THE NEW ZEALAND VALUERS' JOURNAL

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The New Zealand VALUERS' JOURNAL

MARCH 1990

Contributions with a biographical note of the author should be typewritten and sent to the Editor, PO Box 27146, Wellington, who reserves the right to accept, decline or modify material. Views expressed by the editors and contributors are not necessarily endorsed by the New Zealand Institute of Valuers. Copies of manuscript should be retained by the author as they cannot be returned. Deadline: two months prior. Business letters, subscriptions and advice of changed address should be sent to the General Secretary. The mode of citation of this volume of *The New Zealand Valuers' Journal* is (1990) N.Z.V.J. March page.

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Guest Editorial

Voluntary Membership

The Government has given clear signals of its intentions in respect to the profession of valuation in its *Review of Occupational Regulation : Valuers,* released in September 1989, the subject of the *Discussion Paper* circulated to all members of the Institute in October 1989 with the Referendum on the *Future Structure of the NZIV.*

Voluntary or compulsory membership is clearly the crux of the issue. The essence of the status quo position is the retention of the legislative requirement for all registered valuers under a state certification system to also be members of the Institute and therefore come under the influence of the Institute's Code of Ethics and Standards, as being the best way of maintaining public protection.

The referendum results indicate that the membership sees little advantage in changing this aspect of the regulation of valuers, 372 or 67% of the 554 respondents (the latter representing 27% of the total membership) supporting the status quo. It may not represent the majority of the membership, but is surely indicative. 121 or 22% of respondents favour self-regulation. Only 61 or 11% of respondents support the Government position.

However *IF* the Government sticks to its policy and brings in voluntary membership in terms of its current proposals, *THEN* there is a major swing of support to self-regulation 385 or 69% of respondents in the referendum.

The conclusion is that our membership likes what it has now, doesn't like the Government proposal and faced with voluntary membership would prefer to opt for self-regulation (i.e. no state certification).

The main concerns expressed in the comments accompanying the referendum responses centre around the likely increase in costs to the profession of funding the proposed state certification and especially the disciplinary functions. The recurring response was that if the Government considers the public need protection in this form then they should pay for it. To lumber those members who choose to seek state certification with the total cost would make it prohibitive, and be totally counter-productive to the Government's stated aims of reducing consumer transaction costs. Though 311 or 56% of the respondents indicated they would retain state certification most of these were subject to the comment that it would depend on the cost and the market requirement or need to be so certified.

Government, however, to open up competition in valuation services, also intends to review the need to legislate for certain work to necessarily be undertaken by registered or certified valuers.

This would only serve to reduce the need for such state certification! Surely this is a classic case of the Government, on behalf of the public, shooting itself in the foot.

Notwithstanding these criticisms of the Government's proposals, we need to prepare ourselves for voluntary membership as whether we like it or not the change may be forced on us. We need to consider carefully if it would be all that detrimental. Surely it is the *state certification* proposal, not the *voluntary membership* aspect that is ill conceived.

I believe that voluntary membership would not, in itself, be detrimental but beneficial to the health of the Institute. 468 or 85% of respondents indicated they would remain members of the NZIV, though many with the proviso that the costs and benefits would be paramount considerations. However, we currently have a significant element of non-active and "dead-wood" members who given the choice, would see no personal benefits in continued membership, but like pruning a fruit tree to encourage growth and the quality of fruit, the Institute would emerge a stronger and more dedicated professional body. Members would be more active in requesting and being prepared to pay for affordable services that they demanded, while achieving higher level of standards and public recognition than under the present system.

As an Institute we must have a policy that while preserving the majority views of its members, allows a leadership that can foresee changes as they are coming up, be flexible enough to change with the times and anticipate the inevitable. Some changes must be pursued whether or not we actually get voluntary membership, such as increasing standards, improved disciplinary procedures, continuing professional development, and cost effective services to members etc.

If a compromise with Government can be achieved, to maintain public confidence in a state certification system with full support and participation of Institute members, both current and future, then it is essential that the Government at the very least must continue to substantially fund that public protection element of the proposals - i.e. the disciplinary function.

Rodney Jefferies, President

Membershp

List of Fellows of the New Zealand Institute of Valuers

The recently published Index to New Zealand Valuers' Journals 1942-88 has revealed that a number of Fellowships that have been awarded to members have not been recorded in the journal over the years and a complete list of living Fellows has therefore been compiled as follows:

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Archbold D J 0 02/05/88
Armstrong D J 15/04/84
Ashby I H 15/04/75
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Dodd H M 15/04/62
Donaldson R M 30/05/75
ElsmoreS W 15/04/56
Farrell J P 15/04/52
Faulls A P 15/04/50
Findlater M J 01/05/77
Fitzgerald E T 08/04/89
Flux P A 07/09/54
Foote G A 01/01/86
Ford A K 17/04/72
Foster R D 17/01/85
Foster G T 13/04/86
Fright R H 04/06/65
Gamby M E L 13/04/86
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Gibson A E 06/07/76
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Horsley G J 15/04/83
Jansen S R 15/04/72
Jefferies R L 01/04/79
Jenkin N C 15/04/68
Jensen R H 02/05/88
Kingston J R 09/04/73
Kirkcaldie G 08/04/89
Laing A P 15/04/82
Larmer J P 30/05/84
Lingstone R R N 23/02/70
Long A D 20/10/69
Lord R 01/04/76
Lugton D B 13/04/86
Lyall I W 01/04/83
MacPherson J 0 06/08/69
Mahoney P J 27/07/82
Marshall B A 08/07/54
McDonald H F 14/04/87
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Minchin R W H 14/04/80
MolesworthT F 01/09/72
Monds7 F 01/09/72
Moore G S 15/04/71
Morgan J P 01/04/77
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Oldfield J H 14/04/87
Omundsen J E 13/08/48
Osborne G 01/04/74
Ower D K 15/04/73
Ozich S 16/11/48
Pearse H C H 22/10/47
Pedrotti A W 15/04/60
Poole B G A 15/04/76
Powdrell J D 15/04/60
Pyne A F 15/04/59
Ralston S W A 01/04/74
Rawcliffe T 01/04/85
Reid C G 13/09/56
Riley R G 22/12/82
Robertson B J 03/11/76
Robinson A N 14/04/87
Robinson P R 13/09/78
Roper GC 21/11/83
Rowse G W *19/03/74*
Sale V S 20/12/84
Sceats ER 06/07/73
Scholefield G W H 08/04/89
Sharp GH 22/05/75
Sharp J R 02/05/88
Sinclair J R 09/11/65
Smith OB B 30/05/69
Sole L M 20/11/51
Speedy R D 07/07/76
Speedy S L 06/06/69
Stabler J A 02/05/88
Stewart A G 13/04/86
SvensenM L 30/04/78
Tabor G 07/07/76
Telfer IR 16/05/85
Tetzner S A 09/10/50
Tierney P E 15/04/76
Veale J B H 14/04/80
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Wallace R J 15/04/60
Wafters J A 14/04/87
Whale G E 13/04/86
Wilson A R 16/04/78
Wilson A R 15/04/65
YarntonG K 15/04/52
Young R P 15/04/76

NZIV Study Award Papers

The following are the synopses of two study award papers completed in 1989.

A SYNOPSIS OF *AN ANALYSIS OF THE TRENDS IN COASTAL RURAL LAND VALUES IN WHANGAREI COUNTY*

by I C Parsons

The project was prepared as part of a valuation special topic paper for the Diploma of Business Course at Massey University.

The aim of the project was to identify whether any premium is being paid for farmland with coastal frontage within the Whangarei County, and if so, what is the purchaser's motivation for such payment.

The method involved analysing rural sales (all rural properties excluding small holdings as categorised by Valuation New Zealand), within the county over the 1985-88 period.

The sale properties were located and grouped into coastal and non-coastal classes (coastal frontage being actual ownership of the coastal line) and then analysed using Valuation New Zealand records and personal inspection.

Indices such as the price per hectare and stock unit were derived and importantly the sale price as a ratio movement on the Government Valuation. It should be noted that for the coastal properties the Government valuation capital value has a coastal influence proportion built into it. This is expressed as a rate applying to the coastal frontage derived from sales evidence, and over and above the going rate for similar farmland or (backland).

The results of this analysis indicated that for all the sales with coastal frontage premiums were paid over and above that paid for similar non-coastal farms. On average this equated to an average 70% value increment over the inland properties. Of significance was that in a period of decline in farm land values coastal blocks sold on average for 27.33% (even with the coastal portion built into the GV) above Government valuation, whilst inland properties showed a 9.50% decrease.

The conclusions of the paper indicate that purchasers were prepared to pay premiums for the coastal properties for the following reasons:

(a) The nature of the coastline itself having great scenic beauty and recreational potential and its proximity to the large population pool in Auckland.

(b) The demand for the blocks far outweigh supply thus imparting the excellent investment potential of the properties, with values on average showing a 20% compound increase per annum.

(c) The farming potentialities of the properties is secondary to the recreational and investment attributes. Whilst bona-fide farms with coastal influence are purchased for a premium, the nature of the farm and its annual income producing capabilities are heavily discounted in comparison to the aforementioned recreational and investment factors.

(d) It was found that sandy coastlines are the most valuable. However any class of coastline is desired, particularly if it is private with open seascape views. The particular type of coastline and hence price paid for it depends on the personal objectives of the purchaser, eg anchorages, fishing and surfing potential, etc.

(e) Development restrictive coastal zoning is no deterrent to value. With the conservation orientated planning policies protecting the coastline from intensive development, there is no detrimental effect on the coastal properties value. The ability to obtain private beaches, etc, seems to be enough incentive to pay significant premiums.

In summary the findings of this project relate to the Whangarei County coastline and whilst its location and physical makeup are unique it is contended that the findings have parallels with other rural coastlines in the country, eg the Coromandel Peninsula and the Bay of Islands.

Ian Parsons is currently employed as a Valuer at the Hamilton office of Valuation New Zealand.

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A SYNOPSIS OF *THE VALUATION OF TOURIST HOTELS AND TAVERNS IN NEW ZEALAND*

by D Humphries

Tourism in New Zealand has historically been of a cyclical nature and over the past decade enjoyed a relative boom period. Tourism is an attractive proposition to be involved with. It is a high user of labour, a high earner of foreign exchange and produces a high level of total direct and indirect added value to Gross National Product. This prospective growth will create more jobs throughout the tourist industry, including a greater demand for valuers with expertise in hotel appraisal.

Tourist Hotels

Growth in the new New Zealand tourist hotel industry has escalated over the last five years. In the past "hotel investment has been neglected because of the unprofitable nature of the industry".

Due to the upsurge in world tourism, this is now changing, and there is a need for huge amounts of "capital investment to develop tourist hotels".

New Zealand is fast becoming part of the international network of tourist hotel chains, and with the major benefits that will occur from reduced interest rates, a reliably low level of inflation and possible reductions in the value of the New Zealand dollar, this will lure overseas investors such as the Asian and Japanese, who are seen as the major source of funding for the industry in the future. Asian and Japanese investment philosophies correspond to the conditions of large commitments and long term expectations of a return, which are apparent in hotel investment.

Taverns

Two major breweries, New Zealand Breweries and Dominion Breweries, presently have oligopoly of ownership of taverns throughout New Zealand as the effect of regulations make it largely unprofitable for ownership by individual operators. With the possible rationalisation of NZ Breweries and Domin-

ion Breweries coupled with the possible liberalisation of the liquor licencing structure in New Zealand we may see an increasing number of independently owned taverns throughout the country.

Methods of Valuation of Licenced Premises

The best methods for ascertaining the value of licenced premises was seen as:

1. the evidence of actual sales; and
2. capitalisation of true rack rentals obtainable from leasing the premises.

1. Market Comparison Approach

This approach assesses the market value of a hotel by comparing it to recent sales of comparable properties, making adjustments if necessary for the differences that exist between them and the subject property. The reliability of this approach depends upon the availability of comparable sales data and the extent of these adjustments. It is also important to carefully consider the date, terms and conditions of each particular sale such as share swap deals, deferred payments and vendor financing arrangements. Because of the difficulty in obtaining driect comparisons, this approach is more useful in the setting of broad parameters. For a large and complex property such as a tourist hotel the required adjustments can be so numerous and so difficult to estimate that all that can be done is to bracket the value and not provide an exact estimate from the date, which in many cases will be unsupportable.

2. Depreciated Replacement Cost Approach

This approach will determine the realty value of a licenced premises, assessing the value of land to its value as an operational hotel site, and the replacement cost of the improvements less accrued depreciation and obsolescence where necessary. Hotels are particularly vulnerable to all types of depreciation and obsolescence and this estimation requires considerable subjective and unsupportable considerations that the credibility of this approach is suspect.

3. The Income Approach

The income approach is the primary method of ascertaining the value of a hotel property. It conforms best with the various court decisions and principles that have been handed down in he past 40 years with regard to hotel valuations.

The income approach is concerned with the present worth of all future benefits. Maintainable income streams are analysed from the hotel accounts and translated into a value by the use an appropriate capitalisation rate, derived from market evidence and activity at the time of valuation.

The income approach is based on analysis of operating records of the subject hotel, arriving at a pro forma budget of the maintainable income expenditure for the coming 12 month period.

The pro forma budget should take into account prospective trends in occupancy, tariff level, inflation effecting operating costs and maintenance provision.

It is the future maintainable income based on current income/monetary value that sets the basis for the current estimated income, which most influences a prudent purchaser/investor. The valuer is attempting to estimate a stabilised net income, one which should represent the current net income achievable over the property's economic life.

Depending on the type of hotel it can take two to five years for a new hotel to reach potential stabilised income.

Conclusion

Hotel valuation is a specialised area of valuation. Experience, sound judgement and consistency of analysis and comparison are essential keys to confidently and accurately assessing the going concern value.

It requires a thorough understanding of the operation of a hotel and all that concerns the profitability of the investment.

Dean Humphries is currently employed as a research analyst in *the Auckland office of Jones Lang Wootton Ltd.*

Proposal to Establish an Institute of Plant and Machinery Valuers in New Zealand

by Paul Agius

The NZ Institute of Valuers is in the process of setting up a professional body to promote and regulate the profession of valuing of plant and machinery.

The NZ Institute of Valuers has convened a small working party under the chairmanship of its vice-president, John Larmer, and comprising Paul Agius, representing the Association of Consulting Engineers (ASCE), and NZ Institute of Valuers representatives, Ken Parker and Earl Gordon.

This report outlines the current developments and the proposed approach.

1. Background

In New Zealand the standards for valuing land and buildings have been set and regulated by the NZ Institute of Valuers. For a long time there has been a need for a similar body to cater for the emerging profession of Plant and Machinery valuers. The NZ Institute of Valuers has had many approaches to take a lead in this area. In 1988 the NZ Institute of Valuers set up a committee to look into this question and report to the Council of the Institute. The Council in agreement with the Association of Consulting Engineers New Zealand (ACENZ) has now appointed the new sub-committee to progress this matter.

2. The NewZealand Institute of Plant and Machinery Valuers

The NZ Institute of Valuers intends to establish an affiliate body proposed to be called The New Zealand Institute of Plant and Machinery Valuers (NZIPMV). This Institute will shortly be inviting current practising Plant and Machinery Valuers to join and promote their own profession. The aims of theNZIPMV are as follows:-

a. To ensure that members of the Institute render the highest standard of service to the public;
b. To promote and encourage proper conduct among Valuers;
c. To suppress illegal, dishonourable, improper and objectionable practices;
d. To preserve and maintain the integrity and status of Plant and Machinery Valuers generally;
e. To provide opportunities for the acquisition and diffusion of knowledge in relation to the valuing of plant and machinery and kindred subjects;
f. To promote, support or oppose legislative or other measures affecting the valuing of plant and machinery or the business of any of the Institute's members;
g. To promote the close association and ultimate merger or similar connection of the Institute with other valuing institutions in New Zealand;
h. To provide means for the amicable settlement of professional differences;
i. To take or authorise such legal or other lawful proceedings as may be deemed necessary for the proper conduct of the valuing business;
J. Generally to protect and promote the interests of the profession of valuing and the interests of the public in relation to valuation of plant, machinery and kindred subjects, and to do all such other acts, matters or things as are, in the opinion of the Institute incidental to or conducive to the attainment of the objects of the Institute or the exercise of any of its said powers.

