressive and unified approach to export marketing occurs (particularly if export tax incentives were to be removed by Government, and if the Closer Economic Relations with Australia result in significant tariff and import control reductions on Australian wine) oversupply could have very adverse effects on grape producers. The major effect of oversupply is the price depression of the raw material - the grapes. And so a word about prices.

With the protection afforded the New Zealand wine and grape growing industry, it has been possible to maintain high prices in order to encourage increased plantings of the required grape varieties. In an effort to more rapidly increase the volume of grapes in recent years, some of the major wineries have significantly increased plantings - a factor which will provide them with a supply of required varieties at cost of production only.

When compared with world prices, the New Zealand grape producer should have little to grieve about when considering the level of New Zealand grape prices. The current Reisling Sylvaner price which is often regarded as the average or benchmark variety is about $460/tonne for this season, and is significantly above Australian prices for a similar type of grape. Unfortunately, I have been unable to obtain the current Australian base price for comparison. However, looking at the 1979/80 prices, the Australian average reisling price was $215 per tonne compared with a New Zealand price of $345/tonne. And exchange rates were much closer than they are at present. This price differential has been maintained in real terms, but could rapidly decrease if an oversupply situation eventuates in New Zealand.

And so to the economic viability facing the grape grower. Is it a profitable enterprise and a wise use of the expensive land resource? What of long term viability, and of other intensive horticultural systems capable of competing for the land resource?

There are two positions from which the viability can be viewed - that of the established grower with relatively lower overheads in terms of purchase and development debt servicing, and from that of the new growers faced with high land and development costs. Both are facing the threat of phylloxera if their vines have not been grafted onto resistant rootstocks, and the potential threat of oversupply if additional markets are not forthcoming.

To test an enterprise's viability, we must return to figures. These I have summarised as much as I dare, and have looked at each year from planting to full production (a four year period) in order to give an estimate of both development and production costs. I assume 8 hectares of bare land as the base, and have only included necessary costs. The Reisling Sylvaner variety has been used as the example, and productivity is based on Gisborne and Hastings yields as these are the two main areas producing this variety.

	Year (1)	Year (2)
Capital Costs *	$17,360	$9,800
Plants **	30,820	620
Structural Development	1,380	35,442
Total Cost	$49,560	$45,862
Cost/Ha	$6,195	$5,733

* Capital costs include a three bay implement shed, a second-hand tractor and trailer, a weed sprayer, an air blast sprayer, a rototiller, a row trimmer and miscellaneous tools.

** Plants are costed as grafted vines on phylloxera resistant rootstock, and unless replacing vines in an existing vineyard, are not tax deductible.

Costs of establishment excluding land and housing are $11,928/ha of which only $4,603 is tax deductible development.

Profitability analysis:

	Year (1)	Year (2)	Year (3)	Year 4 & onwards
Age of Vines (Yrs.)	11	21	3-',	4-',
Yield/hectare	0	4 tonnes	12 tonnes	16 tonnes
Price/tonne	0	$460	$460	$460
Harvesting & Transp. Cost/tonne	0	$60	$60	$60
Gross Income/Ha	0	$1,600	$4,800	$6,400
Gross Income/S Ha	0	$12,800	$38,400	$51,200
Direct Costs (per 8 hectares)				
Growing Costs	2,585	5,212	15,420	15,420
Overheads & Admin.	2,800	2,800	2,800	2,800
Depreciation	1,537	2,937	2,937	2,937
Total Costs	6,922	10,949	21,157	21,157
Income per 8 h.	-6,922	$1,851	$17,243	$30,043
Income per Ha.	-865	$231	$2,155	$3,755

This level of net income must meet all other charges, including debt servicing, drawings, tax and further development. And while these returns appear to be very good, it is the debt servicing which can reduce them significantly. Costing land at $10,000 per hectare - and this is certainly not land on most of the Heretaunga Plains or Gisborne Flats - the following table summarises the net return before drawings and tax from year (4) onwards. It includes debt servicing at 131% p.a. over a 15 year period, but does not include debt servicing on the operating debt or living expenses in the first three years.

Loan on Land and Plant / Loan on Development	0%	50%	100%
0%	$30,043	$21,337	$13,031
50%	$24,624	$16,118	$7,612
100%	$19,206	$10,700	$2,194
Land Cost		$80,000	
Plant & Buildings		$27,160	
Development		$68,262	
		$175,422	

Based on a borrowing level of 50% of the total ingoing capital (with land at $10,000 per hectare), the current yield and price for grapes will not return an adequate profit margin to compensate the grower for his work, management and capital input. If his time is costed at $12,000 p.a., the residual income represents a pre tax return on equity capital of only 4.7%, and a return of only 2.35% on total capital.

Many will say that this level of return can be lived with, particularly when considering that it is only a basic grape price which is used, and that premiums (some currently very substantial) are being paid for high sugar levels.

From the viewpoint of the new grower entering the industry, substantial debt servicing must be paid in the first three years of operation. The above table lists profitability at varying levels of debt servicing after reaching full production in year (4).

If the operating debt in the first 3 years was borrowed rather than being financed from an independent income or capital source, overall debt servicing would increase as follows:

vj, of Land, Buildings, Plant & Devel. Borrowed	Year (2).	. Year (3)	Year (4)
0% Borrowing Level	$1,098	$1,273	$1,273
50% Borrowing Level	$1,807	$2,718	$2,885
100% Borrowing Level	$3,440	$5,228	$5,630

And note, this debt servicing in the first years does not include drawings or management wages. So, depending on the level of borrowing for land, plant and development, the net profitabilities in the first table after year (3) must be reduced by up to $5,600 p.a. Even if the new grower was able to finance debt servicing and operating losses in the first three years from other income or capital, it must be recovered, and hence the costs as calculated must be included. This can be viewed as the opportunity cost of working capital.

Thus, from a new grower's viewpoint, with capital borrowings at the 50% level, and financing his operating debt from further borrowing, his profitability at full production decreases to $13,233 per 8 hectares (on land costing only $10,000 per hectare).

Where land prices are higher than the $10,000 per hectare (as they often are when small fertile blocks are sold), the returns on capital quickly become negative if additional borrowing finances the purchase. Land costing $20,000 per hectare - twice as much as used in this analysis - would have an additional annual cost of $12,700 debt servicing if the extra $10,000/hectare was borrowed. And note that the interest rate used of 131% p.a. is below the current market rate for ifnance outside of R.B.F.C., and repayment terms of less than 15 years are frequent.

Housing on the block is an extra. It has not been costed into this analysis, but could further increase debt servicing by up to $10,000 p.a. depending on the standard of housing built.

These figures indicate the viability from the viewpoint of a new landless grower entering the industry. An established grower with an 8 hectare area of grapes who wishes to expand to 12 hectares has a greater advantage. The plant and buildings will adequately cope with the increased area and the development expenses would be the same on a per hectare basis. If he already has bare land and develops out of income, his net return for the additional 4 hectares would be $17,000 p.a. at full production after allowing for additional labour. Overheads such as depreciation and administration are spread, no debt servicing is involved, and he will have improved the overall base and viability of his operation. Even if some borrowing for land purchase and/or development is required, the net return per hectare will be higher than on his original area due to the spreading of overheads and the capital costs of plant and buildings.

But any analysis of long term viability must look beyond current prices and yields. Of greatest immediate concern is the risk of phylloxera and its depressant effect on yields. If for reasons of phylloxera infection or other disease and/or prolonged adverse climatic conditions, a yield decrease of 25% occurred (i.e. down to 12 tonnes/ hectare), the residual income after debt servicing at the 50% level would change from $13,233 to a mere $415 from the whole 8 hectare block. And phylloxera may have a greater yield effect than the 25% drop used here - this level in itself requiring the owner to complete extensive redevelopment. Of equal importance is the risk of oversupply of grapes. Unlike Australia, we do not have an alternative outlet for an oversupply of white grapes (the dried fruit industry) and would have to absorb the quantities in our wine industry or dump them. Even Australia in recent years has left up to 30,000 tonnes of mainly red grapes unpicked due to oversupply.