3. Classes of Membership

On a longer term it is intended that the New Zealand Institute of Plant and Machinery Valuers will have the same classes of membership as the New Zealand Institute of Valuers. However, initially there will only be two classes of membership, namely:-

a. Associate Member: This will be the corporate designation for membership, and those elected to this class of membership will be eligible to show their designatory letters after their names. The criteria set for election to this grade is:-
   (i) An applicant shall have been continuously employed as a Valuer to the satisfaction of the Management Committee for not less than four years prior to the date of his/her application; and
   (ii) An applicant shall pass a Test for Professional Competence "TPC".
b. Intermediate Member: This will be class of membership for all members not eligible to Associate grade. The minimum criteria set for election to this grade is:-
   (i) An applicant shall have been continuously employed as a Valuer to the satisfaction of the Management Committee for not less than two years prior to the date of his/her application; and
   (ii) An applicant will satisfy the Management Committee that he or she is of good character and reputation.

To obtain membership of the new Plant and Machinery Valuers Institute, all applicants must first apply for Affiliate association with the New Zealand Institute of Valuers. As affiliates of the New Zealand Institute of Valuers they will then have the right to apply to join the new Institute. Admission as an affiliate of the New Zealand Institute of Valuers is under rule 16 A(2) (c) (ii).

4. Long Term Plans

In the longer term the New Zealand Institute of Plant and Machinery Valuers will be promoting the establishment of a University Course to cater for young people wanting to come into the profession. It should also be possible for current practising valuers who wish to gain Associate grade to do courses to gain their Associateship.

5. Current Status

The sub-committee set up by New Zealand Institute of Valuers now advises all sectors of industry of this proposed new Institute and encourages all those involved in plant and machinery valuations to participate. Numbers are required to make the new Institute viable and office holders will be required to provide for the governance of the Institute.

It is intended that circulars will be forwarded to firms involved in valuation to encourage their staff to join. In the first place all potential members of the New Zealand Institute of Plant and Machinery Valuers must become Affiliates of the New Zealand Institute of Valuers. Rules for the transfer of members to the new Institute are presently being drawn up.

It is hoped that this move by the New Zealand Institute of Valuers will be strongly supported by all those involved in the valuation of Plant and Machinery. A

ROBERTSON YOUNG TELFER NZIV 1989 LECTURE TOUR

Valuations for Commercial Rent Review Purposes

Procedural guidelines and other commentary

by R TM Whipple

A paper presented by Dr R TM Whipple at the sponsored seminars held in Auckland on 1 September and on 5 September in Wellington.

The truth of the human intellect receives its direction and measurement from the essences *of things. For the truth or falsity of an opinion depends on whether a things is or is not.*
St Thomas Aquinas, *Questiones disputatae de spe, 1 ad 7.*

Introduction

The principles to be followed in valuations for rent review purposes are little different from those adopted in other assignments. To be sure, the challenges tend often to be greater, but these usually are surmountable by following the general logic advocated in the recent literature.

The purpose of this offering is to review the logic referred to with special emphasis on commercial rent reviews and to discuss a few issues which have been marked by misty thinking.

Define the Issue

Before accepting instructions, the valuer and the client should reach agreement on the issues that are to be addressed. Bearing in mind that the assignment has grown out of a dispute between the parties to the lease or may well be headed in that direction, it is vital to be clear on the issue(s) from the outset.

The details to be considered and the procedures to be followed will vary with the nature of the assignment. If called in to resolve a dispute, the valuer needs to establish if he is to work as an arbitrator or as an expert. It is not the aim of this paper to survey those matters (important as they are). Rather, the aim is to review the procedures relevant to assessing the rental value of premises pursuant to a rent review clause. It is irrelevant whether the valuer is acting for the lessor or the lessee.

While client instructions are important, of course, they assume a different hue in the rent review context. This is because the issues to be addressed should be set forth in the lease itself. Nevertheless, the terms of the lease bearing on the assignment should be discussed with the client so there is no doubt as to the valuer's task. In a sense, the lease is a third party at the meetings at which the nature of the issues to be addressed are defined and agreed upon.

Because of its central importance, the valuer needs to ensure that the lease handed to him is the final version actually executed by the parties. He should also be provided with any other materials incorporated into the lease by reference together with any other documentation bearing on the assignment. A survey report may be required if the premises are of an irregular shape.

To prevent any future misunderstandings, the valuer should confirm his instructions in writing, define the scope of the services to be rendered, confirm the lines of communication should further consultation be required, set forth the date by which the valuation is to be rendered, provide a fee estimate and other such matters.

In the vast majority of cases, the issue to be addressed will be the market rental value of the demised premises as at a specified date and matters bearing thereon. The effect of some exceptions to this will be noted in the sequel.

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State the Relevant Definition of Value

This should be set out in the lease. There is no assurance, however, that the definition contained therein is a straightforward one. Terms such as "reasonable rent", "best rent" and others have been considered in various court dicta and the valuer should be closely familiar with them all. A useful overview and guide to cases to be studied may be found in Farmer (1986).

Sometimes the lease will direct the valuer to seek current market rental value and then set out in some detail the matters to which he must pay regard and the matters he is to disregard. It is not uncommon for these matters to so constrict the definition of value that the result is anything but current market rental value as ordinarily understood. Such cases degenerate into studies in artificiality.

Nevertheless, the valuer who accepts this kind of task has little option but to square his shoulders and interpret the definition of value, hedged around with possibly all manner of qualifications, as best he can. Ten different valuers may well produce ten different interpretations and consequent monetary estimates because each may be called upon to endow the task with his own set of norms.

If, however, the draftsman has allowed the valuer sufficient scope to conduct himself in a manner befitting a professional, he will see his task as assessing the most probable rent which is most likely to emerge from a transaction involving the subject premises if exposed for rent in the current market for a reasonable time subject to the terms and conditions of the lease. In short, he asks the questions: "What can I rent these premises for?" Wherever possible, we recommend a pragmatic definition of value which of itself frees the valuer from making a host of unrealistic assumptions (the norms referred to in the previous paragraph).

The definition of value also determines the kind of data the assignment calls for. Until the value concept has been fixed with precision, data selection is not possible. Why? Because, in its absence, the valuer doesn't know what he has to assess. For example, take the case where the rent review clause directs the valuer to take account of the fact that the tenant is a sitting tenant and to assess the periodic payment a tenant will make so as not to be in default. Compare this with the requirement to assess the current market rent of the premises on the assumption that they are vacant and available to all comers in the market. Or, as another specification, to assume the premises are vacant and available to let for occupation as a lawyer's office only.

Each of these definitions requires quite different data. The first requires information on agreements reached between landlords and sitting tenants, with the latter under some pressure to agree a rent. The second demands data on recent lettings in the market place while the third calls for information on recent lettings of vacant space to lawyers. In each case, of course, the data must relate to comparable premises and lease provisions and parties thereto with similar motivations. Note carefully that each of these three assignments may result in three different estimates of what purports to be "current rental value" even if applied to the same premises.

It follows, therefore, that the correct definition of value is of crucial importance and results from a close examination of the issues to be addressed the first step in the process.

Determine the most probable use of the premises

This can be a tangled issue in valuations for rent review purposes. The important case law is reviewed by Farmer *(op cit),* to whom the reader is again referred. The *Plinth* case involved a sub-lease which was heavily qualified in many of its terms such that the existence of a restrictive user clause was held to apply on rent review. In the *Land Law* case, an open market letting with vacant possession was referred to in the lease and the user clause was held to be without force for rent review assessment purposes. The reader should study the cases themselves, of course, but these two examples illustrate how other provisions of a lease can bear upon whether a user clause should be ignored or not. Indeed, this observation applies generally because each clause has to be interpreted in relation to all the other clauses.

This also signals another caveat. The judgements usually relate to what may be termed "special purpose" clauses within leases which differ from each other. Thus, a particular judgement may not necessarily apply to the provisions of the lease at hand.

The application of a user clause can have a significant impact on the quantum of rent assessed on review as we shall discuss below. Therefore this is a most important issue which has to be determined before the valuer can proceed further. If the lease is ambiguous on this account or if the valuer has good grounds for suspecting that the courts may construe the clause contrary to how it maybe read by a layman, he should seek legal advice via his instructing client. This applies to any other aspect of the lease which could have a material affect on the value estimate. I cannot emphasise this point too strongly.

Whether or not the lease requires him to assume a specific use for the premises, the valuer must undertake a productivity analysis of the premises. This has several dimensions to it.

First, the valuer needs to define with precision the legal rights which run with the premises. This will be conferred by the lease as well as under the provisions of the relevant land, town planning, health, business licensing and other law. Such sources of law prescribe what can and what cannot be done. Do not neglect to search the title itself to identify restrictive covenants (if any). In this respect, the lease is usually the single most important determinant. It may specify not only use but also other matters affecting rental value: possibilities include hours of access to the premises, obligations such as contribution to building outgoings, responsibility for cleaning and so forth.

Second, the valuer needs to list and analyse the physical attributes of the premises. These embrace size, shape, area, state of repair and a host of other elements affecting the use and efficiency of use.

Third, a review should be made of the aesthetic attributes of the space and of the building and an assessment made as to how these affect value. In this respect, the quality and appearance of the building's lobby is of considerable importance along with the extent to which the building possesses landmark qualities and the enjoyment of views.

Fourth, a study should be made of the locational qualities of the building and of the space within the building. Not only are the accessibility characteristics of the building important but consideration also needs to be given to the location of the demised premises within the building. Matters to be checked on an inspection are reviewed by Heydon (1986) and need not be repeated here.

An important component of the locational study is to inventory the other areas of space competing on the market at the time. This review should be in terms of the relative marketing advantages and disadvantages of each and the competitive standing of the subject premises. Relative proximity to prime institutions and the ability of establishments to tap into and exploit the interactions between other establishments and use areas should be studied.

Productivity analysis is a review of the utilities and disutilities of the property being valued. It is a net concept and can be measured only in terms of the reaction of market participants to each of its components. A detailed knowledge of the market is therefore required of the valuer for he must avoid placing his own evaluation upon the features discerned: his task is to interpret the market, not to impose his own preference scale or norms unless this is absolutely necessary (a point we turn to below).

This part of the work leads to a set of inductions concerning the uses for which the space would be suitable. From this a ranking is made of the kinds of establishment likely to be attracted to it.

In this endeavour, the valuer needs to pay regard to the evolving pattern of land uses in the district. This follows from his continuing study of growth sectors (ie, kinds of establish-

ment registering a need for increased space) and mapping of the origin and destination of movements by establishments within, into and out of the market area.

The next step is to select from the set of likely uses the most probable one. This entails an identification of the major determinants of use in the relevant sub-market and an evaluation of how they are expected to impinge on the premises concerned. Such determinants could be expected to include market demand, legal sanction and rent paying ability. From these considerations, a considered judgement is made of the kind of use most likely to be attracted to the space being valued.

In the majority of cases (and this tends to set rent reviews apart from other assignments), the major use determinant is rent paying ability. It is a well established principle that different uses have varying capacities to pay rent. This is especially marked in the retail sector but applies also to commercial uses. Therefore, in the analysis of rents fetched recently in comparable accommodation, the comparison should be with those which are known to be able to sustain the same level.

Identify the most probable lessee (or type of lessee)

This necessitates matching the set of productivities identified under the previous heading with lessee requirements, their motivations and standing in the market.

Subsequent work can now concentrate on a narrower range of concerns and examine the process of price formation proper to the identified lessee or lessee-type.

Select the appropriate method of valuation

There are three intellectual (as opposed to methodological) approaches to the estimation of value. These are:

- inference from past transactions involving properties having similar productivities *and parties of similar motivation;*
- simulation of the most probable lessee's rent fixing regime; and
- normative modelling.

Inference from past transactions

The productivity analysis stage outlined above has the objectives of helping to identify the most probable tenant or tenant-type and also of discerning those attributes of the subject premises which generate rental value in the market place.

To ascertain the most probable level of rent, the valuer goes into the market place searching for other premises which have been rented recently, premises having value generating characteristics which are as similar as possible. He then proceeds by analogy, comparing like with like, feature for feature. The heads of comparison must, of course, be fundamental value determinants not mere accidentals. Motivation is certainly one of these: the outcome of forced agreements should not be ascribed to those deemed to be open.

Bear in mind that these characteristics extend to the invisible rights conferred under the lease. Therefore, the valuer needs to study the terms of the leases granted in each case to ensure points of similarity and points of difference are taken fully into account.

Whereas physical and locational features are susceptible of fairly objective analysis, one of the greatest difficulties in assessing rental value by the method of inference from market data is in ascertaining lease terms. Even more difficult is gaining a knowledge of the collateral arrangements (if any) entered into by the parties but excluded from the lease.

A useful review of kinds of evidence and matters bearing upon the quality of the evidence is offered by Baum (1986), to which the reader is referred. In view of this, a wide treatment is not required here. Rather, attention will be devoted to three broad areas:

- the use of rents agreed by other tenants on review;
- whether or not incentives offered other tenants at the time the subject rent review is being undertaken should be ignored; and
- the adjustment of data to take account of other market distortions.

Although not leading to a particularly efficient form of presentation, it will be useful to discuss the first two of these more or less in parallel because both feature largely in the case *BHP v AMP*. We now turn to an analysis of those aspects of that action.

BHP v AMP an analysis

The background to the matters of present interest is expressed at page 341 (page references are to the report published in *The Valuer,* Vol 29, No 4, October 1986, pp 340-347):

> During the time that the building of BHP House was contemplated and almost up to the time that its construction was completed, the evidence disclosed that there were boom economic conditions and a considerable shortage of city office space in Melbourne. Accordingly the rental market was no more favourable to new tenants contemplating the rental of city office space, than to existing tenants faced with rent reviews, and in discussing rents for valuation purposes, the valuers who gave evidence before me said that there was no distinction drawn at that time between rents that would be payable by new tenants and by existing or sitting tenants.
>
> However, it appears that by the time that BHP House became available for rent, the situation had changed dramatically so that, in order to attract new tenants, it became necessary for landlords to offer substantial discounts and incentives which would not subsequently be available to the tenant as a sitting tenant on the occasion of rent reviews.
>
> Therefore, a two tiered structure developed which has apparently persisted to this day so that, for valuation purposes it is recognised that rentals available to a new tenant are significantly lower than those available to a sitting tenant. This factor is of significance in the present case because it means that those drafting the 1971 agreements clearly couldnothave and didnot contemplated such a two tiered rental structure.

The strategic points made by His Honour were as follows:

1. Up until BHP House was virtually completed, the office space market was aggressively bullish. No distinction was made between rents negotiated for vacant space and those agreed on review.
2. Then the market changed "dramatically". To let space to incoming tenants, landlords had "to offer substantial discounts".
3. These "substantial discounts... would not subsequently be available to the tenant as a sitting tenant" on rent review.
4. "Therefore, a two tiered rental structure developed" whereunder sitting tenants pay more for rent on review than do incoming tenants.

We examine these points seriatim. At the time BHP House was completed, no distinction was made between space let as vacant and rents agreed on review. This is because the parties doubtless believed the words "current market rent" mean what they say: the figure which emerges as a result of competitive bidding at arm's length when there are many participants having full information, who are free to enter or withdraw from the market and who have available a range of alternatives to consider in the absence of agreement.

If these characteristics are missing one does not have a market. To the extent that they are present but not prominent,

one has a market which is less than perfect but it is still a market.

On rentreview, there cannot be competitive bidding because there are only two parties and they are not at arm's length they are bound by the lease. Usually the tenant has less information than the landlord but can purchase information at a fairly high cost. Neither party is free to enter the market at large because, as noted, they are bound by the lease. The landlord does not have a range of alternative tenants to choose from; nor does the tenant have a range of alternative accommodations to choose from.

Because the characteristics of a market are absent from the rent review process, the latter cannot constitute a market.

Against this it may be argued that, in the conclusion of a transaction, there are only two parties and their agreement constitutes the market price (or rent) of the article traded. Yet this overlooks the ability of either party to break off negotiations and seek satisfaction elsewhere if price agreement eludes them. This is impossible with rent review unless the lease contains a break clause enabling the parties to dissolve their contract in the face of disagreement as to the quantum of rent payable on review (but even then there are removal and re-letting costs which would act as a disincentive for either party to break).

The second point listed above concerned the need to offer space at a discount in the face of a soft market. With respect, this says nothing new. Elementary economics teaches that if there is insufficient demand to meet supply, price must be lowered if the commodity is to be cleared from the market. Given the state of supply and demand, the price required to clear the market is market price. As the supply/demand relationship changes, so market price will change which is to say that market value changes.

It is then noted that these "substantial discounts... would not subsequently be available to the tenant as a sitting tenant" on rent review.

This does not necessarily follow if the criterion on review is market rent. As there has been considerable confusion on this, some discussion is in order.

Take the case where a tenant moves into *a new* building. Leaving to one side for the moment the method of payment, the rent agreed will be market rent for *those* premises at *that* time. Why? Because it will have resulted from a process of competitive bidding. The characteristics of a market outlined above will have been present to a greater or lesser extent. Other space in comparable buildings will be let at a figure consistent with this. The actual level of rent will depend upon the supply/demand factors ruling at the time. If the opening of the building floods the market, the lessor will doubtless achieve a rent lower than if the market had not been so flooded. If that building adds markedly to supply, the rent fetched by other new buildings within closely linked sub-markets also will be affected. *Furthermore (and this is important), rents fetched for vacant space in older buildings which are close substitutes for vacant space in new buildings also will move accordingly.* This effect would ripple through the sub-markets, affecting rents according to the degrees of substitution with those only tenuously linked being hardly affected at all. What I have outlined in this paragraph is the mechanism of the market place (for a full discussion, see Grigsby (1963)). Rents fetched by areas which are close substitutes for each other are what valuers refer to as "comparable rents".

With the aid of two simple diagrams let us fix these points in mind for they are of great importance to the discussion. Refer to Diagram 1 first.

Building A has recently been opened and is renting up. Building B is an older building (a year or so, say) but is a fairly close substitute for A. Now that A is on the market, rents in B will have to be lowered to rent space therein because they are both competing for the same potential tenants. If the market is so weak that progressively greater discounts have to be offered to attract tenants into A, then rents asked in B will have to be lowered still further. Such rental changes in B would be reflected in rent reviews made at that time if they are determined as market rents. There could, of course, be tenants in A paying a higher rent because the market was firmer at the time of their negotiation but that's irrelevant to determining today's rental value.

A

B

DIAGRAM 1

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DIAGRAM 2

Assume A is now at 100% occupancy but there is still some space vacant in B. Rents negotiated in B will probably increase (because supply is now diminished) and this would likewise be reflected in rent reviews in B under the changed market conditions.

If there are no further additions to competitive supply and if there is no slump in business conditions, rents in A and B will probably increase and this also will be reflected in the level of rents agreed on review.

Later, building C comes on stream (Diagram 2). It is a closer substitute for A than is B but B is not a very close substitute for C. This is reflected by the relative length of the lines connecting A, B and C in Diagram 2 and the use of arrow heads. For whatever reason, some vacancies appear in A and B.

Depending upon the strength of demand, rental inducements may be offered to attract tenants into C. This affects rental levels in A by virtue of the close substitution link between them. Rental values in A ease in response and also in B but probably not to the same extent because its link is longer. At that stage of the proceedings, rents agreed on review in A and B would reflect the altered market circumstances.

With the structure as given in the illustration, recent rents for vacant space in A would constitute "better" evidence of market rental values in B than would the rents currently being fetched in C. So the comparison is with new buildings only when they are close substitutes. Recent lettings of vacant space in B would be an even surer guide, of course. The lettings in C would be a more reliable guide to setting rents on review in A than would lettings in B because A and B are now competing for the same occupiers.

The magnitude of a particular inducement would vary, of course, with the bargaining strength of a tenant: one seeking multiple floors would carry more weight than another who wants to rent a small area.

While the material just presented is an over simplification, it nevertheless illustrates how rents fixed on review also are subject to shifts in the market place. Recall our assumption that the quest is market rental value; if it is something else, it must be fixed outside the market.

Therefore the statement that these "substantial discounts... would not subsequently be available to the tenant as a sitting tenant" on rent review is correct only if demand for

comparable space consistently outstrips supply. Failing this, the statement is erroneous: rents fetched in the A-type buildings certainly will not be immune to the level of discount offered in the C-types. If demand outstrips supply, it will be unnecessary to offer inducements. Why would a landlord offer a rental inducement when it is unnecessary?

The next point concerns the emergence of what is called "a two tiered structure". In chapter 1 of *Commercial RentReviews: Law and Valuation Practice,* I outlined a number of reasons why in a bull market a tenant might accept a rent on review which is in excess of market rent. That discussion will not be repeated here; suffice it to say they largely revolve around ignorance and coercion (real or imagined).

Ignorance may manifest itself under a number of headings. These include ignorance of what other tenants in the building are agreeing to, ignorance of current market rents for comparable premises and ignorance of rights under the lease.

Coercive factors include certain landlord tactics, fear of escalating costs arising out of a protracted dispute and a conviction that valuers, called in to resolve the matter, may owe allegiance to the property industry rather than to the tenant.

For these and other reasons, many tenants agree to a rental on review which is in excess of market rent. Market rents and review rents are the outcome of two entirely different processes.

Before proceeding, let us consider briefly the question of inducements. Over the years practices concerning the treatment of office fittings has changed. In days of yore, these were paid for by the tenant or, if provided by the landlord, were leased separately. It is now not uncommon for landlords to provide fittings and this is incorporated into the budget for the project. Such a provision will result in a higher rent for the premises but, if met by the tenant, rent will be less on this account.

Our present concern, however, is not with the fittings or who pays for them in whatever manner. Our present concern is with the "substantial discounts" noted in the judgement.

A report in the *Australian Financial Review* of 8th June, 1989 is fairly typical of the arguments advanced. The report cited a study by Melbourne stockbrokers B B L Mullens and statements attributed to one of its analysts, Mr Michel Bostrom:

> The reason (for incentives), according to Mr Bostrom, was that tenants faced considerable costs in relocation so that the rental inducement was needed to place the developer of the new building on the same footing as the landlord of the building the tenant currently occupied.
>
> 'The rental inducement is therefore a once only payment... and in so far as they compensate the tenant for the expenses and inconvenience of moving, inducements are not a discount on rents but rather a development cost,' he said.

The fact of inducements is a red herring because what matters is the effective rent. If no inducement is offered, then the rent will have to be lowered. If an inducement is offered, a higher rent compensates for this. This would certainly be the tenant's calculus. An inducement, no matter how paid, can be converted into a periodic equivalent which, when subtracted from the rent actually passing, results in the effective rent. This is a trivial exercise in the mathematics of finance (see Exhibit 1).

It suits landlords to offer inducements when needed to attract tenants because this means a higher rental figure can be entered into the lease and used to advantage in marketing. It is not unknown for some landlords to obtain an undertaking from the lessee barring the latter from disclosing even the existence of the collateral consideration let alone its nature or magnitude. In this way it is hoped (one assumes) to conceal the fact so it will not be used as an ingredient in rent reviews elsewhere.

Some rent review clauses require the valuer to ignore the effect of inducements presently available in comparable buildings in setting the level of rents on review. Tenants are disadvantaged by this; the practice, if it exists, raises certain ethical questions of leasing agents if they are impressing prospective tenants to sign contracts knowing they will suffer loss thereby.

Where inducements are offered it seems to me quite reasonable to regard them as a promotional cost. One must never forget, however, that they have a revenue consequence. To state that inducements are not a discount on rents because they are a development cost is erroneous. We have seen above that inducements can affect rental levels throughout the market area concerned. To ignore them is to disregard an important component of market rent the level of which it is desired to estimate. Lessors' interests are served if inducements are ignored for the purposes of rent reviews because the reviewed rent will be higher. That, it seems to me, is the whole point of the exercise in spreading obfuscation. In a bear market tenants may well be offered an inducement to agree on a review rent favourable to the lessor. Would that be a development cost? Not likely!

We return to the two tiers distinguished by Mr Justice Nicholson. That His Honour regards these tiers as being part of the overall market is obvious from the following statement:

> ..where a rent obtainable on the market is to be assessed, it is the market which must be examined and the market would include rents payable by continuing tenants as well as new tenants. (p 347)

This, however, is illogical because, as seen above, "rents payable by continuing tenants" are the outcome of a non-market process. The two tiered view is fallacious because there is only one market - the kind described above in the discussion of Diagrams 1 and 2. Areas occupied by tenants are not substitutes for space actually on the market and the two do not compete unless a move is imminent- they are insulated from each other. If, by a very remote chance, all tenanted space in a city were to fall forrent review on the same day, market supply would notbe changed by one whit. Neither does a tenant compete with other tenants who are undergoing a rent review at the same time: that notion is ludicrous - but it is an essential prerequisite to establishing a market! Those who speak of a "sitting tenant market" create an irreducible paradox. The elements the Judge distinguishes are not sub-sets of a larger set, they are disjoint sets.

A few lines further on in the judgement, we have:

> Without trespassing on the function of the arbitrator, it would seem to me that the figure that he would arrive at would ignore special discounts to new tenants in order to attract them into occupationbut would similarly ignore loadings which mightbe attached to the rentals payable by an existing tenant such as taking into account factors of the expense of a move and corresponding inconvenience resulting therefrom. (p 347)

The first leg of this directive leads to ignoring a significant component of market rent in attempting to estimate that very fact under the conditions illustrated in the diagrams above. Let us examine the second leg a little further.

Assume a recent rent review was agreed at $X. Assume, too, that the tenant assesses the cost and inconvenience of moving (if he can move) is $Y. Is market rent $(X Y)? If $X is the outcome of a non-market process, it appears to me that $(X Y) is of the same ilk because the implied base is not necessarily market rent. This calculus would be reversed, of course, in a bear market if it applies at all. The only time"factors of the expense of a move and corresponding inconvenience resulting therefrom" are relevant are on lease inception or renewal, not on rent review because relocation is impossible in the absence of a break clause in the lease.

The logical consequence of this part of the judgement is, with respect, an absurdity. Both legs instruct the arbitrator to use non-market data in an attempt to impute market value.

In arriving at this conclusion, I specifically disclaim any criticism of Mr Justice Nicholson and I make no comment on the other aspects of the case which called for him to construe elements of the contract between the parties. Courts have to act on the basis of the expert evidence placed before them and it appears to me that, in this regard, the technical quality of the evidence could have been of a higher standard.

When one invokes concepts of the market which are false and applies them in assessing market value, the result usually is absurd. That this is so in the case under review has been demonstrated above.

In like manner, an absurdity resulted in *Segama N V v Penny LeRoy Ltd* (1984) 269 EG 322, which I demonstrated in chapter 10 of *Commercial Rent Reviews-Law and Valuation Practice.* The result there was to assert, on analysis, that premises to be valued are not to be compared directly with market evidence. Those who cite this authority must support the valuation method upon which it is based.

Allowing for other market distortions

When studying the market for comparable rental data, the valuer needs to beware of distorting influences. Such influences are non-market determined but affect the magnitude of periodic or other payments actually passing. They may even affect their timing.

Given the quest is to estimate market rental value, observations which include a non-market element should be discarded if that element cannot be removed.

We have already reviewed examples of distorting influences arising when agreements between landlords and tenants are treated as being market determined and when inducements are treated as being non-market determined. The material of this section extends those sophisms to another class of phenomena.

Here we are specifically concerned with imposts on land which fall more or less arbitrarily. The outstanding example of this is land tax in those cases where the impost is passed on to the lessee without a corresponding diminution in the base rent. The following remarks do not apply where adjustments to the base rent are allowable under the lease.

The usually advanced rationale for land tax is that it encourages owners to put their land to optimum use. Those users of space on land which is not so developed are penalised because of that fact.

Consider two sites of identical value and, hence, land tax liability. One has a multi-storey building on it, the other is less intensively developed. Clearly, the land tax charge per unit of lfoor area will be higher in one than in the other. Now assume several tenant types are common to both buildings and have identical gross business receipts and expenses other than land tax. Clearly, the establishments in the lower rise building will be less profitable and will have a lesser surplus to meet rent. The distortion arises partly because land tax is a revenue charge against a capital good which may generate insufficient revenue to meet the impost and partly because of the owner's inability to develop the site more intensively in the short run. Which of the two sets of passing rent is evidence of market rental value?

Even if a building exploits its site optimally at the present, it may not be long before it represents a less than prime use because of changes originating beyond the site which affect its use and over which the owner has no control.

Given this prospect, it is in the nature of things that land tax will usually bear unevenly on the users of space across the city. Why? Because at no point in time will every parcel making up the city be developed so as to release its full potential. Not only may it be economically impossible to do so in'a particular case, but planning legislation may prohibit it. Thus, there will always be a degree of inequity in the incidence of this particular tribute to the public purse.

Contracts between parties also may add to the distortions referred to. Simply because of a difference between two leases of otherwise comparable premises, one tenant may be liable for a contribution to land tax while the other may not. Which of the two is evidence of market rent?

If a lease provides for a monthly contribution to land tax which the landlord has to remit only annually, there is a pre-payment component which needs to be taken into account if that rent is to be used as evidence. How does one do this?

There are, of course, other possibilities. Take a lease which provides for a contribution by the lessee to the building's land tax liability but which also specifies that rent on review is never to be less than the rent currently passing.

If the body politic in a fit of unparalleled largesse abolishes land tax, how can this benefit be passed on to the tenant? Cynics may think this possibility to be so remote as not to be worth contemplating.

Nevertheless, the same concern applies if the rate of land tax is reduced. If the rent passing after the reduction cannot be altered, is it evidence of market rental value? After all, the tenant is paying more than he should be.

As assessed land values move further away from reality, the distortion is intensified. The liability is now in proportion to a base which is artificial. The only remedy for this is frequent revaluation - especially following any dramatic change in market values. This, however, has a cost consequence which the administrators may be unwilling to incur.

Debate on the issue is further convoluted because our notion of rent is now nowhere as simple as it used to be. In times past, the tenant paid his rent and the landlord paid *all* building outgoings.

The parties to leases were fairly sure of the likely level of future commitments because inflation has little impact. In short, landlords could forecast net annual income with a comfortable level of certainty.

When building outgoings became more volatile under the spur of inflation, the practice of passing increases over a base amount through to tenants became more widespread. The assumption (usually a reasonable one) was that base rent plus outgoings contribution equalled market rent.