If oversupply does eventuate, then severe discounting for poorer quality and unwanted grapes could well occur, thus forcing average prices below current levels, and towards world prices. This may be caused by free trade agreements, poor export market development, or static consumption per head of New Zealand wine. Whatever the cause, future price reduction is a distinct possibility - particularly in real terms.

Based on the analysis used in this paper, a reduction of $50/tonne (only 11%) would reduce net income from the 8 hectare vineyard by $6,400 p.a.

And so to summarise the viability of the viticultural enterprise before turning to alternative land uses. Given average yields and current prices, the grape enterprise is viable but shows a percentage return on capital below market rates when owner's time and management are costed into the analysis. Use of high cost land severely constrains economic viability in terms of either debt servicing or return on capital, but expansion of an existing vineyard which does not require additional plant and buildings will strengthen the viability of the total unit.

The established grower is in a much stronger economic position than the newly establishing grower as his land purchase and development costs (and their associated debt servicing) were at less than current levels in absolute if not real terms. But both growers face uncertainties. Phylloxera infection and/or price reductions due to oversupply. And should either or both occur, then both growers may experience significant income reductions with the new grower hard pressed to draw a living from a small block of 8 hectares.

The interest rate of 131 %o used in this analysis is also below market rate, and some of the machinery component is included as low cost second hand plant. It is not a high cost regime that has been analysed, and where new machinery and current market interest rates are applicable, the 8 hectare vineyard will quickly reduce its economic return to a level of wages or less.

After debts have been repaid, a much higher return to the owner eventuates, but after deduction of payment for owner's time and management, this still only represents a 12% return on the total capital involved where land is included at $10,000/hectare. Of course, as debts are repaid, equity in the property increases, and providing oversupply or disease factors do not occur, asset value will increase to at least the value of land, buildings and development costs. In other words, while debt repayment is included as a cost, it is not lost as equity increases as loans reduce.

And now to look at land use alternatives. Livestock and cropping enterprises on small high cost land areas - even deer farming - do not return sufficient profit to be competitive with viticulture. Only perennial horticulture is seen as a competitive land use, but some forms of this can be excluded quickly due to lack of economic viability stemming from low prices, oversupply and inadequate market research and promotion. Berryfruit (in particular boysenberries) is one such crop. Those enterprises strongly competitive with viticulture include apple production, kiwifruit and stonefruit.

Without going into the same level of detail as the analysis of grape growing, I will comment on each.

Stonefruit falls into two sections - fresh market and processing.

The processing side is now (again) in oversupply, but those with contracts are protected at least until the contracts expire. Those without contracts are facing re-development, and are being encouraged to remove trees in blocks through a payment per tree being made by the main processing company. Fresh market stonefruit is a fairly specialist enterprise, and annual viability fluctuates markedly according to climatic conditions, auction floor prices, availability of export markets, and gradeouts to export. It is a relatively high cost enterprise in terms of labour, packing materials and freight.

Fresh market stonefruit is difficult to analyse due to fluctuating market conditions and the ever changing varieties and market demand. The good growers who are supplying established markets with a good varietal range and quality are reaping excellent returns. But the smaller grower relying on local gatesales and some market floor sales has large income fluctuations between years, and during periods when supply exceeds demand for a variety. So a clear cut analysis of the stonefruit industry cannot be made on a long term basis, but under good market conditions, can generally be said to be more profitable than grapes.

The pipfruit industry is backed by a strong export orientated marketing organisation. A very specific pricing system is operated, and market preference and demand for varieties is exhibited through the price levels set annually. However, it is an industry which is sensitive to cost/price squeezes, and maintenance of adequate grower incomes in the past has seen some very sizable Apple and Pear Board trading deficits occur.

Profitability of a well balanced pipfruit orchard runs at about $1.1 per packed carton of fruit, but this profit must meet debt servicing, drawings, tax and further developments. As with the grape growing enterprise, it is the debt servicing facing the new grower which severely constrains the viability of the enterprise.

Taking an 8 hectare area of land costing $20,000 per hectare (and this is low on current trends), annual debt servicing on land, buildings, development costs at the 50% equity level plus accumulated debt in the early years amounts to more than $30,000 per annum by the time the trees are nearing full production at 8 years. If the orchard also has a packing shed, then this cost escalates even higher.

Production from an 8 hectare orchard by year (8) would hopefully be 30,000 cartons, but on the basis of the profit of $1.10 per carton, debt servicing reduces profit levels to zero. Increasing yields as the trees get older would slowly increase the profit margin, but prices would have to increase very markedly to return an average profit margin over the first 15 years of production in the order of even 5% on capital.

So, is it any wonder that the two groups of individuals planting new pipfruit areas involve established growers on the one hand, and syndicated groups on the other. Both have income from other sources, possibly with associated high taxation. They can stand the prolonged period with no income, and thereby reap the substantial capital gains associated with the development.

Some may ask the profitability of buying a pipfruit orchard at full production. An 8 hectare block of preferred varieties would sell for at least $300,000 all up, and debt servicing at 132% p.a. over 15 years on only half of this amount totals $24,000 p.a. And so to the boom industry - kiwifruit. Again, a longer lead in time to production, and development costs per hectare similar to grapes in the first 2-3 years. But at full production (about six years after planting) an average crop of 20 tonnes per hectare would gross about $270,000 per 8 hectares on current and gradeouts and price. Deducting all direct costs including packing, the return is still in excess of $140,000 from the 8 hectares. With debt servicing similar to grapes of up to $20,000 p.a. at a 50% equity level, there is no comparison in economic viability.

But it is a boom industry, heavily dependent on an unsaturated world market for its high levels of return. And therein lies the unanswerable question of kiwifruit's long term viability. Now to review the points I have made in this paper and if possible reach a conclusion.

With the possible exception of kiwifruit, a new grower entering the horticulture industry faces a very difficult economic situation unless he has accumulated substantial capital. He is facing land prices which are higher than their productive values for most perennial horticultural enterprises, and this combined with the high cost of debt servicing on purchase and development ifnance nearly exhausts the income from the crop for at least the first ten years. Any downturn in price (in absolute or real terms) will rapidly erode what little profitability there is.

On the other hand, those expanding their enterprises, or those entering the industry with alternative income sources and tax problems have distinct advantages. Overheads are spread or shared, debt servicing is reduced because development is financed by income and tax savings, and generally speaking, the objective of operating for capital gains rather than income can be realised.

And established growers in the industry are generally in a good position, as their purchase and development costs were much lower in real terms than those being incurred today. With specific reference to the grape growing industry, I suggest that many grape growers are facing a somewhat uncertain future. The threat of phylloxera and the resultant need for redevelopment is part of it. So is the risk of price depression due to oversupply of grapes, particularly if industry protection reduces, and/or if export markets are not forthcoming. The high costs of land, pressured ever upwards by the value of kiwifruit production, and by the capital gains seekers in the Queen Street professions, make it extremely difficult for a new, full time grape grower to get into the industry.

I lay the blame for the lack of viability squarely at the feet of inflation. Unrealistically high land values and high rates of interest constrain the viability of all but the most profitable horticultural enterprises. Cheaper land, further away from the traditional growing areas is now being planted to overcome the debt servicing problem, but often the land quality is inferior and requires greater input of development finance to realise economic levels of production. Development in Central Hawke's Bay - first with process cropping and now with perennial horticulture - certainly provides the proof that high land prices on the Heretaunga Plains have made economic production very difficult. Grape growers must get behind their industry to ensure that the viability of established growers is maintained.

Phylloxera resistant rootstocks must be used. Increased research into high producing clones suitable for export wine production must occur, and a unified effort to establish export markets is a must. Research into the export of grapes, or grape juice concentrate to the likes of Japan must be undertaken.

But little, I fear, can be done to hold the land price and inflation on development costs, and this does not provide a very rosy future for young potential fulltime growers wanting to get into the grape growing industry.