Where leases did not make such a provision, this was taken into account in rent reviews. This was reasonable to the extent that such charges were distributed equitably among the tenants of a building and that, in aggregate, outgoings as between buildings were similar.

Under these conditions there were few distortions except where non-competitive pricing in building maintenance crept in through the employment of sub-contractors who were subsidiaries of the owner entity.

With land tax, however, the conditions necessary for equity just specified are frequently not met. The result is a distortion in the level of payments actually passing.

Such a distortion will be more keenly felt in times of economic adversity. Much of the confusion referred to above, it seems to me, results from our more complicated view of rent complicated, that is, in terms of the number of components specifically passed through to the tenant.

Thus, a valuation problem looms when using rents which include a distorted land tax component in the attempt to assess the rental value of other premises.

Let me summarise. In many instances now, the passing rent may be partitioned into three components: base rent, contributions to building outgoings which are usually little distorted and a contribution to land tax which may be highly distorted as to magnitude and timing.

Since the valuer's task is to interpret the market, he needs to remove distorting influences from the data. The procedures to be adopted will vary with the particular assignment and the nature of the available data.

Incidentally, this underscores the need for defining the issues at the outset and deriving from this the apposite definition of value. In the absence of these two steps it is not possible to define the data required, let alone to establish its relevance to the particular instance.

By way of illustration, take the case of where the tenant is not responsible under the lease for a contribution to land tax. Clearly, the best evidence would be comparable rents recently negotiated for vacant premises which would compete with the subject space for tenants. Comparable rents meanjust that: rents which are paid under leases having a similar provision.

What if there are no such rents available as evidence? Then the valuer needs to resort to rents which include a land tax component and remove that component therefrom.

This is best done using a discounted cash flow approach at an appropriate interest rate in much the same way as set out in Exhibit 1 (over page).

For each lease reviewed the passing rent is partitioned into its land tax component and the remainder. Both are arrayed in their appropriate time intervals and discounted back to present value. The present value of the remainder is then converted into its periodic equivalent to become one item of evidence.

If appropriate a loss of interest factor would be added to allow for the pre-payment of land tax factor noted above. This is repeated for the number of observations available and proper inferences drawn.

Now take the case where the tenant is responsible for a land tax contribution. The procedure is much the same as just described. To the level of rent adduced, the land tax liability under the lease is added.

The result may be a payment higher or lower than that being met by a comparable establishment which has a different land tax obligation. The land tax liability may even consume the property's rental stream.

This is an outcome of the distortion discussed above and which is beyond the valuer's ability and, indeed, responsibility to meliorate. Were he to attempt to do so, he would be acting beyond the sphere of his professional competence and may face a legal challenge on that score. The distortion is a product of fiscal policy determination and its administration. The valuer should not be brought to account for effects which are not of his making. The remedy lies in addressing the areas of public policy referred to or in approaches to the body politic.

Other adjustments

There is, of course, a plethora of other heads of comparison on which it may be deemed necessary to effect adjustments. Space limitations dictate a treatment of only two of these and a brief one at that: namely, adjustments for differing lease durations, the problem of "key money" and a note on current practices concerning assignment premiums.

This was considered by the High Court of New Zealand in *Feltex International Limited v J B L Consolidated Limited (In Receivership)* (1988) in which the umpire's action in allowing for differences in duration was upheld.

Whether or not such an adjustment should be made will depend upon the circumstances of each case. There are cogent reasons why, under certain circumstances, lessees will pay less rent for the grant of a longer term lease; on other occasions they may well pay more (Baum, *op cit, p* 144). In a particular case, the valuer would need to establish that there is indeed a relationship and then study its direction.

If sufficient observations are available the valuer could attempt a form of interpolation into the relationship between unit rental and lease term. It would be necessary to ensure that the effect of other factors causing differences in rental level have been removed from the data. A form of multiple regression analysis suggests itself.

Baum *(op cit,* pp 136-137) discusses the problem of "key money" briefly. I am able to add only little to it. In most Australian states, key money paid in the retail sector by lessees to lessors is outlawed but there is no legal prohibition on such payments being made between lessees on lease assignment. It is rarely encountered in the office space sector of the rental market. When it is paid there is usually a shortage of prime space in established areas.

Those retailers who offer key money on lease assignment seem to regard it as a premium against the risk that would be incurred in establishing themselves in an inferior location. Another reason sometimes cited is to exclude competitors from the chosen location. It is probably best regarded as a form of locational good will. Its size may depend in part upon whether the assignee regards the passing rent as being lower than he would be prepared to pay.

Establishing that this is so is very difficult, however. The accounting treatment would be to write it off over the unexpired term of the lease. Unless it can be established that key money has a defined rental component, an adjustment on this score is unwarranted.

There would appear to be a growing practice in Australia to require the rent review clause to be activated before the lessor agrees to a lease assignment.

This is a response to some cases where tenants advertised space at a rental level lower than that being asked on rent review elsewhere in the building. Obviously this worked against the lessor's perceived interests. The consequence is not difficult to imagine: the assignments usually do not proceed because incoming tenants can obtain comparable space elsewhere at a rent less than that resulting from the ordained review.

Simulation of the most probable lessee's rent fixing regime

The second approach to estimating value is to simulate the most probable lessee's rent fixing calculus. This route will be followed if there is no market evidence available upon which to base a reliable inference. It may also be adopted to check the result obtained from another approach if the required identity can be established.

Here the valuer interviews similar tenant types who have recently made leasing decisions to ascertain how they determined the level of rent considered feasible to their kind of undertaking.

The ascertained logic is then applied to the instant case and is followed by checks using another method.

Clearly, it is not as satisfactory as the inferential approach but it is nevertheless positive in nature in that it does not call on the valuer to make a set of normative assumptions. It recognises that different kinds of enterprise have fairly distinctive rent paying abilities as noted above.

Unless instructed to the contrary under the terms of the lease, my view is that the question of probable use is already settled. This is because the lessor has agreed to the kind of establishment at the outset of the lease.

What remains to be fixed is the current rent such an enter-

prise should be paying as at the review date. The aim of the exercise is to restore economic balance between the parties a balance that has been altered by the course of inflation and the trend in supply/demand factors in the market place.

In short, I do not hold with the view that the space is notionally available to all comers. One potentially damaging consequence of this assumption is the influence of the special bidder.

The procedure I recommend is to regard the space as available to the same kind of establishment as is presently in possession.

This, I submit, is closer to reality, it does not require the valuer to indulge in the absurd assumption of hypothetical parties and bypasses the special bidder problem (for a discussion of the latter, see Farmer, *op cit,* pp 49-50).

Given this procedure, the valuer studies evidence of recent lettings of comparable premises to the same tenant-type and checks this against the results of the simulation approach. Even so, a productivity analysis is required in order to effect comparisons between the subject premises and those recently leased. Normative modelling

If the valuer is unable to locate data from comparable transactions and if he is unable to identify the most probable lessee or lessee-type, he resorts to normative modelling.

In short, he acknowledges there is currently no market for the space he has to value. Even in this circumstance the use of rents agreed on review is of no assistance because it is impossible to ascertain whether such transactions should be adjusted up or down.

Apart from that, there is no logical way in which such adjustments can be made - those who believe there is are invited to make their case. (Spare us, 0 Lord, from "the stuff of valuation"!).

Therefore he has no option other than to erect a set of assumptions and proceed upon that basis. He has no market data upon which to base these presuppositions for he endows the situation with his own value judgements or norms. In effect he says "if the market were me,what would it do?"

Obviously this is the least reliable intellectual route to assessing market value rental or otherwise.

There are special reasons why the valuer may be forced into this mode. First, the lease may instruct him to do so. Second, in the process of making adjustments while pursuing either of the other two intellectual paths, he may lack market data to support them and must needs invoke his own norms.

Thus, what appears to be a non-normative approach may well become a normative one before the exercise is completed. This is a danger valuers and the users of their services need to be alert to. Thirdly, as mentioned above, a normative approach may be employed to check a result derived in another way.

The classic rent review case illustrating this approach is F R *Evans (Leeds) Ltd v English Electric Co Ltd* (1977) 36 P & C R 185. This case is reviewed at some length by Farmer *(op cit,* pp 46-49). I will notrepeat all of that material except to note that the circumstances of the case precipitated an exercise in artificiality which caused the learned judge (Evans, J) to remark:

> In the hypothetical life of hypothetical higglers, there is always one rent and never more than one rent which meets these criteria. If the arbitrator is heard to mutter: `Oh happy hypothetical higglers!' this is only too understandable. He has my sympathy. (at p 192)

Part (but by no means all) of the difficulty arose from the wording of the rentreview clause which provided for "...the rent at which the demised premises are worth to be let with vacant possession on the open market as a whole between a willing lessor and a willing lessee...".

Immediately the valuer is charged with the responsibility of assuming hypothetical parties and he is then exposed to most of the shortcomings endemic to the normative approach.

As different valuers have different perceptions of lessors and lessees and endow them with different preference scales, the approach will produce as many results as there are valuers.

Draftsmen should be aware of this. If they force a normative approach, they virtually guarantee a diversity of results as between the valuers called in to resolve the dispute - the antithesis of what they strive to achieve.

There is in this an implication for valuation practice. Some valuers tend to be seduced by the notion of putting themselves in the shoes of hypothetical willing but not anxious lessors and lessees as advocated at times by the courts.

This is valid when confined solely to the normative approach. As the primary approach to estimating value, there is no excuse whatever, however, for doing so when market evidence is to hand. The evidence is the outcome of actual parties who may or may not have been willing, who may or may not have been anxious, who may or may not have been fully informed and so on.

If the definition of value adopted at the outset is a normative one it is incumbent on the valuer to demonstrate that the market data he employs is consistent with that definition. It is a safe bet that it never is.

The likely outcome is a lack of consistency, a loss of credibility, a failure to address realistically the issues to be resolved and a dissatisfied client.

Adjustments for external factors

Having derived an initial estimate of value, its likely order of accuracy (discussed below) and having tested the outcome using another method, the valuer should then consider whether any adjustments may be required due to extraneous factors. Such influences may reside in the definition of value adopted or they may form part of the initial instructions set forth in the lease.

The sensitivity of the result also should be tested for variation in any assumptions made along the way and the whole work reviewed for consistency especially consistency between the definition of value and the data employed, as already stated.

Because valuation is not a science, its results are always couched in uncertainty. Epistemologists would regard valuation as being in the area of opinion or probable knowledge.

The fact of this inherent uncertainty dictates that the final value estimate be expressed in probabilistic terms. Usually this will not be the outcome of a statistical modelling process but, rather, expressed as a range within which the predicted rent could be expected to fall. This is supplemented with a point estimate being the figure the valuer regards as being most probable.

There are features to the rent review process which add to the uncertainty of estimation the major ones have been outlined above.

It behoves the valuer, as the one best able to do so, to convey to his client the value range as a reflection of the accuracy of the work.

This is especially useful in the negotiations which will probably ensue. If retained as an arbitrator or expert to determine a dispute, the point estimate would be used.

EXHIBIT 1

INDUCEMENTS AND EQUIVALENT RENT

For the sake of illustration, assume an area of space is available on the basis of the first six months of the term being rent free. The rent of $25 per square metre, entered on the lease at the outset, is to be paid monthly thereafter until the date of the first rent review due at the end of two years. Two questions arise. First, what is the equivalent monthly rent? Second, if the lessee paid $25 per square metre from inception, what inducement by way of an initial payment (in cash or kind) is required to produce an identical result? An interest rate of 17 per cent is adopted.

Without loss of generality, the analysis is carried out on a square metre basis.

Case A: Rent Free Period

To compare like with like, it is necessary to convert all payments into present worth and then compute the monthly equivalent of that amount.

The sum of $25 is paid for 18 periods. The present value of that stream is $400.35 at the given interest rate.

That lump sum is deferred for six months. Its present value is $367.95.

This may be regarded as a mortgage. What monthly payment must be made to repay it over 24 months at 17 per cent interest? The answer is $17.94.

Readers wishing to verify this result should note that I have assumed an annuity due (the case with rental payments) and have rounded to two decimal places.

Therefore, a rental of $25 per month following a rent free period of six months is equivalent to $17.94 per month for 24 months.

Case B: Cash Inducement Offered at Inception

Here the lease quotes a monthly rental of $25. The present value of this annuity due at 17 per cent is $512.80.

To arrive at an equivalent result as for Case A, the two present values are subtracted to give the required initial payment: $512.80 $367.95 = $144.85.

Discussion

The following three payment plans are identical:

1. $17.94 per month for 24 months.
2. Six months rent free followed by 18 payments of $25 each.
3. Receive a cash inducement of $144.85 at the outset and pay $25 per month for 24 months.

As a strategy when the market is soft, a number of variations on these major three themes is possible. For example, the tenant may be compensated for part, all of or more than the fitting out costs. Whatever the scheme, it may be analysed by using the cash flow approach illustrated above. It matters not at all what the inducement is called or the method of its payment.

A tenant will be attracted to the cash payment arrangement if his reinvestment rate exceeds his cost of capital.

The claim that cash inducements and rent free periods are not part of the rental calculus is spurious. Landlords and their agents who make this claim, however, are acting rationally. The practice of proffering an inducement (in cash or kind) in return for secrecy and entering a higher rental figure on the lease places those who are ignorant of the arrangement at a disadvantage in negotiating contemporaneous rent reviews. In fact, in the illustration, the equivalent rent is $17.94 not $25. This would be amaterial consideration if the spacebeing the subject of areview is a close substitute as discussed in the main paper.

The irony is that this ploy could work to the disadvantage of those who espouse it. In a recent case heard before Mr Justice Spender in the Brisbane Federal Court, the Commissioner for Taxation brought a case alleging that a cash incentive is taxable in the hands of the lessee. The Court ruled otherwise and it is reported *(The WeekendAustralian,* August 12-13,1989) that the Commissioner will probably appeal to the Full Bench of the Federal Court.

With respect, it is submitted that the Court could scarcely have ruled otherwise. This view is based on the logic of the calculations set forth above.

If, however, such payments are taxes in the hands of the lessee, they will have to be divided by the complement of the tax rate to achieve the same effect. Thus, in the illustration and taking the full marginal tax rate of 49 per cent, the $144.85 would have to be increased to $284.02 if the tenant's after-tax position is to be maintained.

To overcome this, the parties might structure the lease payments to provide for the equivalent rental payment. That would undeniably be rent and therefore not taxable. The disadvantage from the landlord's point of view is that (continuing the illustration) an amount of $17.94 per month is entered on the lease and this is a lower base for rent review purposes. If there is no growth, the rent on review will remain at $17.94. But the entering of a higher figure on the lease from the outset locks in a certain amount of growth *whether it occurs or not* by virtue of the operation of the ratchet clause the usual clause which stipulates that the reviewed rent will not be less than the initial figure entered on the lease: $24 in this case. Would this be evidence of market rental value at that time?

Investors should be wary, however, to ensure that it is the net rent actually passing which is capitalised in estimating the value of the building. If lessees are bound by agreement not to disclose the existence of incentives, greater than usual care will be required. In the absence of this, over valuation is probable.

Alternatively, the lease payments could be structured to provide for a rent free period. On the basis of the logic evidently being pursued at present by the Commissioner, the tenant may be viewed as being in receipt of a taxable benefit. So, the rub remains.

The solution, it seems to me, is eminently simple: for taxation or any other purpose, call market rent what it is.