Questions and Answers

K. R. Crone and J. King

G. Hilton, Auckland

Q. I would like to congratulate Mr King initially on his excellent paper, it's a pity we didn't have two weeks or so to observe it before commenting on it. Phylloxera has been well known in the Auckland region for some time and then why with the fairly recent establishment down in the Hawke's Bay area didn't they use resistant strains in establishing their areas of vineyards. I don't know who would like to answer that question. But I would like to give one question to Mr Crone, how does he convince existing contract growers to change their varieties when those varieties lose favour?

K. Crone

A. Well to answer the second question first, that situation has not arisen yet. When we recommend grape varieties to growers we are convinced they are going to grow those varieties for a long time. Now it might turn out that we are wrong but obviously we would have to, if a problem did ever arise, we would have to work that out between ourselves and the grower. Well we don't see any major problem in that direction; however, varieties have been very carefully selected for future viability of our wine industry both for domestic markets and for export.

Maybe I can make a comment on the first question; the reason why grapes have been planted on their own roots is because there has not been the root stock available in the country to do a large scale grafting programme. The last ten years or so in Poverty Bay and Hawke's Bay has . seen relatively wet summers and phylloxera has had very little effect whatsoever on production under those growing conditions. The last two summers have been relatively dry and the phylloxera is having some effect on production but it is still at a fairly economic level, even in Poverty Bay where it is supposed to be devastating everybody. Now, it could well be that if we have another three or four dry summers vineyards will slowly decline. The answer to it all we don't really know yet. A lot of growers are thinking about replacing their vineyards, there is a chemical which is not yet registered for use against phylloxera but it is effective against phylloxera and hopefully it will become registered in N.Z. and this chemical once it is used should at least see growers through the next ten years and then during that time they can slowly replant their vineyards if they want to. We at this stage are not in a particularly great panic about the situation.

J. King

A. Just to follow up on Keith's comments; a new person getting into the industry faced with plant costs, for example for 20 acres, (8 hectares) if the grafted root stock was available. He's looking at $30,000 as against cuttings at approximately $2,000. So he looks at it and weighs up his chances and $28,000 saved in development costs, and heads for cuttings. It's always been a Ministry of Agriculture policy to advise that they should be planting the resistant root stocks. Fingers have been pointed towards the Ministry in the Poverty Bay area in recent months but in all our publications and in all our work we definitely advise that plant root stocks should be used, if they are available. Now the other point is that the word `panic' often comes in because phylloxera and panic both start with a `p', and as a result of this there was a survey done of the Poverty Bay area. Now that survey showed that 76% of the blocks had phylloxera and that 46% had some yield reduction associated with it and the average yield reduction over the whole 76% that were infected was estimated at 6%. So it is not of dynamically disastrous proportions as yet. There is an aerial survey being conducted in Hawke's Bay I think this week, but there is a lot of worry associated with the phylloxera and I do know that a number of growers are putting in orders for root stocks for the next year and two years to be able to replace bare areas that they want to replace in the first instance, to change the varieties over to a better variety.

Judy Lenart, Wellington

Q. I heard something on the radio this morning about Penfolds offering 25% premium on grapes in this area. I had the impression from Mr Crone that the contract thing was pretty well tied up but there is a suggestion there that it possibly isn't. What I would like to know actually is; is there a shortage of grapes in New Zealand?

K. Crone

A. Yes, in answer to your question, right now there is a shortage of grapes in N.Z. If you look at the volume of wine made and the tonnes of grapes harvested there is a shortage. Many wine companies probably at this stage don't have a chronic shortage but obviously some wine companies have got more grapes than others and Penfolds are short of grapes and that's why they are offering higher prices for them just to get any uncommitted grapes. There are not very many uncommitted grapes in Hawke's Bay. There have been a few in Poverty Bay. There are a number of growers who in fact operate with no contracts. In the last few years they have been getting extremely good prices for their grapes. As soon as Penfolds get the volume of grapes they require the spot market pressure for grapes will decline.

J. King

A. Just a word concerning the base price for grapes. The Hawke's Bay price I think is $458 as the base price for grapes for this season for the Reisling Sylvaner generally accepted bench mark variety. This price increases as the bricks levels increase per unit. The base price in Poverty Bay is only $393, but Penfolds price pays a premium of over $100 a tonne to catch up the market that is uncommitted. Also up there I understand they have a new juicing plant and they are very anxious to get the volume through put for that juicing plant to justify the operation of it in this particular ifnancial year.

R. Speedy, Napier

Q. Assuming that a variety say that has been planted now doesn't go out of fashion, what would be the economic or the life of a grape vine? If it was still a good market from a production point of view.

K. Crone

A. On its own roots unfortunately the long term life of a grapevine does not look all that marvellous. We have got phylloxera. It's inevitable that it's going to affect every vineyard in Poverty Bay and Hawke's Bay. It depends on weather patterns. If we have a prolonged spell of dry summers, it's going to affect it a lot quicker. I would suppose about 15 years for present vineyards, if they were grafted probably 30-40 years, who knows it maybe even longer.

G. Mclndoe, Gisborne

Q.Mr King, you indicated that if a grower wanted to transfer from non-resistant root stocks to resistant root stocks, he would have a 4 year time delay. Is it not feasible to interplant his established vineyards with resistant root stocks and therefore reduce the non-productive period?

K. Crone

A. Yes, unless the grower wants to change his grape variety and there is a possibility, he does want to change his grape variety. There are a lot of palaminos growing in N.Z. at present that there might not be a great demand for it in the future, as we change from sherry type production to table wines. But that's how we would envisage growers doing it if they were changing their vineyards over. They would in fact interplant. If they have got phylloxera in the vineyards obviously the grafted vines, even though they are grown amongst normal growing vines, they are going to grow extremely well because the other vines are weak. If the phylloxera is not having much effect on their existing vines, well interplanting is okay, it's a bit of a struggle but it will work, but they will sacrifice a year or two of production because they will have to pull the old vines out before the young vines are completely ready to take over. But if there is a bad phylloxera situation no problem at all.

K. Parker, Napier

Q.Mr King painted a somewhat dismal picture for admittedly new growers going into the market, meeting the high land costs and high establishment costs, whereas Mr Crone painted a somewhat happier picture for, admittedly, there again more established growers. What I am trying to get at is. Are there in fact any new growers getting into the market at the present time?

1. King

A. Very few that are getting in on a full time basis starting with very little money. There are, for example, some on a scheme similar to the 85% settlement loans through the rural bank for farming. There are very few that are actually managing to do that. There are some who are going into sharing arrangement, a partnership with the sleeping partner, or where it is a son of an established orchardist or grape grower who has finance behind him from father or parents. But it is a very difficult situation to get into. Having very little money trying to go grape growing, waiting for that number of years to reach full production even at only four years and facing very high development costs right from the start. Even in that one there, that 8 hectare area that we were looking at, with at $20,000/hectare which is still land priced lower than on the Heretaunga Plains. We are talking $280,000 capital for 20 acres. Now it's not really feasible for the young person trying to get in to have much more than $50,000 or $60,000 to get in at the 50% debt servicing level that we were looking at in that particular instance. He is going to have saved something in the order of $140-150,000. Well if you have got that sort of money it's probably better to go to Central Hawke's Bay or Wairoa or somewhere like that and buy more land.

K. Crone

A. I would have to go along with those comments, but at the same time we are currently having to turn people away from wanting to grow grapes for us. Really I suppose what I was saying, and it's probably a little bit obscurely put. You have got a lot of traditional land use here in Hawke's Bay the same as Poverty Bay. There are a lot of people just running sheep upon land and there are a lot of people still growing for Watties. Land is being used for all sorts of things that are really not at all profitable, and really all that is happening is that people are changing their land use from a less profitable enterprise to a more profitable one. They are going from low income crops and going into things like horticulture with grapes. And that's where our grape growers are coming from. It's just not possible for a young fellow to go out there and start a vineyard. And this is true of the other enterprises such as apples and kiwi fruit. And the unfortunate thing is that especially in the kiwi fruit industry I feel young fellows should be involved in the industry and they should be running their own small block of land. I think that the kiwi fruit industry would be very successful that way. Ultimately our grape growers who have large acreages of grapes may in fact pull some of them out once they have reached high taxable incomes from grapes and they will redevelop into much higher value crops per acre such as avacados and kiwi fruit. I hope it doesn't happen but I think it is inevitable, and there is sort of just a general flow through the land usage. It's an unfortunate fact of life but not everybody can become a farmer in N.Z. If you haven't got the land now you have got no show. Whether that's good or bad I'm not sure.

J. King

A. I would just like to also point out that virtually every time land changes hands for its new capital gains price it intensifies one step further. You have still got a lot of land on the Heretaunga Plains that is carrying sheep. The next time it is sold it will go one step further in its intensification. In the 10 years I have been here I have seen land go from sheep to process cropping to grapes to kiwi fruit, etc., each time it changes hands. Well now with very high land pricing associated with it, it is now going to be usually a jump direct from sheep and cattle grazing right through to the most profitable crop, to justify the purchase.

The Effect of Inflation on Value

By Michael D. Carpenter and Donald S. Shannon

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The double digit inflation of recent years has caused large increases in the cost of constructing and operating income-producing properties. Frequently, these costs have increased at a faster rate than that of rental incomes. Despite these conditions, rent controls are becoming more popular (See page 36 of The Wall Street Journal, February 1, 1980). Thus it is imperative that a clear understanding of interaction of rents and expenses and values be achieved.

Jaffe and Sirmans [2] have recently examined how simultaneous changes in rents and expenses affect valuation. Their analysis assumes that rents and expenses remain constant in all future periods after the current period during which the change takes place.

This paper will carry their analysis a step further by proposing an alternative model where rents and expenses grow in each future period. The impact of changes in these growth rates on valuation of income-producing property will be assessed. The implications of this model will be compared to recent experience in national income and expense summaries prepared by the Institute of Real Estate Management [1].

Valuation Model

The income approach to valuation is based on the concept that value is determined by the present value of future after-tax cash flows. Predictions of these cash flows require estimates of gross income, the vacancy factor, operating expenses, depreciation schedules and an appropriate capitalisation rate. One method of obtaining these future estimates begins by assessing the current market rents and operating expenses for comparable space. The appraiser may then rely on experience and judgement to estimate future rates of growth in these items. In the model used here the reversion value of the property is implicitly considered by discounting the cash flows over the entire economic life of the project.

The capitalisation rate should include the return required by the creditors and the required rate of return of the investor. One method of determining this rate is known as the mortgage-equity or band of investment method. Since the mortgage is normally self amortizing, an adjustment for principal payments should be made to the capitalisation rate. The Ellwood procedure adjusted for taxes is one method that can be used to find this basic rate. However, in the process of using the Ellwood method to find the capitalisation rate, no adjustment should be made for appreciation or depreciation since the model used here has already taken appreciation or depreciation into account by discounting the cash flows over the entire economic life of the project.

The above model may be expressed in algebraic symbols by the following equation.

$$V = \sum_{t=1} \frac{[R_0(1+a)^t - E_0(1+\beta)^t](1-z)+D_t-I_t}{(1+k)^t}$$

Where V = the value of the property
R_0 = the initial rental income
a = the growth rate of rental income
E_0 = the initial operating expenses, including depreciation'
β the growth rate of operating expenses
the tax rate of the investor
D_t the depreciation expense of the property during year t
I_t = the investment in capital improvements during year t
k = capitalization rate
n = the economic life of the project

If the appraiser can make accurate estimates of the parameters of Equation 1, the value of the income-producing asset can be determined. This is easier said than done.

In order to simplify the estimation requirements, it is sometimes assumed that the depreciation expense equals the necessary investment in capital improvements (i.e., $I_t = D_t$).

In addition to this assumption we will tentatively set the growth rate in rent equal to the growth rate in expenses (i.e., $a = \beta$). Then Equation (1) becomes:

$$V = \sum_{t=1}^{n} \frac{(R_0-E_0)(1+t)}{(1+k)^t} \quad (2)$$

To see how this model relates to other familiar valuation methods it is first necessary to consider some restrictions. If taxes are ignored ($t = 0$) and no growth is assumed ($a = 0$), the numerator becomes the popular net operating income (NOI), which is stable or constant for all future years. Under these conditions Equation (2) becomes:

$$V = \sum_{t=1}^{n} \frac{NOI}{(1+k)^t} = \frac{NOI}{k+s} \quad (3)$$

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where s is the sinking fund factor required to produce $1 in n years at k rate of interest 2 This will be recognised as the annuity recapture method.

When n is very large as in the case of non-wasting assets, the sinking fund factor reduces to a negligible number which can be ignored, and the value of the asset in question is found by simply dividing the NOI by the yield or cost of capital. k.

The major difference between these more familiar forms and the model proposed here is that here the growth rates in rent and expenses are not assumed to be zero. In Equation (2) the growth rates are equal and greater than zero (i.e., a = (3>0) and taxes are considered. When n is very large this equation simplifies to

$$V \quad \frac{(R0-Eo)(1-i)(1+(x)}{k - a} \quad \text{or} \quad (4)$$

$$V \quad \frac{(1-OER)R,, \ (I-i)(1+a)}{k - a}$$

where OER is the operating expense ratio (OER = EORo).

Equation (4) is similar in form to the growth stock model used in corporate finance and investments where the growth rate in the net income is subtracted from the discount rate when capitalizing current income.3

When The Growth Rates Are Equal

While it is unlikely that the growth rate in rent will equal the growth rate in expenses, the simplicity of Equation (4) can provide some convenient preliminary insights. Under these conditions even a slight increase in the rate of growth of income and expenses results in unreasonably large increases in the value of the property. For example, if OER = .4, R, = 100, T = .5, then the initial year's after tax income is $30. If the rent is assumed to remain constant in future years (a = 0) and a 10% yield is desired, then:

$$V - \frac{(1 - .4)\ 100\ (1 - .5)\ (1 + 0)}{.10-0} - \frac{\$30}{.10} - \$300$$

Thus, this model suggests that the value of the property would be $300 as long as the growth rate were zero. However, if a growth rate in rents and expenses of three percent a year had been used, so that the after tax annual incomes are $30.00, $30.90, $31.83, $32.78 etc., rather than a stable $30.00 in each future year, the value of the property would increase to:

$$V = \frac{(1 -.4)\ (100)\ (1 \ +.03)\ (1 - .5)}{.10 - .03} - \$441.43$$

an unrealistic 47 percent increase in value.

One might expect the capitalisation rate, at least in the long run, to increase and offset the growth rates caused by inflation. If we assume that the growth rate of incomes and expenses increases from zero to three percent and the capitalisation rate from ten to thirteen percent, then the value of the property still increases to:

$$V - \frac{(1 - .4)\ (100)\ (1 + .03)\ (1 - .5)}{.13 - .03} \ \$309$$

a three percent increase in value. Thus, even if capitalisation rate increases by the same absolute amount as the growth rate in rents and expenses, this model implies that the investor will receive, in the above example, a one-time increase in his return of three percent because of the increase in the value of his property, plus thirteen percent due to the relationship of the new cash flows to the adjusted property value. The type of increase will occur whenever the growth rates and capitalisation rate increase by the same amount. It is interesting to note that the reverse will be true if the level of growth is reduced. This reversal may be even more severe if the investor is locked into a high rate of interest on his long-term financing.