For further computational examples in the context of lease analysis see Vernor (1988). It appears he treats rent payments as ordinary annuities not as annuities due. In the example given above, I have adjusted over the period up to the first rent review. This is the appropriate period (rather than the term of the lease) for two reasons. First, the review defines a new economic relationship between the parties which will run thereafter and, secondly, the lessor is in effect purchasing the right to a higher effective cash flow thenceforth it is, in certain respects, akin to a futures contract. A

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Valuations for Commercial Rent Review Purposes

by R P Young

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Introduction

Dr Whipple precedes his paper with a St Thomas Aquinas quote dealing with truth or falsity. In commenting on matters relating to commercial rent reviews and the legal decisions, arbitrations and arguments arising therefrom; I can think of no better quotation than that of the great English philosopher and poet (among other things), Mick Jagger, who said "You can't always get what you want".

It is appropriate that a seminar on Property Valuation and Investment in the 1990's should commence with papers dealing with the rent review process. In the final analysis, all forms of commercial real estate investment have as their foundation the rent or income producing capacity of the property. From an investor's point of view, capital growth is not achieved unless there is rental growth; and from a lessee's point of view the factors which influence total cost of occupancy of business premises have an important direct and indirect impact on the success of that business. The rent review process is therefore critical to the subject.

It is now slightly more than 200 years since Ricardo put forward the logical economic concept to the affect that the price of land is determined by the price of corn and not the other way round ie that value is a function of rent, rent is not a function of value. The sad thing is that over 200 years later many people involved in the commercial leasing and rent review process still fail to grasp the importance of this fundamental economy principle.

The relevant definition of value

Under this heading Dr Whipple notes: "Terms such as `reasonablerent', `best rent' and others have been considered in various Court dicta and the valuer should be closely familiar with them all.

From a valuer's point of view, one of the most daunting aspects of the rent review task is the study, understanding and assimilation of these various Court dicta.

From the late 1970's and early 1980's we have had to grapple with:

- The niceties of the principles laid down in *Ponsford v HMS Aerosols Limited.* (Including the emphasis preferred by Lords Wilberforce & Salmon in their minority decision).
- The underlying foundations of the decision in *Thomas Bates & Son Limited v Wyndham's (Lingerie Limited.*
- Possible complications which may be posed in considering Reardon & Smith (1976); *Photo Products v Securicor; Davis Contractors v Fareham UDC;* not to mention *Auckland Hospital Board v Auckland Rugby League.*
- Further complications arose at about the same time as a result of *Plinth Property Investments Limited v Mott, Hay and Anderson.*
- Compounded shortly after by *Law Land Company Limited v Consumers Association Limited.*
- Backgrounding all this new law is the old New Zealand principle generally referred to as "the prudent lessee test" whatever that now means.

Prior to the emergence of this flood of Court dicta, we simple valuers were able to proceed on the equally simple assumption that all we had to do was fix a "fair market rent" or a "current marketrent". The niceties of the distinction between a"fair rent" and a "market rent" were not worthy of consideration let alone the distinction between these two and a "fair market rent".

In those days, to suggest that we should waste time debating such issues would have been treated with incredulous disbelief and I am still not entirely convinced that that was not the correct attitude.

Notwithstanding personal opinion as to the desirability or otherwise of the situation, the rent review process is now hedged about and confused by the legal principles which have emerged from the above decisions and numerous others. Dr Whipple is quite correct we simple valuers should be closely familiar with them all.

By way of a brief aside from my commentary, and hopefully to better demonstrate to non-valuers the element of confusion which has emerged in recent years, I would like to take a brief look at part of the *Ponsford* decision.

This case went from the Court of Appeal to the House of Lords where the five Law Lords examined the meaning of a clause requiring the rent to be reviewed at "a reasonable rent for the demised premises".

The lease provided that if the parties failed to agree on the assessment of the rent such assessment was to be made by an independent surveyor. During the first period of seven years the premises were burnt down. They were rebuilt by the Landlords but by arrangement between the parties substantial improvements were made to the premises these improvements being paid for by the tenant. When the rent came to be reviewed for the second seven year period the tenants argued that in assessing a reasonable rent no account should be taken of the improvements for which they had paid.

In considering the meaning of "a reasonable rent for the demised premises", Lords Wilberforce & Salmon were in the minority and they cast the emphasis more on the word "reasonable" than on the words "demised premises". They were of the view that it was not reasonable for the tenants to have to pay rental based on an assessment which ignored the fact that their money had been used to make the premises, in part, what they were.

The majority however focused more on the words "the demised premises". Lord Keith expressing the view "in my opinion the words 'reasonable rent for the demised premises' simply means the rent at which the premises might reasonably be expected to let." The decision was that the lessee had to pay rent on the entire premises including that component paid for by the lessee.

I have extensive experience on rent review work in New Zealand and do not know of any case where a lessee has been required to pay rent on lessee's improvements, even when the lease contract is silent on the subject. I am also unaware of the case being followed in any New Zealand Court. It further appears to me that cases decided subsequent to the *Ponsford* decision, where the same matter has been raised, have produced decisions in which the Judges have engaged in quite amazing legal gymnastics in order to avoid following the *Ponsford* ruling.

I am probably on extremely thin ice in making that statement and if I am wrong I would appreciate being put right on the matter.

My principal point however is that valuers are now required to understand and apply numerous legal decisions, most of which run into many pages of complicated legal reasoning. It is not surprising that many valuers have reacted to this situation by simply ignoring it, and carrying on as if nothing had happened.

While this reaction is understandable, it is of course professionally unacceptable. That it persists right up to the present time is a reflection on the valuing profession as a whole. We suffer from the existence of a number of practitioners who refuse to open a textbook or read professional journals. Indeed, it appears that some of them regard such habits as an admission of technical and professional incompetence, apparently believing that their innate intelligence and ability would be insulted by additional study.

Some two or three years ago, shortly after obtaining Whipple's *Commercial Rent Reviews* textbook I quoted from it at an arbitration hearing. My actions were roundly ridiculed and criticised by a valuer also present at the hearing. He accused me of relying on the statements of academics who had no practical experience in the matters then under review and whose writings could not possibly be taken seriously. I am certain that the critic had not read the material which I quoted and was unaware of who had written it. The case does demonstrate an attitude which I believe is now becoming weaker but which still persists.

In New Zealand the valuer's task of sifting through the legal decisions and crystallizing important principles was simplified to a considerable degree in late 1986 with the arrival of the abovementioned textbook edited by Dr Whipple. We are indebted to the various authors of chapters in this book for expressing in a logical manner the current state of the art with regard to law and valuation practice.

This does not mean that we have to accept all of the opinions and conclusions expressed by the authors, but the publication has certainly crystallized the issues and thrown considerable light on the debate.

BHP v AMP an analysis

Dr Whipple's analysis of this 1986 Australian decision is very interesting. I am in agreement with almost all of Dr Whipple's statements and observations on this case and, in particular, would like to comment:

1. The two tiered market mentioned in this decision has not developed in Auckland except in the prime retail areas where a distinct two tiered market exists, but in reverse to that described in the BHP case. In prime retail areas in Auckland, rent reviews have, for illogical reasons, become fixed at much lower levels than the rentals achieved for vacant space on new lettings.

   In the much more extensive office market the inducements offered on new lettings are discounted (over the period of the lease) in much the same manner as is outlined in DrWhipple's paper. The discounting is however undertaken over the entire period of the lease and not to the period up to the first rent review.

2. The 8th June 1989 article reported in *theAustralia Financial Review* has received some attention in New Zealand, but is generally not taken seriously.

   I note with some interest that this article originated from a Melbourne stockbroking firm. The analyst quoted states his understanding that there has never been a Court case in any country with common law which has substantiated an argument that rent reviews should be based on rents adjusted for inducements.

   I have in my possession a "Rental Determination" dated May 1989 (approximately one month before the said article appeared), determining the rent for office accommodation located in one of Melbourne's largest office buildings, the review being effective March 1989. The author of this award was appointed to determine the rent and in effect was acting as a sole arbitrator or umpire, although his appointment did not use these titles.

   The "Umpire" was himself a valuer and he heard evidence from valuers appointed by the lessor and lessee. All three valuers were from well known local or international valuation and property consultancy firms.

   The rental determination dealt at some length with the question of rental concessions being offered in the leasing market, noting that the valuer representing the lessor contended that there is clear legal precedent to the effect that rental concessions offered to new tenants should largely be ignored in the establishment of market rentals upon review. The "Umpire" considered the legal decisions *Edmond Barton Chambers v Mutual Life & Citizens* (NSW Supreme Court August 1985); *Segama v Penny Le Roy* and the *BHP vAMP* case. In commenting upon the latter case the"Umpire" expressed the view that the Judge probably did not contemplate that rental concessions would be totally ignored. He concluded that the major point to come from the case is that a valuer is entitled to look at all facets of the market, and that that would include new letting evidence, as well as mid-term reviews.

   The rent review clause in the lease in question required the assessment of "the current market rent of the premises as at the review date". The "Umpire's" decision was that, in the case of new leasing transactions, the actual rent paid should be adjusted where necessary for concessions. He accepted the calculations of the valuer appointed by the lessee in this respect, these calculations discounting the rent free period over the total term of the lease, but after allowing for a "normal" lessee fit-out period of two months ie a six-month rent free period attracted a discount for only four months, the remaining two months being regarded as normal market practice.

   In Auckland we are currently seeing rent free periods ranging in term from six months to in excess of 18 months. Accordingly, the discount for the longer term over a 12-year lease period is quite significant. In my experience this form of discounting is being undertaken and accepted by valuers experienced in this work.

3. In commenting on the magnitude of a particular inducement, Dr Whipple states that a tenant "seeking multiple floors would carry more weight than another who wants to rent a small area" and therefore receive a greater inducement.

   With respect, I suggest that this is a matter for market research and analysis. The experience in Auckland is that single floor tenants have in fact received greater inducements, expressed as a percentage of total annual rent, than

have tenants seeking multiple floors or whole buildings. The assumption that there is a "discount for size" is a dangerous one and must in each case be tested in the market.

Allowing for other market distortions

Under this heading Dr Whipple deals principally with "imposts on land which fall more or less arbitrarily".

The outstanding example he quotes is Land Tax. This subject is of course very familiar to New Zealanders involved in the Real Estate field. It has been the subject of much heated debate over the last two years, to the extent that the Government has recently been persuaded to reduce the levy of Land Tax from 2% of Government land value to 1%. Even at the lower level, it still impacts differently on different properties. The land tax component in Central Auckland office building operating costs, even at the rate of 1 % of land value, will range between a low of approximately $7.00 psm per annum to a high of approximately $18.00 psm per annum.

The "Valuation Problem" referred to under this heading has not proved to be particularly great in New Zealand, even where a distorted land tax component is passed on to the lessee. In these circumstances it is standard and accepted practice to adjust the base rent so that total occupancy cost is comparable as between comparable properties. Without further explanation, I am unable to follow Dr Whipple's reasoning in the last paragraph under this heading. As is noted above, an excessive land tax obligation falling on a lessee is taken into account as one of the many adjustments required when adjusting comparable rental evidence to apply to the property which is the subject of the assessment. I believe that New Zealand legal decisions support this practice - eg the *Feltex International Limited v JBL Consolidated* case citedby Dr Whipple in the next section of his paper.

Other adjustments

Under this heading Dr Whipple notes the problem of "key money". This problem certainly exists in Auckland, principally in the prime retail portion of Queen Street.

Valuers acting as arbitrators or sole umpires continue to ignore the evidence of high rents paid on new lettings and exorbitant premiums paid on lease assignments.

The high rents paid on new lettings appear to be ignored on the grounds that these rents do not demonstrate the market level because of some element of "scarcity value" or a built-in "premium for a new letting". How such reasoning stands up to any form of economic logic has mystified me for some time. The large amounts paid to outgoing lessees on lease assignments are almost always accompanied by the assignee removing all shop fittings and installing a new function in the shop. Accordingly, the amounts paid on assignment cannot be said to include any component for the outgoing lessee's business goodwill, because that disappears, or any component for shop fittings.

There have been numerous such payments ranging from as low as $100,000 where the shop has a short term lease and/or demolition clause; up to $500,000 for longer term leases of large shops but subject to rent reviews generally at two-yearly intervals. In the few cases where shops lease to new incoming tenants from a vacant state, the rents achieved are so far above the levels fixed on recent rent reviews as to make the latter levels appear quite ridiculous. We have here in fact the reverse situation to the lessee inducement question discussed above. In the office market, lessees are offered inducements amounting to between 1 and 1-3/4 times the annual rent for the space, in order to secure that lessee into the office accommodation. In Queen Street shops the reverse situation applies. The lessee has to pay (in one form or another) a very large capital sum, either to an existing lessee or to a lessor, in order to secure the lease of that space.

I know of no logical argument as to why the two payments should not be treated in an equivalent way. If the incentive paid to the lessee must be discounted in order to achieve an equivalent "market rent", then surely the premium paid by the lessee in the retail situation must also be decapitalised and added to the rent in order to demonstrate the equivalent "market rent". The former situation is universally accepted and, with few exceptions, the latter situation is almost universally rejected. Why this is so defies any logical explanation.

This subject is covered in chapters 7 and 8 of *Commercial Rent Reviews,* these chapters having been written by Andrew Baum. I note with interest that when dealing with a capital sum paid at the start of a lease by the lessee to the lessor, Baum states "Using new lettings as evidence, the estimate of open market rent will depend upon the manner in which such a premium is decapitalised and there is by no means a single accepted means of doing this." (See Chapter 8.)

The interesting point is that Baum does not argue with the fact that the premium must be decapitalised. That is accepted. He simply notes that there may be some argument as to the mechanics of undertaking the decapitalisation.

There is a further pertinent point concerning the very large amounts paid for Queen Street shops on assignment. This is that the magnitude of these payments surely demonstrates a very high demand for the accommodation in question. Since a "market rent" is always produced by the interplay of supply and demand, it must follow that the high amounts paid on assignments of leases is evidence of a demand level which has outstripped supply. That factor in itself must indicate that existing rents are at a demonstrably low level and where new lettings also demonstrate this state of affairs, then the logical market result should be that rents increase on review, up to the level demonstrated by new lettings. That this is not happening must raise serious questions as to the validity and logic of recent arbitration awards of retail premises in Queen Street.

If "the aim of the exercise is to restore economic balance between the parties", then all evidence demonstrating the magnitude of supply and demand must be taken into account by the sole arbitrator, umpire or valuers concerned.

I agree with Dr Whipple's assertion that "the claim that cash inducements and rent free periods are not part of the rental calculus is spurious." By the same token, the claim that very large payments for lease assignments (where it is clear that the consideration includes no allowance for vendor's business goodwill or fittings) are not part of the rental calculus is equally spurious.

Conclusion

Lease contracts on commercial and industrial property contain rent review provisions so that the widely divergent financial interests and aspirations of the parties involved can be reconciled in a manner which keeps costs and emotional stress to a minimum. In this process, the lessor and lessee are at liberty to make outrageous claims and counter-claims in so far as the new rent is concerned; the lawyers involved are at liberty to act as advocates in their clients' interests (and indeed may be required to do so); but the valuer is obliged to act as an independent and objective expert.

Each year there are many thousands of rent reviews negotiated and settled in a city the size of Auckland. The system will continue to work provided the valuers do not confuse their role with that of the party who appointed them or with that of the legal advocate. Where the situation does get out of hand, it is often because the valuer or valuers involved have no real interest in arriving at a "fair market rent" (or its appropriate equivalent), but are hell bent on securing the best solution possible for their client.

A well known Barrister once told me that his definition of arbitration is: "A very expensive method of achieving the wrong answer." I do not believe this is true, at least with regard to rent review arbitrations, and trust that it never will be. ,&

Valuations for Commercial Rent Review Purposes

byJNBWall

John Wallisa director of Roberston Young Telfer (Central) Ltd and is retained as valuer, property advisor, real estate analystand arbitrator by many leading property investment companies in Welington and other North Island centres. Ile is a Fellow of the NZInstitute of Valuers.,

Introduction

It is pleasing to valuers that other professions are interested in attending a seminar on this topic, particularly the legal profession on whom we rely so often to place an interpretation on a lease document.

The ordinary valuer has great difficulty in the interpretation of many leases drawn up by legal people.It is not necessarily the ordinary interpretation of the document, but the law relating to property where we have difficulty. For example when there is no mention to the contrary is it reasonable that "the premises" can include work carried out by the lessee?

Should the lessee pay a rental that is enhanced by his work and capital expenditure? As I understand the law there are such instances where the lessee can be so penalised.

Was that really the intention of the parties when the lease was originally documented?

The market

In a recent paper prepared by the Immediate Past President of the Australian Institute of Valuers and Land Administrators Mr Greg McNamara and published in *The Valuer* (Australian) of July 1989 and entitled "The Impact of Rental Concessions on Assessment of Market Rental/Capital Valuations", the question of a two tier market in Australia was discussed.

It is apparent from that article that many Australian valuers do not agree with Dr Whipple and that the current rental market is clearly not as simple as Dr Whipple would have it.

The suggestion of a real rent as being something different from a market rent is a fantasy.

Undoubtedly, the property market in Australia has seen an increase in central business district office space and when there is an over supply, the prudent landlord will use various commercial incentives to entice tenants. This is not a new phenomenon, but is highlighted in the current market.

Two tier market

There has been considerable debate regarding what is commonly described as the two tier market in respect of prime office accommodation. The argument put forward by the tenant is that rents on review should be assessed having regard to new lettings with vacant possession as these transactions most closely align with true open market conditions.

Accordingly, the lessors argue that it is in fact the new lettings that should be disregarded. They argue thatrents achieved in respect of new development do not reflect true market value in that it is the lessor who may be considered to be under duress.

In respect of the sitting tenant market, it is argued that the renewal market is more stable and generally reflects movements in the economy.

Accordingly, a bank of evidence of renewal rental does, in itself, establish a level of marketrent set by tenants who have had the opportunity of assessing the merits of any short-term benefits that can be gained by taking advantage of the new letting market, and who then, in subsequent negotiations, have reached agreement with the existing lessor.

It would appear that the arguments put forward by both sides to an extent have merit, but each goes too far by suggesting that any particular class of evidence should be totally disregarded.

In summary, it may be said that valuers are reflecting concessions in their analysis when circumstances indicate it is appropriate.

Market rental

Dr Whipple has written several books, one of which has been quoted on many occasions at arbitrations in Wellington where principles within the book have been adopted to support various opinions.

I am bound to say it does not impress me that such principles, unsupported by market evidence, should be given the same weight as analysed local evidence. In this respect the New Zealand scene has a wealth of precedence on which valuers should enhance their knowledge rather than accept, sometimes without question, overseas opinion.

In my opinion, analysed Wellington market evidence is quite superior to all else, when setting the level of a Wellington rental. For example at present the Wellington rental market is characterised by a wider range of rentals than has ever existed before in my experience.

Rentals vary from a low being set by anxious lessors of office space that has been on the market for some time with little interest, to a high for prime centrally situated floors of large area.

In monetary terms this range is currently:

$180 psm Gross Occupancy Cost to
$500 psm Gross Occupancy Cost.

So where is the market within this considerable range?

I agree with Dr Whipple that there is only one market, but the rental within that market can vary. As valuers whether we agree with the principle or not the Wellington market, and also as I understand it the Christchurch market, for Central Business District office accommodation has a different level for space being leased that was previously vacant when compared with similar accommodation where the rent is being reviewed under a lease document.

Having listened to Dr Whipple you may well agree with his quite logical argument that in theory the lessee in a lease review situation should not agree to a rental in excess of what the same lessee would pay in a new lease situation.

However the fact of the matter is that locked in lessees under review situations are making these agreements and therefore in

my opinion they have set the market for their particular level of rental as they see it.

It is also a fact that within the same building in Wellington lessees have agreed to a particular level under the review clause of their lease while new lessees have been able to obtain a lower rental because they had the choice of alternatives.

1. Rentals reviewed under a lease

   Here the lessee is in a locked-in situation usually with a capital input in existing partitions erected specifically to suit his particular needs and a lease that defines " the current market rental".

   Such a lessee may consider moving to alternative accommodation that has been vacant for some time at a lesser rental than he has been asked to pay, with possibly a rent free holiday or partitions supplied at no additional cost or some similar inducement.

   But this lessee would also consider the aspects of being able to sublease the existing premises in an oversupplied market and the cost and inconvenience of moving.

   In Wellington at the present time this lease renewal rental tends to set the upper level of the market.

   Just how long the situation will continue depends upon the future forces of supply and demand. If the available office space remains at the present level or increases it is probable that the rental levels under a lease review will not show increases and if demand increases to a stage where there is no available oversupply all rentals will equalise at the one market level.

2. Rentals for Unoccupied Areas

   The prospective lessee here is in a good bargaining position to obtain a rental suitable to himself where there is an oversupply of space, particularly where it has been available for some time and remains vacant.

   Lessors in such situations become the anxious party and in extreme circumstances have been known to accept a rental for a short term that gives only a small margin over the Operating Expenses.

   Thus, contrary to popular belief that there is only one market rental level, at the present time the facts of the market place show otherwise.

Subsequent Sales & Rentals

Over the years there has been considerable discussion on the validity of valuers placing weight on sales that have occurred after the relevant date in completing their valuation.

"Subsequent rentals", in my opinion, can be substituted for subsequent sales. One of the older New Zealand Authorities, Archer J in the *Poverty Bay Catchment Board v Forge and* others, had this to say in respect of valuers who have the benefit of later information which was not available to buyers or sellers of the land at the specified date.

> *A valuer now valuing the property is entitled to have regard to all relevant facts within his knowledge, including information as to sales subsequent to the specified date for valuation, but should use that information only for the purpose of determining the market value of the land at that date. It follows that though a valuer is entitled to make use of the facts disclosed by subsequent sales, he is not entitled to assume that such information was available to buyers or sellers at the subsequent date.*

In a more recent Queen's Bench Division decision of 1983 *Segama N V v Penny, L E Roy Limited,* Justice Staughton had this to say.

> *In that state of the authorities the arbitrator was, in my judgement, entitled to hold that the evidence as to rents agreed after the relevant date was admissible, andl consider that he was right to reach that conclusion. If rent of comparable premises had been agreed on the date after the relevant date, I cannot see that such an agreement would be of no relevance whatever to what the market rent was at the relevant date itself. If the lapse of the time before the agreement for comparable premises becomes greater then, as the arbitrator said, the evidence will become progressively unreliable as evidence of rental values at the relevant date. The same is no doubt true of rents agreed some time before the relevant date: but nobody suggested to me that those should be excluded. So, too, political or economic events may have caused a change in market rents, either before or after the relevant date. All those factors must be considered by the arbitrator in assessing the weight to be attached to a rent agreed for similar premises, whether before or after the relevant date. It may happen that no rents of comparable premises that were agreed on the relevant date, or for months beforehand, can be found, but a great number very shortly thereafter. It does not seem right to me that the Arbitrator would be bound to disregard them. I recognise that different judges may take different views on this issue but, for my part, I feel bound to say thatI consider that the Arbitrator's conclusion was right.*

Based upon such legal decisions, my interpretation is that the further away from the operative date the less reliable the evidence becomes and it is a matter of weight to be placed on the whole range of evidence available.

Thus a valuer need not necessarily exclude subsequent evidence, but the prime data is that which was available as at the relevant date.

It would be unreasonable, in my view, if information was used to show a trend after the valuation date which was not capable of prediction as at that date.

When there is sufficient evidence of value at the date of valuation it carries a far greater degree of weight than subsequent events.

Rental Inducements

During the recent high demand and buoyant redevelopment years that existed up until mid 1987 in the main centres of New Zealand, office rental levels increased considerably with each new leasing setting a higher rental and a springboard for the next development.

There seemed to be an unsatisfied demand for new hi-tech office space which was being leased prior to building completion and in some instances before buildings were commenced.

Rental increases were high during this period compared with previous years, with 15% to 25% per annum compounded not uncommon for well located, prime, air conditioned office space. Such increases for new office premises were also reflected in the rental levels for existing space within older buildings of the Central Business District.

Particularly firms associated with investment and finance needed additional and upmarket accommodation in keeping with their high image at this time. This buoyancy filtered throughout the commercial sector of the market as business increased and the working environment expanded and was upgraded.

However, during the 1987 year, many individuals and organisations who had researched past market trends became uneasy as to just how long the hype of the market could continue.

It was predicted that at the then present rate of building there would be an oversupply of office space by about 1990.

The events of October 1987, the sharemarket collapse, and in December 1987, the Government announcement in respect of superannuation fund investment in property, were not foreseen

and indeed the depth of market reaction even well into the 1988 year and beyond came as a surprise and a shock to the business community.

Commencing in 1988 and continuing into 1989 the New Zealand and overseas economies have reeled from the liquidation, receivership or substantial losses of major companies.

Except for committed redevelopments many planned buildings were abandoned in this uncertain market with this impacting upon developers who have been faced with considerable holding charges on in some instances cleared land.

There have been examples of considerable upfront payments to well established lessees for taking substantial areas within developments that would otherwise not have proceeded. Having obtained a substantial tenant for possibly in excess of 80% of the total development this has enabled developers to continue with their plans and construct the buildings as financiers have been prepared to accept the funding in these situations.

To the developer this inducement merely is part of the development cost.

To the lessee it is areduction in the rental over the period of the lease.

There have been several such inducements with new developments and it is usual that there is a confidentiality clause associated with them.

In addition to these inducements on new developments there have been either lump sum payments or rental reductions within existing buildings either under lease renewals or rent reviews again where there has been a confidential agreement between the lessor and lessee with these situations not recorded within the document, possibly with the intent of influencing other lessees within the same or a similar building.

Further it is now quite common as an encouragement to lessees to select particular accommodation that rent free holidays or no charge for existing partitions for the first term or other similar inducements are being offered and accepted throughout the commercial sector.

In analysing rentals where these apply I agree with Dr Whipple that they must be reflected as part of the market transaction.

Building Outgoings or OPEX

In most major cities of New Zealand leases have progressed from gross leases of the 1960's where the lessee was responsible for say the rental and in addition paid either the total or increase in a minimal number of outgoings such as Local Authority rates to the net leasing situation whereby lessees pay the net or base rental and in addition are responsible for all outgoings that are reasonably chargeable against the property.

These outgoings or OPEX vary from year to year and are generally budgeted in advance by the lessor, paid monthly with the net or base rental in advance and reconciled as soon as possible after the lease year has been reached.

In comparing these net leases between properties because the outgoings also vary from property to property the only true comparison is on a gross basis, that is the Gross Occupancy Cost, GOC, payable by the lessee including both the base rental and the OPEX.

It is quite erroneous in my view to compare the net rental from building to building where such outgoings vary.

Thus I do not see the difficulty with such items as Land Tax as Dr Whipple, except if this is altered during the term or where the ratchet clause comes into effect as at the rent review date.

Quite clearly in my view where you have two identical sites one with a multi-storey building on it and the other less intensively developed where the Land Tax charge per unit of floor area will be higher in one than the other, the lessee should pay the same occupancy cost if the buildings are identical and it is the lessor that receives a lesser net rental where the Land Tax is higher than the other.

Key Money

Even with the current downturn in business confidence and the plateau of many retail rentals, key money, which is quite separate from the sale of a lease, still changes hands between an outgoing and incoming lessee in such major retail locations of Lambton Quay, Wellington, and also in Queen Street, Auckland.

Such payments which are generally labelled key money but can also go under the guise of many other descriptions are in my view rental paid in advance.

These amounts paid either to the lessor or the outgoing lessee should in my opinion be treated as part of the rental just as the reverse applied with rent free holidays currently being obtained for first leasings of office space. The difficulty that the valuer faces however is obtaining the amounts so paid unless he has been directly involved in the rental settlement.

Conclusion

In the valuation of rentals for commercial property, valuers will be confronted with numerous different lease variations. Conlficting rental settlement evidence will be obtained from various sources.

Asking and offered rental levels will also conflict in a volatile market.

It is the valuer's role to independently weigh this evidence and apply the principles of past court and arbitration decisions in arriving at the fair market rental, current market rental, open market rental, full market rental or whatever under the lease document. A

Balance Sheet Valuations

by G J Horsley

Generally accepted accounting principles require that companies not only keep proper books of account but also that the balance sheet shall give a "true and fair" view of the affairs of the company at the end of the financial year.

That very simple principle has over the last decade led companies to disclose information in their financial statements as to the current value of the real estate assets of the company.

In 1980 the New Zealand Institute of Valuers first published guidance notes with background papers on the valuation of fixed asset and certain other non current assets for reporting purposes. They strongly recommended these standards as their preferred option for valuation of non current assets for use in corporate financial statements. The New Zealand Institute of Valuers are members of The International Asset Valuation Standards Committee (TIAVSC) and the NZIV have undertaken to assist all controlling and regulating authorities both statutory and voluntary and societies of other concerned professions in Australia to ensure that published asset valuations comply with the standards and guidance notes of TIAVSC.

Valuation standards and procedural guidance notes published by TIAVSC are undertaken following close liaison with the International Federation of Accounts, the International Accounting Standards Committee and the International Auditing Practices Committee as far as this work relates to the treatment of fixed assets and financial statements.

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...in determining the value of real estate assets...the valuer remains responsible for the quality of his or her work...

Financial statements are the representations of management who are responsible for the presentation of the statements and conformity with general accepted accounting principles. When a valuer determines or assists management in determining the value of real estate assets that are included or disclosed in financial statements, management's responsibility does not change although the valuer remains responsible for the quality of his or her own work.

Ideally when receiving instructions as to valuing real estate for inclusion in the financial statements of the company, the valuer and client representatives responsible for financial accounting and reporting matters should agree on the nature and scope of the work to be performed. The valuer should be informed about the client's plans and intentions for the property and about the eventual intended use of the valuation report. The valuer should be asked to provide sufficient information in his or her report that will ultimately satisfy the auditor of the financial statements. Such information may include, for example, support for significant assumptions, market analysis, comparable sales and capitalisation or discount rates used. If such information is not to be included in the valuation reports arrangements should be made during the instruction phase for the company's auditor to have access to the valuers supporting documentation so that the auditor might better understand and approve the basis of valuation, the facts relied upon and any assumptions made. In so doing the auditor is not him self valuing but checking the basis on which the valuer has arrived at the valuation. The auditor must be satisfied that the valuation is reasonable and that it represents a "true and fair" view as to the worth of the asset in question.

The basic tenements of valuation principles and practice remain constant, and balance sheet valuations must reflect the fact that the assets are in continuing use by the undertaking for the purpose of its current activities. The prime assumption of an asset valuation should be "value to the enterprise". The process of undertaking balance sheet valuation is simply one of estimating "market value" or other properly defined value of an identified interest or interests in a specific parcel or parcels of real estate as of a given date. It should be noted that "market value" and "open market value" are intended to be identical and interchangeable in that they are both based upon the concept that all prospective purchasers of a property will have the opportunity of entering into the transaction. Being the most fundamental basis for asset valuation it is as well to spell out the full definition so that its meaning may be more easily appreciated.

Open market value is the price for which an interest in a property might reasonably be expected to be sold at the date of valuation assuming:

a. a willing seller,

b. a reasonable period within which to negotiate the sale, taking into account the nature of the property and the state of the market,

c. that values will remain static during that period,

d. that the property will be freely exposed to the open market, and

e. that no account will be taken of any higher price that might be paid by a purchaser with a special interest."