When Growth Rates Are Not Equal

The above examples make the assumption that growth rates in rents and expenses are equal. However, expenses will normally increase at a faster rate than rents due to the investor's inability to pass through all of the increasing costs of inflation and higher maintenance costs because of the aging of the property. As a result, the marginal expenses will exceed the marginal revenues at some point in time causing the building to have a finite life.' The economic life of the property (n) can be identified as that year when the marginal expenses equal the marginal revenues from this project. That is:

Ro (1 + a)" = E,, (1 = (3)°, which implies that:

$$n = \frac{\ln OER}{\ln (1+a) -- \ln (1+(3)} \qquad (5)$$

When the assumptions of an infinite life and the equality of the rates of growth of rents and expenses are dropped, then Equation 1 reduced to Equation 6.

$$V = \frac{IRo(1+a)(1-r)}{k - a} \left[1 - \frac{(1+a)^n}{1+k} \right] - \frac{R,, OER(1+(3)(1-i)}{k} \left[1 - \frac{1+}{(1+k} \right] \qquad (6)$$

Thus the value of the property is a function of a, (3, k, and OER. As long as the change in the rate of growth in rents is equal to or exceeds the change in the growth in expenses, the value of the property will increase. The value of the property will decrease as the O.E.R. or the capitalization rate increases.

1. Depreciation in this context refers to the depreciation expense claimed for income tax purposes.
2. See appendix one for a derivation of equation three.
3. For example see Van Horne [4] pages 31 - 33.

Tables 1 and 2 have been prepared to present a clear view of the cash flows implied by Equation 6.5 In this model the growth rates in revenues and expenses need not be equal, so in the first case rents are presumed to be a stable $100,000, the operating expense ratio is 50 percent and expenses grow at the rate of nine percent per year. (These conditions are obviously hypothetical and were selected purely for illustrative convenience). In this set of circumstances, level rents but increasing expenses, the asset would be expected to have a relatively short economic life. As shown in Table 1, the expenses would exceed the rents in year nine.

TABLE 1

Cash Flows and Value When OER = .5
R,, = 100,000, (3 = .09, and a = 0.

Year	Revenue	Expenses	NOI	Present Value
1	100,000	54,500	45,500	41,364
2	100,000	59,405	40,595	33,550
3	100,000	64,751	35,249	26,484
4	100,000	70,579	29,421	20,094
5	100,000	76,931	23,069	14,324
6	100,000	83,855	16,145	9,114
7	100,000	91,402	8,598	4,412
8	100,000	99,628	372	174
			Value =	149,516

* The capitalisation rate used in this table was k 10%.

Discounting the cash flows in the example yields a present value of $149,516, which is the same value that Equation 6 will produce if the following values are used: = 0, = .09, OER = .5, = 0, k = .1 and R 100,000.

TABLE 2

Cash Flows And Value When OER = .5
Ro = 100,000, (3 = .09, and a = *.0234.**

Year	Revenues	Expenses	NOI	Present Value
1	102,340	54,500	47,840	43,490
2	104,735	59,405	45,330	37,462
3	107,186	64,751	42,435	31,882
4	109,694	70,579	39,115	26,716
5	112,261	76,931	35,330	21,938
6	114,887	83,855	31,032	17,516
7	117,576	91,402	26,174	13,432
8	120,327	99,628	20,698	9,656
9	123,143	108,595	14,548	6,170
10	126,024	118,368	7,656	2,952
11	128,973	129,021	(48)	(16)
			Value =	211,198

* the capitalisation rate used in this table was k = 10°%o

4. The careful reader will notice that the assumption It _ D, has not been relaxed. We continue to assume that capital expenditures *are* being made in amounts equal to the tax depreciation expense. We are now, however, assuming that tax depreciation is equal to *economic* depreciation. Thus it is not inconsistent to presume the life of the asset is finite even though It = D,. Likewise, it is not inconsistent to suggest that the operating expenses consisting of routine maintenance (such as painting, utilities, management fees, insurance, property taxes and the like) are increasing under inflationary pressure, despite the fact that some capital expenditures are being made.

5. In order to minimize the differences in the valuation model and the typical stabilized income models utilized by many appraisers the tax rate in the example and in the following sections has been assumed to be zero and the before tax capitalization rate has been used.

Table 2 has been prepared to show the effect of changing the growth rate in rents. All the parameter values are the same as in the prior example except that the growth rate 2.34 per cent is used for rents. As would be expected, the economic life of the building would increase somewhat (from 8 to 11 years) and the GIM would also increase, from 1.5 in the prior case to 2.1.

Relationship of Growth Rates to Valuation

Given the above results, a question of interest is at what rate must the rents increase in order that the project not lose value. Equations 5 and 6 were used to determine an answer to this question for various rates of growth of expenses. Instead of discussing value, we will refer to the gross rent multiple, i.e., the GIM = V/Ro.

TABLE 3

Growth Rates in Rents Required To
Produce a Gross Rent Multiple of Seven*

Growth Rates In Expenses	Operating Expense Ratio 30%	40%	50%
3.0%	1.1%	2.1%	2.8%
4.0	1.6	2.6	3.4
5.0	2.1	3.2	4.0
6.0	2.7	3.8	4.7
7.0	3.3	4.5	5.4
8.0	3.8	5.2	6.2
9.0	4.4	5.8	6.9

* The capitalisation rate used in this table was k = 10%.

Table 3 shows the combination of growth rates which support a gross rent multiple of 7. For example, if the current operating expense ratio is 40 percent and expenses are increasing at eight percent annually, then rents must increase at 5.2 percent in order to justify a GIM of 7. As one would expect, higher growth rates in rents are necessary in order to maintain value as the growth rate in expenses or operating expenses ratios increase.

The particular values shown in Table 3 simply show some combinations of conditions which produce a GIM of seven. We do not intend to say that any of these particular sets of conditions exist, although some may.

Some of the conditions we can observe are presented in Table 4. As would be expected, as the age of the project increases, so does the OER. This, in turn, implies that older projects will sell for lower GIM since it is not likely that rents will grow at a sufficiently high rate to offset the effects of the higher OER's.

TABLE 4

Operating Expense Ratios
For Years 1972 75

Year Built	1972	1973	1974	1975	Average
1946-60	47.70/,	52.2%	50.3%	50.8%	50.280/,
1961-67	45.0	45.7	46.5	46.7	45.98
1968-75	*42.0*	41.9	43.7	44.9	43.13

Source: Income/Expense Analysis - Apartments, Condominiums and Cooperatives, (Chicago, Illinois: Institute of Real Estate Management. 1976 Ed.). pp. 11-13.

Columns (3) and (5) of Table 5 present the results of using Equations 5 and 6 when the OER is increasing while the GIM is decreasing. For example, if one were to buy a building with an OER of 40 percent and expenses growing at eight percent, the investor would need to plan to increase the building rent by 5.2 percent annually in order to justify a GIM of seven. That is, the growth rate in rents would have to be 65 percent of the rate of increase in expenses. If instead of this purchase, the investor decided to purchase a building with an OER of 50 percent and expected expenses to increase at a rate of eight percent the investor would need to plan to increase his rents by 5.8 percent annually in order to justify a GIM of six. This rate of growth in rent is 73 percent of the growth rate in expenses. If this level of rent increases is not possible, then the investor should not purchase the building or should offer a lower multiple.

TABLE 5

Growth Rates in Rents Consistent With Various Combinations of GIM, OER and a Capitalisation Rate of 10%

Growth Rates In Expenses (1)	GIM = 8 OER = 40% (2)	GIM = 7 OER = 40% (3)	GIM = 6 OER = 40% (4)	GIM = 6 OER = 50% (5)	MIN ' o (6)	MAX o/P (7)
5.0%	3.7%	3.2%	2.7%	3.6%	54%	74%
6.0	4.3	3.8	3.3	4.3	55	72
7.0	4.9	4.5	4.0	5.1	57	73
8.0	5.6	5.2	4.6	5.8	58	73
9.0	6.3	5.8	5.3	6.6	59	73

A comparison of Columns (2) and (3) of Table 5 reveals that the GIM that can be used for a project increases with larger growth rates of rents. Columns (3) and (5) show that the GIM decreases as the OER gets larger, despite larger growth rates in rents. However, reading down the table indicates that the growth rate in rents does not need to equal the growth rate in expenses in order for the value of the project to remain the same. For example, the combinations in Table 5, the percentage of the growth rate in rents to the growth rate in expenses ranges from 54 (2.7/5.0) to 73.3 (6.6/9.0) percent.