It is worth pausing for just a moment to dwell on this definition as it has now been refined to its present state over 15 years of international debate and could therefore perhaps be carved in marble for posterity. At first sight the only thing that one might question is sub paragraph a. above where the first assumption is a `willing seller' but apparently not a `willing buyer'.

This is entirely deliberate. In any proposed transaction there must be a vendor who is willing to commence the process by willingly placing his asset upon the market with an intention to sell but it is not by any means necessary to assume that there is a market for his asset at a particular moment in time either at his price or any other price. Indeed it is essential to the concept of market value that the market is an open forum out of which there may or may not come a purchaser. It is a matter of fact not of presumption and the vendor is faced with whatever market (or lack of it) exists for his asset. Accordingly it is for the valuer to assess the reality of the marketplace at the time of the valuation when considering his opinion of the level of value he will attribute to the asset concerned. Indeed it is by no means unusual for nil or even negative values to be quite properly arrived at.

Some may find this difficult to come to terms with because of the old adage that everything has its price. Remember that we are concerned in asset valuations with the worth of assets within continuing businesses for financial statements. If an asset contributes nothing or less than nothing to the profits of such a business it is both correct and prudent to consider attributing a nil or negative value. Whilst open market value therefore is the prime concept, there needs to be an extension of it to take account of the value to thebusiness of properties occupiedby the undertaking itself and this definition is termed "market value for existing use" to distinguish it from the value of the premises for any other purposes which if clearly different from existing use value should be reported by the valuer as "alternative use value".

To summarise at this point, all the assets of a continuing enterprise not actually occupied or used specifically for that undertaking should be valued to "open market value". Whereas all those assets occupied and used for the purposes of the undertaking itself should be valued to "open market value for the existing use". Essentially, asset valuations will be concerned with what are termed "fixed assets", as opposed to current assets (which may be expected to be consumed within the normal course of trading), or assets which are neither fixed nor loose; and fixed assets themselves may be sub-divided into "tangible assets", "intangible assets" and "financial assets". The first of these will include land and buildings, plant and machinery, fixtures, fittings, tools and equipment, payments on account of tangible assets and assets in the course of creation. The intangible variety will include research and development costs, concessions, patents, licences, copyrights, trade marks and similar rights, goodwill and payments on account of intangible assets. Lastly, financial assets will include all shareholdings, loans and investments.

The asset valuer will normally only be concerned with tangible assets and will be a person of good repute with appropriate qualifications and experience in valuing the particular categories of assets in their localities, being a member of a recognised professional body concerned with the valuation of fixed assets or appointed by the Courts or other authority of equivalent status.

The Valuation Certificate, or appraisal report, will normally report valuations within the following categories and on the following bases:

a. For properties occupied by the undertaking - either market value for the existing use or, where a market value cannot be assessed, depreciated replacement cost subject to adequate potential profitability.
b. For properties which are surplus to operational requirements; market value.
c. For properties held by the undertaking as investments; market value.

Generally speaking, owner-occupied properties, ie those in use by the undertaking itself, may be either non-specialised or specialised. Non-specialised properties are those which are usually bought or leased in the open market for their current or a similar use and for which a market value can be ascertained. Specialised properties are those which are rarely if ever sold for a continuation of their current use (for a variety of economic or technical reasons) and consequently, it is likely that there will not be evidence of any market transactions involving comparable property, in which event, the depreciated replacement cost method of arriving at valuation is normally the only satisfactory approach.

Investment properties are those held for income and/or capital appreciation, valued to open market value, and properties which are surplus to requirements are those which are declared by the management of the undertaking to be no longer required for occupation for the purposes of the business within the foreseeable future and therefore available for disposal, again valued to open market value.

Many properties may be designed or adapted for particular uses such as hotels, cinemas, theatres, petrol filling stations, casinos, marinas and other specialised leisure and sporting facilities and may either be owner occupied or held as investments or classified as surplus to requiremnts. They are normally valued having regard to trading potential, reflecting the prices paid for comparable properties in the open market.

Plant and machinery

A valuation of land and buldings will normally include those building service installations which permit their use by an occupying business, such as electricity, gas, water, drainage, heating, ventilation, air conditioning, lifts and allied facilities.

Where, however, plant machinery and equipment is used mainly for the process purposes of an occupying commercial or industrial enterprise, it will be separately valued as part of the fixed assets, substantially in accordance with the basis of valuation already given for real estate, ie. `value to the business' which is equivalent to "Open Market Value for existing use"and will usually be the net current replacement cost of the asset or its recoverable amount (the value obtainable from continued use of the asset over the remainder of its useful life, plus any residual net realisable value from its disposal at that time).

Because the financial statements within which asset valuations appear are normally prepared on the assumption that the undertaking will continue in operational existence for the foreseeable future, net current replacement cost will be derived by depreciating the gross current replacement cost of an essentially similar asset in new condition, to reflect the asset's remaining economic working life. Alternatively, of course, where there is readily available market evidence, the net current replacement cost will be the cost of acquiring a similar asset with the same remaining economic working life in the open market, plus the depreciated costs of installing the existing asset.

Net current replacement cost will be reported as subject to the adequate potential profitability of the enterprise having regard to the value of the total assets employed. The recoverable amount basis, referred to above, will obtain when the value of the asset is below the net current replacement cost.

Conclusions

As individual asset valuers, each of us should have a copy of and understand these standards. At future meetings within the profession it would be appropriate to hold workshops to discuss particular guidance notes, background papers, and associated valuation issues. Each of us should participate within our profession to ensure that these standards are adopted and are established as the norm of our marketplace. It is essential that we apply these standards in all assignments for which they are applicable. Misunderstandings can arise so easily by failure to communicate and perhaps that is the greatest lesson of all. If we can learn to talk to each other with common understanding throughout our dealings, then the establishment of standards for the valuation of assets will have played its part.A

The Evolution of the Highest and Best Use

by R V Hargreaves

Although the language of real estate seems static, it is not. - James Graaskamp

1.0 Introduction

The concept of highest and best use is basic to valuation. Property students are taught at an early stage in their courses that the present use of a property may not be the highest and best use. An example could be a Hawkes Bay sheep farm surrounded by pipfruit orchards. In this case, purchasers would base their offering prices on the most profitable land use. If orcharding is more profitable per hectare than sheep farming, or other alternative land uses, then the highest and best use of the sheep farm is orcharding.

The most profitable land use this year may not be the most profitable land use next year. For example, current difficulties with the kiwifruit industry have resulted in the removal of the vines from some established Bay of Plenty orchards.

When the property has a good house and is handy to Tauranga, it may now be worth more as a lifestyle block without the vines than as an orchard. Thus, highest and best use is a dynamic concept that changes as demand patterns change in the real estate market.

In line with the changes in economic thought overtime, there have also been changes in the definition of highest and best use. This paper outlines these changes and then goes on to discuss some of the current issues with the application of highest and best use theory.

2.0 The Classical Concept

The classical definition of highest and best use was expressed by Babcock (1932):

That available use and programme of future utilisation of a parcel of land which produces the highest present land value.

This definition is based on the free market approach advocated by the economist Adam Smith. Smith argued strongly against any type of government intervention in the marketplace. The classical concept of economic man developing property to its highest and best use was clearly seen in terms of what was best for the individual and not what might have been best for society as a whole. Historically, societies with a large amount of undeveloped land and a small population base have been relatively unconcerned about the question of public versus private land use rights.

In New Zealand the pressure for land settlement during the early days of European occupancy resulted in a highest and best use forrural land that first saw the millable timberremoved from the bush and then saw the cut-over bush removed to make way for pasture and livestock farming. In the space of a couple of generations, a large percentage of the landscape was transformed from indigenous forest to pasture. Except in a few relatively isolated localities, and in the National Parks, indigenous forests no longer exist.

These days, however, if the farmer is contemplating changing a block of indigenous forest into pasture there is likely to be considerable opposition from the environmental lobby. In several recent cases, cutting bush on privately owned land has been blocked by outside pressure groups or planning regulations. Clearly, the idea that economic man can operate in a vacuum without recourse to the public good is not a realistic proposition.

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3.0 The Modern Concept

The textbook definition of highest andbest use has been changed in recent years in recognition of the community influences that act on property decisions. For example, the definition of highest and best use contained in *The Appraisal of Real Estate* (1983) defines the concept as:

The reasonable and probable use that supports the highest present value, as defined, as of the effective date of the appraisal.

Alternatively:

The use, from among reasonably probable and legal alternative uses, found to be physically possible, appropriately supported, financially feasible, and that results in the highest land value.

The second definition only applies to the property as if it were vacant. This modern definition of highest and best use raises the following questions about land use for the valuer.

1. Is it legally permissible?
2. Is it physically possible?
3. Is it financially feasible?
4. Is it adequately and appropriately supported by the market?
5. Is it reasonably probable?

3.1 Legally Permissible

Speedy (1980) explains that since the introduction of Town and Country Planning Legislation, there has been a general recognition that individual property rights have to be reduced in order to create new property rights on behalf of the society as a whole. Without some controls, the individual is likely to put up buildings that may have the effect of blocking the sun from neighbouring properties.

Similarly, individuals may pollute the environment or exploit the natural resources in such a way that the value of nearby properties are depreciated. Public controls on these types of activities help to maintain neighbourhood property values and discourage individuals from exploitive types of development.

Planning regulations normally affect the size and type of building that can be put on a site. They can also be used to

regulate the type of activity carried out on a site. Legal restrictions influencing highest and best use can be found in lease agreements. For example, farm leases may have cropping restrictions imposed on the lessee. Similarly, a ground lease specifying residential usage would inhibit redevelopment to more profitable commercial activity.

3.2 Physically Possible

The question of what sort of improvements are physically possible on a site relates to the contour of the land and its underlying geology as well as the size and shape of the site. A very steep site will generally be unsuitable for a suburban shopping centre. Tall buildings will not be possible unless the underlying geological structure can support the necessary foundations. Small sites may be uneconomic for redevelopment unless they are amalgamated into larger sites. Irregular shape sites are generally more expensive to develop than regularly shaped sites.

3.3 Financial Feasibility

Having ascertained a range of uses that are both physically possible and legally permissible, the next step is to carry out a feasibility study to assess the best option. For a particular site, the options may range from a two-storey to a five-storey office building development. The capital costs of each option would be calculated along with projected income and expenses for each option. The return on investment would then be calculated to show which was the most profitable development under a range of financing and after tax scenarios.

3.4 Market Demand

The demand for the type of property envisaged under highest and best use is a very important consideration. As a general rule there is usually plenty of land that can be made available for any given land using activity. Developers tend to all look at the same demand signals without looking at the cumulative effect of their actions on the supply side of the equation. This means that if there is only a demand for one more office block in town and three new office blocks have been built, then rental levels will fall and there will be surplus of vacant office space. Demand must be supported by purchasing power. Many consumers have a desire to upgrade their accommodation but only a relatively small number have the finance necessary to achieve this.

3.5 Probability

The introduction of probability into the concept of highest and best use is in line with modem property management theory. There are a number of possible uses for which most properties can be applied; some uses have a much higher likelihood of occurring than others. In thereal world, most development plans fall short of the ideal because of the trade-off between expediency and maximising the use of the site. Developers are well aware of the long time delays in the objection and appeal procedure under the planning process.

Time delays in planning procedures are very costly for developers and this factor is often used by their opponents to try to force them to agree to smaller compromise developments. A developer faced with the option of having to wait two years to obtain planning permission to put up a large controversial office tower or being able to obtain immediate planning permission for a smaller non-controversial office building may well take the latter option. The developer will be aware of the added legal and holding costs associated with the first option and the cash flow implications of these on the business. Perhaps more importantly, the developer will want to continue in business in the same city and may be aware that institutional purchasers of completed projects do not like to be associated with controversial developments.

3.6 Most Fitted Use

Professor Graaskamp (1981) advocated that highest and best use should be replaced by the terms "most fitting use" and "most probable use". Graaskamp said the most fitting use is that which best reconciles consumer demand, the cost of production, and the impact on third parties. He went on to say that the most probable use will often be something less than the most fitting use, depending on political constraints, real estate technology, and cash flow pressures on participants in the real estate process. Graaskamp suggested the interaction of valuers with planners will help to resolve questions relating to most fitting and most probable uses. The valuers will also need to evaluate financially the various options and the cost of these on both the developer and outside parties.

4.0 Highest and Best Use Improved

This concept is used with respect to the existing improvements on a site. At the present time there is an oversupply of motel units in Palmerston North. This means that motels generally are experiencing low occupancy rates and some of the older and smaller motels are no longer economic. Given the demand for rental accommodation in the city, the highest and best use for some motels is conversion to rental flats.

At some time in the future the demand for motel units will probably increase and it is possible some of these units will be refurbished and converted back into serviced motels. As motels are generally a much more intensive land use than the adjoining residential properties, it is unlikely that the buildings will be demolished or redeveloped. Thus, in the medium term, it will be a case of utilising the existing improvements to the best possible advantage.

5.0 Highest and Best Use as Though Vacant

In this case existing improvements to the site are ignored and highest and best use is assessed on the basis of a vacant site. The land residual method is the most frequently used valuation approach for the assessment of land value. The analyst considers a number of possible development scenarios and chooses the most profitable option. For example, a proposed new development may generate an income stream of $3 million per year and have a building cost of $30 million. Capitalising the income at, say, 8 per cent produces a value of $37.5 million. Deducting the building cost from the total value of the project leaves a residual land value of $7.5 million.

Valuing an improved site as if it were vacant is not in line with modern economic thought. Ratcliff (1972) made the point that:

> *The appraiser therefore is forced to resort to fiction, an assumption that the land is vacant, and an estimate of what the hypothetical vacant land would sell for...*
>
> further,
>
> *We therefore raise the question of whether a land value which assumes a non-existent use different from actual use can be meaningful as the measure of the contribution of land alone to the total market value of the improved subject property and whether it is additive to another hypothetical figure independently determined for the subject structure so that the total is the most probable selling price of the property.*

The modem economist sees land as simply one factor in the production process. Without the combination of capital, labour, and management, land on its own is not a productive entity. Separating the income from a property into that attributable to the building and that attributable to the land is fraught with difficulties. The residual approach only makes economic sense under certain limiting assumptions. These are that except for

one factor, the market price of the resources are equal to their marginal value product, and that the reward to each factor is exactly equal to its marginal productivity.

This is known as the Euler principle which assumes a linear homogeneous production function. It turns out that this type of production function may be atypical in the real estate market. Even if we are confident that the market value of all non-real estate factors are equal to their marginal value products, we are still faced with the awkward apportionment between land and improvements. According to Ratcliff, the only circumstance where we can be confident of the value of the improvements is where the site is already being utilised to its highest and best use and we have good market evidence for the value of the land. This implies that new improvements on the site have market value equal to their cost. Valuers will be aware that cost is seldom equal to market value.

When assessing highest and best use as though vacant, it is an underlying principle that any detrimental factors resulting in sub-optimal use of the site should be attributed to the improvements and not to the land.

6.0 Highest and Best Use in Areas of Changing Use

The difficulties of applying the classical land residual approach are becoming highlighted in rapidly changing inner city areas. Because there is usually a dearth of vacant land sales in built-up areas, valuers are forced to use the sale of improved properties purchased for redevelopment. If a developer paid $5m for a redevelopment site, then the assumption is that similar sites would also be worth $5m. (For simplicity we will ignore the cost of demolition.) However, this assumption can only be true if there is another developer waiting in the wings to purchase a similar redevelopment property.