Table 6 presents the results of using Equations 5 and 6 when the capitalisation rate is increased to 12 percent. The functional relationships that were revealed in Table 5 have not changed. The growth rate in rents still does not need to equal the growth rate in expenses in order for the value of the project to remain the same. However, the percentage of the growth rate in rents to the growth rate in expenses now ranges from 65 (5.9/9.0) to 90 (4.5/5.0) percent. This appears to be a considerable shift in range until one recognises that the higher cost of capital is not consistent with the lower rates of expense growth in Table 6. If the growth rate in expenses is constrained to 7 percent or more, then the range is 65 (5.9/9.0) to 80 (5.6/7.0) percent, which is similar to the results presented in Table 5.

TABLE 6

Growth Rates in Rents Consistent With Various Combinations of GIM, OER, and a Capitalisation Rate of 12%

Growth Rates In Expenses (1)	GIM = 8 OER = 40% (2)	GIM = 7 OER = 40% (3)	GIM = 6 OER = 40% (4)	GIM = 6 OER = 50% (5)	MIN a/4 (6)	MAX o/4 (7)
5.0%	4.5%	4.0%	3.4%	4.3%	68%	90%
6.0	5.0	4.6	4.0	4.9	67	83
7.0	5.6	5.2	4.6	5.6	66	80
8.0	6.2	5.8	5.2	6.3	65	79
9.0	6.9	6.4	5.9	7.0	65	78

Some Observations

In order to obtain some insight into how realistic the above model is, data from the Income/Expense Analysis published by the Institute of Real Estate Management is presented in Table 7. The table shows rents and expenses per room, for 1972 and 1975, and the OER's and growth rates implied by these numbers. The last column shows the percentage of the growth rate in rents to the growth rate in expenses, which falls between 67 percent and 76 percent. For reasonable multiples the difference in this range of actual ratios and the ranges of ratios given by the model in Tables 5 and 6 are quite small. Thus, if we assume that during the period 1972 to 1975 owners of low-rise units of 25 units and over have been able to at least maintain value with ratios between 67 and 76 percent, the model results of a range of 54 to 80 percent for reasonable multiples appears quite realistic.

TABLE 7

Summary Of Changes in
Rents and Expenses
1972 through 1975

	1972		1975		Growth Rates		
Year Built	Expense Per Room	Rent Per Room	Expense Per Room	Rent Per Room	Expenses (a)	Rent 1)	o4
1946-60	$292.07	$611.86	$354.76	$698.68	6.7%	4.5%	67%
1961-67	233.23	518.19	270.98	580.64	5.1	3.9	76
1968-75	224.56	534.15	279.52	622.27	7.6	5.2	68

Source: Income/Expense Analysis Apartments, Condominiums and Cooperatives, *(Chicago,* Illinois: Institute of Real Estate Management 1976 Ed.) pp. 11-13 pertaining to low-rise of 25 units and over.

Conclusion

From the results of the model presented in this paper and data published by the Institute of Real Estate Management, it appears that in order to maintain value, one must be able to increase rents at a rate which is about 70 percent of the growth rate in expenses. Because of the assumptions of the model and data problems, it is difficult to say much more. However, one could be confident that if the investor were able to raise rents at a rate which was 80 percent of the growth rate in expenses, the investor would be increasing his wealth. On the other hand, if the investor can only manage to raise rents at a rate which is 50 percent of the growth rate in expenses, he may well be losing wealth.

APPENDIX 1.

The present value of a constant stream of NOI over n years can be found by

$$V = \sum_{t=1}^{n} \frac{NOI}{(1+k)^t}$$

or by the popular equation

$$V = NOI \left[\frac{1 - 1/a}{k} \right], \text{ where: } a = (1 + k)$$

V=NOI aka l =NOIk(a a 1)+kj=N0Ik+sl

where: s = a k

Sources

1. Income/Expense Analysis - Apartments Condominiums and Cooperatives. (Chicago Illinois: Institute of Real Estate Management, (1976.)

2. Jaffe, Austin J. and Sirmans, C. F. "The Relationship Between Growth Factors, Operating Expense Ratio, and Valuation" The Real Estate Appraiser, July August 1978, pp. 30-34.

3. Van Horne, James. Financial Management and Policy. (Englewood Cliffs, New Jersey: Prentice Hall, 1980).

4. Wall Street Journal, February 1, 1980, p. 36.

Legal Decisions

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IN THE HIGH COURT OF NEW ZEALAND
HAMILTON REGISTRY

IN THE MATTER of the Public Works Act 1928

AND

IN THE MATTER of a claim to compensate for lands taken by proclamation

BETWEEN THE TAUPO TOTARA TIMBER COMPANY LIMITED
Appellant

AND: THE CROWN
Respondent

Hearing: 8th December 1981

Counsel: P. F. Feenstra for Appellant
V. R. Jamieson for Respondent

Judgement: 18th December, 1981

JUDGEMENT OF BISSON, J. and
RALPH FRIZZELL ESQ.

This decision of the Land Valuation Tribunal at Hamilton, in February 1981, became the subject of an appeal to the High Court, resulting in the "inflation adjustment" payable on compensation awarded being increased from 7 *1%* compounding to 10% compounding.

The High Court also emphasises the necessity of arriving at compensation for land taken using the "before and after" approach, rather than treating the land to be taken in isolation.

The appellant was the owner of land situated in the city of Hamilton which was taken by the Crown under the Public Works Act, 1928 for the purposes of a motorway, the amount of compensation being determined by the Land Valuation Tribunal at Hamilton on the 21st February, 1981 at $90,000, being the value fixed by the Tribunal as at the 20th October, 1975 when the land was taken. As the Crown had paid $25,000 towards compensation, a balance of $65,000 was payable to the appellant in terms of the Tribunal's decision. The Tribunal refused to allow 10% compound interest on the amount payable to off-set the effect of inflation but allowed interest of 72% from the 20th October, 1975 down to the date of payment of the balance payable. The appellant had originally sought $69,396.20 as the balance of compensation due but at the hearing was granted leave to increase its claim to a gross amount of $164,200. The land taken comprised 3.7109 ha which is approximately 9.17 acres. This land was part of a block of land acquired by the appellant in 1965 for subdivision into residential sections so as to promote its other business interests. A scheme plan for the subdivision of all the appellant's land had been drawn up prior to the registration by the Crown against the title of a proclamation on the 9th November, 1967 defining the middle line of the Hamilton Eastern By-pass Motorway. The evidence does not disclose whether the scheme plan of subdivision had been approved by the Hamilton City Council but nothing turns on that as it was accepted that such a subdivision, as planned, would have become a reality. The appellant's land was undulating with some gullies but these natural features were intended to be used to advantage in contouring the land into desirable residential sections, the more elevated of which would command a view of the Waikato River. At the hearing, contour models were produced showing the lie of the land when it was originally acquired and then as it would appear when the development works for housing sites had been completed and finally showing the modified plan with the development that had taken place as a result of the land taken for the motorway. A claim for injurious affection was abandoned at the hearing before the Tribunal because the Crown had reimbursed the appellant for the cost of a loop *road* it had constructed to serve the remainder of its subdivision. The land taken by the Crown for the motorway was mainly a deep gully and the Crown according to the Tribunal's decision argued that it was not an economic proposition for subdivision except for some 13 sites which could be provided on opposite sides of the gully, the balance of the gully being left as undeveloped terrain. Mr Millar, a registered valuer called on behalf of the appellant, assessed the value of sections over the whole of the appellant's original scheme of subdivision at an average sale price of $12,500 each. He took into account sales of sections in other subdivisions but the Tribunal did not consider them comparable as they were in a generally superior area and preferred the evidence of Mr East, a valuer called on behalf of the respondent, who assessed section prices for the hypothetical subdivision of the land taken at an average of $10,000 each and it appeared to the Tribunal that his figure would also accord with Mr Bell's view. The Tribunal's assessment of compensation at $90,000 was calculated as follows:

Gross Realisation	
35 Lots at $10,000 per lot..........	$350,000
Less Legal and commission 35 lots at $400 per lot........	$14,000
	$336,000
Less Profit and Risk at 33; of outlay	$84,000
Outlay	$252,000
Less Development Expenses and other costs 35 lots at $4,600 per lot	$161,000
	$91,000
Less Legal and Stamp Duty	$1,000
	$90,000

Mr Feenstra for the appellant submitted that the Tribunal's decision was erroneous in fact and in law and said that the Award should have been for the amount claimed, namely, $164,200 with compound interest at 10% to off-set inflation and that the costs allowed of $500 inclusive of witness's expenses were quite inadequate and should be increased. Mr Feenstra's main submission was that the Tribunal having accepted that the appellant's scheme plan of subdivision would have provided 135 sections, after contouring the land in the gully taken for the motorway, then applied the Crown's approach in arriving at the value of sections in a hypothetical subdivision of the land taken for the motorway without such sections being developed in the way originally planned by the appellant.

Secondly, Mr Feenstra submitted that the Tribunal had made errors in its own calculation by applying a figure for legal costs and commission based on sales at an average figure of $12,500 when it had made its calculation on the basis of sales at $10,000 per lot. There had also been an error, he said, in taking $4,600 for the development expenses and other costs so that according to Mr Feenstra's calculations, instead of a figure of $4,600 there should have been a figure of $4,150 deducted per lot.

Mr Feenstra's third submission was that the Tribunal was wrong in not allowing 10% compound interest to offset inflation. He relied on Drower v Ministry of Works and Development (1980) 2 NZLR 691 in which the judgement of the Court comprising Davison CJ, R. J. Maclachlan Esq. and R. Frizzell Esq. had considered six possible approaches in determining how the claimants were to be compensated for being out of part of their compensation monies for varying periods of approximately 5 years. The Court adopted what is described as the Coomber approach which reflected the decision of Speight, J. and R. J. Maclachlan Esq. in Coomber v Birkenhead Borough Council (1980) 2 NZLR 681. In that case the Court allowed as compensation to the plaintiff for being out of part of his compensation for a period of time a sum calculated at 10% per annum compounded on the amount due. In adopting the Coomber approach, the Court in Drower held at P 695:

> "We have decided to apply the Coomber approach to the assessment of compensation in this case. We do so because we recognise the inflationary pressures evident in the community at the present time and consider that some regard should be had to this matter in fixing the proper sum to be paid by way of compensation where claimants have been kept out of their money over a period of time."

After giving its reasons and reviewing the various indicies over the relevant period the Court then said at p. 696:

> "These considerations indicate to us that by using the Coomber calculation of 10% per annum compounded we will be allowing for inflation proofing which might reasonably have been achieved by the claimants had they had their money in 1975."

The Drower decision had not been delivered when the Tribunal considered the Coomber decision. The Tribunal expressed its view of that decision as follows:

> "It is obvious from that judgement that the novel approach taken by the Court, if indeed it can be said that the ultimate formula used, of 10% compound interest, amounts to what might be termed inflation indexed compensation, was the result of "the Council's procrastination." There is no suggestion of any procrastination on the part of the Crown in this case and indeed the Crown has responded on the evidence before us, with the utmost diligence to all overtures made by the applicant company with commendable alacrity."

Mr Feenstra submitted that a decision whether to allow compound interest to off-set inflation did not turn on the question of whether there had been procrastination or delay on the part of the Crown. It was not to be regarded as a penalty against the respondent but as part of full compensation in terms of s. 42 of the Public Works Act, 1928.

In conclusion, Mr Feenstra submitted that the Tribunal should not have accepted a value of $10,000 per section because he said the Crown's assessment of the value of the sections in the gully land taken for the motorway treated them in isolation instead of as part of the original plan of subdivision for the whole of the land. The Crown's scheme for a subdivision without recontouring the gully was entirely unreal as such a subdivision would never have taken place in that form. Mr Feenstra described the decision as a "hybrid decision" because while accepting the gully subdivision and the overall subdivision were not comparable and that the overall subdivision would have been carried out and that the appellant had lost 35 sections, it then departed from those findings by not accepting that the value of the sections lost was their value based on the average value of the sections in the original development plan.

Mr Jamieson in reply submitted that the decision ought to stand although it had not been entirely in favour of the Crown. Mr Jamieson accepted that there were mathematical errors and if a strict approach were required adjustments would be needed with regard to the costs mentioned by Mr Feenstra if section values were reduced from $12,500 to $10,000 each. Mr Jamieson submitted that the land taken for the motorway would have been the more costly to develop because of the steepness of the gully and that the appellant had been spared that higher cost so that the remainder of the subdivision would have been less expensive when taken on its own, resulting in a higher profit on those sections. In other words, the part of the subdivision which remained was easier to develop and therefore less expensive to develop and would command the best prices and not have to carry the more expensive development work for the land taken by the Crown which would have created less valuable sections in any event. Mr Jamieson submitted that in taking the higher figure for development costs, the Tribunal had been reasonable in its approach because there would have been a greater saving to the appellant through not having to do the development work on the land taken and that in any event there, was no exact amount known so that the figure accepted by the Tribunal could be regarded as a fair estimate. Mr Jamieson said that as the Crown accepted that the appellant had lost 35 sections the question simply was what was their value? He said that Mr Millar had taken sections over a wide range including the Bryant Trust and the northern end of the subdivision to arrive at sale prices over a period of 12 months prior to the taking of the land whereas the Crown had relied on Mr Bell and Mr East who had listed sales closer in time to the relevant date and all within one area of the appellant's own subdivision and that the average prices were from $9,750 to $10,000 per section was a proper finding by the Tribunal. Mr Jamieson argued that one could not compare sections with a good view and superior location with sections which would have been created in the gully taken for motorway and that Mr Millar had not taken an average to arrive at a figure of $12,500 per section, but had arrived at that figure after increasing the average sale price and then applied it to sections in the gully area which, as Mr Jamieson put it, was "loading the dice" too much in favour of the appellant.

As to the claim for compound interest, Mr Jamieson submitted that there had been a delay of 20 months on the part of the claimant to set down the case after receiving a final offer which it declined in March 1978 and that there had been a gap following the proclamation to the lodging of the claim so that, in this case, the time lapse was the responsibility of the claimant, and not of the Crown, which made it unfair to the Crown to pay compound interest.

In reply, Mr Feenstra submitted that although the Tribunal accepted the before and after approach, it had only paid that approach lip-service as it had not accepted the consequences of it and he criticised Mr Jamieson's submission that a strict arithmetical approach was not required when making calculations to arrive at section values. Mr Feenstra submitted that there had not been any undue delay on the part of the appellant and that it should not be penalised by being refused compound interest to which it was entitled as compensation for a loss it would otherwise suffer as a result of inflation.

We are in agreement with Mr Feenstra's submission that we are required in this instance to arrive at the amount of compensation payable by the use of the "before and after" method as being the most appropriate. This claim has a very close similarity to the circumstances surrounding the case of Prestige Homes Corporation Ltd v Ministry of Works heard by the Land Valuation Court in May 1968 where a portion of a sizeable holding in the process of residential development was required for a school site. The taking of the school site from which 32 lots could be subdivided as an individual area reduced the total number of sections capable of being developed over the whole area "Before" from 237 to 200 "After". The loss of 5 sections on the residual area as a result of the work was an injurious effect which could only be taken into account by a Before and After valuation and this was the approach adopted by Archer, J. in his decision.

Although in this case Mr Millar's evidence does not make a similar comparison of injurious effect, he does in his evidence indicate that because of the increased development costs which would be incurred in his after valuation these may indeed be injurious effects and this was not seriously challenged.

With the greatest respect to the Tribunal, we are unable to accept the method it adopted of making a valuation of the land taken by dealing with it by means of a hypothetical subdivision in isolation and using costs and prices which are apparently related to those over the whole "after" subdivision.

Mr Bell and Mr East for the Ministry of Works valued the land in isolation and on this basis because of the contour were unable to produce more than 13 saleable sections. We consider their approach was also in error.

We must now therefore turn our attention to the valuations of Mr Millar as the basis upon which a decision can be reached.

The total development costs and expenses adopted by Mr Millar in his Before valuation was $4,542 per section and $4,604 in the After valuation. In the limited subdivision of Messrs Bell and East the total development costs and expenses were $3,910 and $3,477 respectively.

Mr Millar's figure is of the order of about $750 per section higher than the average figure of Messrs Bell and East and it also based on the assumption of there being significant earth movement in contouring the land to maximise utilisation.

Mr Millar's roading costs are nearly actual, being based on the part completed work on the property itself. No other matters in Mr Millar's development costs were questioned in cross-examination including the allowance for interest and this being so we prefer Mr Millar's costs to those of Messrs. Bell and East as a basis upon which to work.

All three valuers were closely cross-examined by Counsel on the average value they placed on each of their hypothetical subdivision section prices.

Mr Bell placed values of $9,750 and $10,500 on the northern and southern portions of his subdivision and supported these values by eight sales in Totara Drive, Morrow Avenue and Sandwich Road area at prices from $8,500 to $11,800 between June 1975 and February 1976. These sales consisted of three front sections averaging $9,330, one corner site at $11,000 and four rear sites averaging $9,450.

Mr East did not produce comparable sales evidence in written form but in oral evidence indicated his average value of $10,000 per section was based on seven sales in Totara Drive and one sale in Morrow Avenue. These sections ranged in price from $5,600 to $12,750 during the period from September 1974 to March 1976. The average price was $8,900 which he subsequently increased for what appeared no valid reason.

Mr Millar used an average price of $12,500 on all the saleable lots in both his Before and After valuation and supported this value with a schedule of 28 sales in the Totara Drive, Morrow Avenue St Andrews Terrace, Madill Road, Wilfred Avenue, Sandwich Road, Challinor Street locality at prices ranging from $9,000 to $20,000 between September 1974 and March 1976. The average price was $11,035. He subsequently increased this to $12,500 for reasons which are difficult to follow.

We inescapably reach the conclusion that the evidence of Mr Bell is to be preferred in that his sales represented a fair cross-section of sections likely to be produced from this land on its western extremities and including most of the more contoured land in that area.

The land to the north of the motorway would have a proportion of sections with some direct and elevated river views as well as virtually flat sites and we accept that these sections overall would have a somewhat higher valuation than those to the south of the motorway. The value we consider which should be placed on the sections is $10,750 in the Before valuation and $11,000 in the After valuation to allow for the greater desirability of sections on average once the motorway area is severed from the whole.

Mr Birdsall in evidence considered that the motorway area could have been developed at a similar cost of roading to that of the remaining area at a price of $3,800 per chain and Mr Sheran, the successful contractor carrying out the development was of the same opinion. Neither of these witnesses however had gone into a detailed costing of the hypothetical development of the motorway area.

Mr Frost estimated that it would have cost $53,500 more to develop the motorway area than would have been the case for average roading or approximately $3,300 additional for each of the 16 chains of roading involved so that his estimate of roading cost was approximately $6,900 per chain for this 16 chain length.

We are convinced that there would be additional costs involved in this motorway area over and above the average cost on the remaining area and we favour Mr Frost's opinion but not to the extent claimed.

We consider that the additional roading costs which should have been used by Mr Millar in his Before valuation should have been at the rate of $1,500 per chain over the extra length of 16 chains above that costed at $3,800 per chain in the After valuation.

We therefore determine the Before valuation as follows:

Gross Realisation - 153 lots at $10,750			$1,644,750
Less Commission	153 x 293.75		
Legal	153 x 66.25		
	153 at $360.00		$55,080
			$1,589,670
Less Profit & Risk 331 of outlay			397,420
	Outlay		$1,192,250
Less Development Costs			
Interest at 10% for 12 years on outlay		$178,840	
Reserves at 5% of gross realisation		$82,240	
Roading		$ 305,200	
Other costs assessed by Mr Millar		$109,960	
		$676,240	$676,240
			516,010
Less Cost of Purchase			6,010
Block Value (Approx. $15,000 p. acre)			$510,000

We also determine the After valuation as follows:

Gross Realisation - 118 lots at $11,000		$1,298,000
Less Commission 118 at 300		
Legal 118 at 65		
118 at $365		$44,070
		$1,253,930
Less Profit and Risk 33$% of Outlay		$313,480
r		
		$940,450
Less Development Costs		
Interest at 10% for 1 2' years on outlay	$141,070	
Reserves at 5% of gross realisation	$64,900	
Other costs assessed by Mr Millar	$308,950	
	$514,920	$514,920
		$425,530
Less Cost of Purchase		5,530
Block Value (Approx. $16,800 p. acre)		$420,000

The value of approximately $15,000 per acre as a block value before the work and $16,800 per acre after the work can usefully be compared with a sale of Morrow/Brian Perry Ltd. for $90,000 in May 1976 at a price of approximately $12,550 per acre for inferior but land subsequently also developed for residential purposes.

Before Valuation	$510,000
After Valuation	$420,000
Compensation payable	$90,000

Having arrived at the total loss sustained by the appellant, we do not find in this case it is necessary to try to divide the loss suffered between the land taken and the injurious effect and/or betterment which may have occurred to the residual area.

It so happens that our assessment, although made on a different basis, accords with that of the Tribunal but there remains the question of an adjustment because of inflation. We accept the submission of Mr Feenstra that it is proper that in this case we should apply the formula used in Drower in recompensing the appellant for delayed payment. We accept the Tribunal's view that the Crown had acted with commendable alacrity but the Tribunal did not find that the appellant had procrastinated or caused unreasonable delay. It is not a case of penalising either party. It is a question of assuring the appellant full compensation provided he has not been the cause of undue delay. It should not be assumed that a claimant will automatically receive compensation to cover inflation from the date of the proclamation down to the date of the Award in all cases. Each case will call for consideration of the extent of and the reasons for delay. We have considered the intervals of time referred to by Mr Jamieson and do not consider them excessive in the particular circumstances of this case. The application of the Drower formula is not unfair to the Crown which has enjoyed both the land and the use of its money while the appellant has had neither. Because of the evidence of inflation in the Consumer Price Index it would be grossly unfair to award the appellant compensation in 1981 assessed at 1975 values without regard for the depreciated value of our currency in 1981. The respondent made payment of $25,000 on the 17th February, 1977. We see no occasion to allow for inflation in respect of this amount but only in respect of the unpaid balance.

We therefore determine that the Award of compensation should include 10% compound interest on the unpaid compensation of $65,000 from 20 October, 1975 being the date at which values are fixed until 18 December, 1981 when this judgement is delivered. This further compensation amounts to $52,044.

The appeal is allowed and the Tribunal's award of $90,000 with interest at 71% on the unpaid balance of $65,000 is discharged. In lieu thereof this Court awards total compensation of $142,044 being $90,000 plus $52,044 of which $25,000 has been paid leaving a balance of $117,044 payable as at the date of this judgement.

With regard to the appeal against the costs awarded by the Tribunal this Court would not lightly interfere with the Tribunal's discretion as to costs but would if it considered the Tribunal's discretion had been exercised on a wrong principle. Costs in respect of claims for compensation under the Public Works Act are covered by s.64 of the Finance Amendment Act, 1939 by virtue of which the Tribunal should have ordered the respondent "to pay the costs of the claimant" unless there were special reasons such as an unreasonably high claim. No special reasons were advanced in this case. In our view, the Tribunal failed to have regard to this statutory provision in fixing costs at $500 "inclusive of witnesses expenses". Witnesses expenses as fixed by the Registrar should be paid as such and a figure for costs fixed separately. Accordingly, the appeal against the quantum of costs is allowed and it is ordered that the decision of the Tribunal be amended to read "the applicant is entitled to costs which we fix at $500 together with disbursements and witnesses expenses as fixed by the registrar."

The appellant is entitled to costs on his successful appeal which we fix at $500 together with disbursements as fixed by the Registrar.

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Printed by The Daily Telegraph Co. Ltd., Tennyson Street, Napier.

ISSN 0027-7282