If demand is limited (and it usually is) then it is surely not valid to impute a price paid at the margin across a range of similar properties. As Murray (1969) points out, the site under the empire State Building may well have a different value to an identical site right next door. The reason for this is that the market can only support, let's say, one Empire State Building. As soon as this building was put up, then the highest and best use becomes something less. In a city like Palmerston North, the supply of office space can be dramatically altered by the erection of one more office building, particularly if it is a reasonably large one for the town. As soon as a new office building is put up, the highest and best use of the site next door to the new office building most certainly isn't a new office building since the new building has absorbed all the market demand over perhaps the next two years.

Mahoney (1974) makes a similar point using the analogy of a corner store at the crossroads. If there is a demand for only one store in the locality, then once this demand has settled on a particular site on the corner, the highest and best use for the remaining three sites will probably be their existing use.

When establishing the highest and best use of properties that are not yet ready for development, it is necessary to recognise interim best uses. Assuming that a property is not going to be redeveloped for five years, then the interim best use will be to continue to utilise the improvements until the property is `ripe' for redevelopment. Demolishing the existing improvements too soon will result in a reduction in the future earning capacity of the property.

Properties with inappropriate improvements have a much higher chance of being redeveloped than properties that are being utilised at, or near, highest or best use. Thus it is possible to predict the properties most likely to be redeveloped and assign an interim highest and best use to them.

7.0 Implications for Rating Valuations and Land Tax

The Valuation of Land Act 1951 requires two highest and best use considerations for all properties being valued. First, the highest and best for capital value, and secondly, for land value. Applying the modern concept of highest and best use to capital value does not present a problem so long as the values arrived at are in line with the market.

There is, however, a problem with the assessment of land value. The Act specifies that when valuing for land value, the improvements on the site must be ignored. Two identical sites side by side, one vacant and one with a building will both have the same land value. There is some logic to the use of this approach for rating valuations since it does achieve uniform land values between similar properties. The danger is that land values may be too high if they are based on the sale of a few redevelopment sites that do not reflect the overall demand factor.

To some extent, the difficulties with assessing land value under the Valuation Land Act 1951 are recognised by sections 25A to 25E of the Act. These subsections allow special rateable values so that in particular circumstances, as defined by the Act, individual properties can be valued as to actual use rather than market value. The operational problem is that the special rateable values only apply in very specific circumstances. They do not cover all situations where rating difficulties are encountered.

The 1989 budget increased the number of properties that are liable for land tax to approximately 56,000. Land tax is assessed on land value. Ratepayers have generally been content to live with the present method of assessing land value as it does achieve uniformity, and the level of land values-is not particularly important. With land tax, the issues are different because a higher land value results in a higher land tax bill. Opponents of the land tax are likely to question the present system of assessing land value because it appears to create a `fictitious' level of values in areas of changing use.

8.0 Summary and Conclusions

The definition of highest and best use has changed over time. Initially, highest and best use was a product of laissez-faire economics with the focus very much on what was best for the individual property owner. The modern concept recognises that land use decisions are the end product of a process that involves owners, consumers, and the public infrastructure. Land owners will still strive for the most profitable use but this has to be in harmony with the public interest and consumer demands.

The concept of considering an improved site vacant and assessing land value from the sales of redevelopment properties is inconsistent with modem macro-economic theory. The over-valuation of land at the expense of improvements causes a distortion in the pricing of productive factors. A

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MPUTER FORUM

Compiled by Leonie Freeman

Managing and controlling PCs security, housekeeping, computer viruses

Personal computers continue to receive media hype where used as tools to "hack" systems or contract "viral"infections which can delete program and data files. However, they produce real productivity gains in uses *ranging from simple word processing to complex financial analysis. All organisations have* seen *accelerating growth in usage and employees continue to demand additional units.* How can *this growth be managed and controlled?* Jan Smolnicki, *Computer Audit Partner at Price Waterhouse, provides the following advice.*

More and more people are using personal computers for an ever widening and varied range of uses. Individual PCs are becoming increasingly powerful and can carry out more sophisticated and complicated tasks.

As a result, the importance of the programs and data and their continuous reliable and accurate operation becomes critical to an individual user, the department or the organisation. Important management decisions are made using extremely sensitive data stored in PCs and it is essential appropriate controls are in place to keep this information secure. Your organisation should protect itself against the public embarrassment and legal action that could ensue from the use of "pirated" software.

A further complication in today's microcomputer environment is the software virus. A software virus is a deliberately placed program code intended to confuse the user or cause malicious damage to other programs and data files. It is quite often embedded in an innocent looking program and is able to reproduce itself onto other diskettes that are introduced into the microcomputer. This article summarises the most important security and housekeeping procedures for a controlled PC environment. These procedures should be explained during the initial training for a new user and periodically refreshed for existing users.

We have defined 30 basic rules which will help ensure that your PC will continue to provide reliable information within a secure environment. These rules have been divided into 10 housekeeping rules to provide a continuous service, 10 security principles to provide a controlled environment and 10 rules to protect your organisation against viruses.

Housekeeping rules

REGULAR BACKUP

How long will it take to re-input the model, data, document or program you have just finished inputting? Develop a routine so that you take a backup copy onto a separate diskette when you finish and store the copy securely but not near the original.

DELETE OLD FILES

Delete all those old documents and data files, release the disk space and increase the performance of your programs.

DOCUMENTATION

Have you documented how to use the program or what input is needed for the model to run? Help other people to use the programs and models.

OW "M

CONTROL THE TEMPERATURE

Protect your PC and diskettes from direct sunshine and sources of heat such as radiators. Allow air to circulate freely around the PC to help ventilation of the equipment.

NO SMOKING

Smoke can seriously damage your PC and diskettes. Create a no smoking zone.

BAN FOOD AND DRINK

Sticky fingers and spilt coffee will damage equipment and diskettes. Avoid the problem by banning eating and drinking when using the PC.

PACKAGE SOFTWARE SELECTION

Have you purchased the right product for hour needs? Did you really investigate all possibilities? Was your choice in line with corporate guidelines?

IN HOUSE DEVELOPMENT

Building financial models and writing programs is important and time consuming. Can you be certain your development is complete, accurate, efficient and that it will be easy to maintain and enhance?

SOFTWARE LICENCE

Are all the software products loaded on your PC licensed? Unauthorised copying is illegal and can result in very large fines and unwelcome publicity.

SOFTWARE REGISTER

Maintain a register of authorised and approved software. Record distribution of legal copies to all locations.

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Security principles for personal computers

RESTRICT PHYSICAL ACCESS

Control who has access to the PC, the media (original backup copies) and documentation. Disable the PC and secure the media out of office hours.

CONTROL USE OF FIXED DISKS

Do not keep confidential data or sensitive programs or financial models on the fixed disk instead use diskettes which are stored securely when not in use.

PREVENT HACKERS

Control communication equipment and software to prevent unauthorised hacking into your PC or from your PC.

IDENTIFY USERS

Every user of the PC should be uniquely identified by an individual password and user name.

CONTROL DISPOSAL OF PRINTED MEDIA

Once reports, documents, program listings, graphs, manuals are obsolete and no longer needed they should be shredded if they contain confidential information.

MONITOR THIRD PARTY ACCESS

How do you know if an engineer has accessed the PC and what he/she has done? Control and test upgrades to system software and packages for reliability and security.

PREVENTION OF EAVESDROPPING

All PCs emit signals which can easily be picked up by an unauthorised person using inexpensive electronic equipment to display exactly what is on the PC screen.PCs running sensitive applications can be shielded to prevent emission of these signals.

CONTROL OVER PC INVENTORY

Who has a list of all PC equipment and locations? Is it kept up to date and regularly verified by a physical "stocktake"?

RECOVERY FROM DISASTER

Hasa plan been drawn up or arrangements made so that if your PC failed and was unavailable for a day, a week or a month an alternative PC could be obtained?

MONITOR SYSTEM USE

Is a log kept of who uses the PC and what software they execute? Will this detect use of unauthorised software or unauthorised use of existing software?

Rules to prevent the spread of viruses

RECOGNISED DEALERS

Only purchase software from reputable dealers who can provide a legal licence.

AUTHORISED PERSONNEL

Only authorised personnel should be allowed to load software onto your microcomputers. Employees should be warned about the dangers of loading unauthorised software.

REGULAR BACK-UP

A regular routine to back-up the fixed disk will help to minimise the damage to your organisation in the event of a virus attack.

TEST SOFTWARE

Unknown or untested software should be fully tested on a stand alone microcomputer before being loaded onto your production computers. Test run software from diskette fully before loading onto fixed disk drives.

LOCAL AREA NETWORKS

With multi-terminal and hence multi-user environments organisation need special precautions to ensure that unauthorised software is not loaded from terminals other than the file server.

SOFTWARE CENSUS

Regularly undertake a software census of your microcomputers to determine what software is loaded. Erase all "pirated" software and other unauthorised software.

ELECTRONIC BULLETIN BOARDS

Do not allow personnel to access electronic bulletin boards via your networks.

DIAL UP ACCESS

If your microcomputer network has dial up access, establish rigorous procedures to prevent downloading of unauthorised software to your network.

CHEAP SOFTWARE

Control acquisition and use of free or inexpensive programs by your staff on your microcomputers.

MONITORING FAULTS

Regularly monitor faults and have an established reporting mechanism. Analyse faults to identify recurring problems possibly caused by virus infected software.

These thirty simple rules if applied and incorporated into a corporate PC policy statement should help minimise risks and ensure the continuing business advantage of using personal computers.

VNZ-Link - the new dial-up property information service from Valuation NZ

by Lesley Valentine

Over the past twelve months, Valuation New Zealand has been involved in a substantial upgrade of its computer system to better meet the needs of its major clients and increase the efficiency of the organisation as a whole.

Associated with this upgrading has been the development of a new dial-up personal computer based property information facility which has been designed to replace the existing PROVIDES videotex service.

VNZ found that the Videotex technology behind Provides had considerable limitations and was not able to be developed in conjunction with VNZ's long term plans for the provision of a more comprehensive information services.

VNZ-Link incorporates the best features and facilities associated with PROVIDES and adds among other things a faster method of access, additional search criteria, historical sales data (to January 1981) and more information per screen. Function keys are used to carry out an enquiry rather than the cumbersome videotex commands such as *menu#, *?#, or *bill#.

Having been developed in conjunction with the recent Local Authority Boundary changes, VNZ-Link takes full advantage of regional access to data making knowledge of the specified boundaries between individual City/District Councils less imperative.

What you need to access VNZ-LINK

Equipment

1 An IBM PC AT or XT or compatible (or PS2 series) personal computer. This PC may be stand alone or networked as long as a MS Dos or PC-Dos environment operates.

2 A modem cable of 1200 bps* (or 2400 bps in main centres), connection to Telecom Corporation's Packet Switching network (PACNET).

* bps = bits per second and refers to the speed at which the data travels up and down a telephone line.

Software

3 Micro-tex, a New Zealand developed and award winning communications software package designed to manage all the modem dialling commands and make storage and retrieval of saved screens of information easy and efficient.

Micro-tex is the basic software for a growing number of computer based information services and electronic mail systems in New Zealand.

4. A VNZ-Link gateway module that links to the base Micro-tex software and specifically manages the VNZ-Link commands and security.

What it costs to access VNZ-link

An average enquiry session for a single government valuation or sales record costs between $1.57 for 1200 bps access and $1.12 for 2400 bps access.

Some ways in which VNZ-LINK differs from Valpak or Valpak-2

Your VNZ-LINK subscription gives you Nationwide access.

Lesley Valentine, BSc (hons), is presently Man-4 ager-Conununications for Champagne Consultants Limited.

Lesley has had a number of telecommunications related roles over the last six years including involvement with .L'I'T=POSand a range of computer based in formation enquiry systems.

Champagne Consultants Limited are communications resource specialists retained by Valuation New Zealand to market andsupport the VNZ-Link and PROVIDES information services.

You can locate property sales or government valuation records for any location in New Zealand.

No file maintenance. With VNZ-LINK you are dialling directly into VNZ'S own databases. These are maintained throughout the day by the individual VNZ office around New Zealand.

You can locate the current government valuation record for a property regardless of whether a sale is recorded against it.

Examples of screens from VNZ-Link

VNZ-Link is VERY simple to use with on-screen instruction and help behind every input field. Some examples of the principle screen for VNZ-Link are as follows:

Valuation New Zealand
MASTER MENU

Valuation Roll Information
Property Sales
Real Estate Market Statistics

Change password

Selection ■ ■ ■ •I ■ ■

Call 1 Exit Call 2 Prewous Menu
tan-Next Hd AltS-Or l-ld Enter-Send Enquiry F9-Bill Ctrl F10-Logoff AM Index

Screen 1

Master menu this is the initial screen received, from this a user selects an option (1 to 4) and presses the <enter> key.

```
                    Valuation New Zealand
                                                    Screen Cost:        0
KEY DATA            VALUATION ROLL ENQUIRY

        City/District..      Ward..:   D   R      Region...:
        Street.. .
        Street Number from.:          To..
        Access Type. . .  : A (A=AII,O=Odd numbers, E=Even numbers)
        City/District..... . . :      40 Ward..: _     D R   Region .
        Occupier.Owner Name,:         VALENTINE N
        Street.. .
        Valuation Ref  From.:
                      To..                          (Blank for single assessment)
        Certificate of Title,


Complete any one of the four panels above
F1-Exit    -F3-Clear Screen-    F4-Additional Search Criteria-F-10-Help
Tab-next FId All Fld Ehter-Send Enquiry F9 Bill Ctrl F10-Logoff Alt1-Index
```

SCREEN 3. An optional "additional Search criteria" screen is available to narrow down the search criteria if the user wishes to locate a range of properties

```
                    Valuation New Zealand
                                                    Screen Cost:        75
VALUATION ROLL ENQUIRY              District          40 PALMERSTON NORTH CIT
OCCUPIER/OWNER NAME SELECT   Occuper/Owner  VALENTINE N
Search criteria                     Street
Capital Value          90,000 to    150,000
Floor Area               100 to       160


                                                Roof Construction: T   or I
Set Occupier/owner Name        From     o  Street          Valuation_Ref_Cat._
  VALENTINE MARGARET ANNE  52              MANAPOURI CRE1467053300  R3B
  VALENTINE MARION JT      78              LONGMELFORD 1473034200   R6B


I-Select              FI-Exit     F4-Neer Search Criteria
Search completed, 00003 records read, 00002 matches found.
Tab-next Ad AltO-Clr FId Ehter-Send Enquiry F9 Bill Ctrl FIO-Logoff Alit index
```

SCREEN 5: An example of a Valuation Roll record

```
                    Valuation New Zealand
                                                    Screen Cost:        0
KEY DATA            SALES ENQUIRY

        City/District...          47   Ward.      0R       Region..
        Street .....              WILLIS
        Street Number from.              To..:
        Access Type .....    .: -A (A All,O=Odd numbers, E=Even numbers)
        Sales between ..          26018 to 260190
        Valuation Ref        From.:          /
                                                  Blank for single assessment)
        Sales between ..          26018  to  260190
        Certificate of Title:


Complete any one of the panels above
F1-Exit    -F3-Clear Screen-    F4-Additional Search Criteria    F10Help
VAL  Si  ENO
Tab-next Fid All FIdEhter-Send Enquiry F9 Bill Ctrl FlQ-Logoff AM Index
```

SCREEN 7. An optional "additional Search criteria" screen is also available for sales enquiries, to narrow down the search criteria if the user wishes to locate a range of properties.

SCREEN 2. To carry out a Valuation enquiry a user completes one of the four panels on this screen'. The example shows a search by owner/occupier

```
                    Valuation New Zealand
                                                    _ S reen  Cost:
ADDITIONAL
SEARCH CRITERIA              VALUATION ROLL ENQUIRY
input      District.                  40     Ward.
           Occupier/Owner Name.       VALENTINE N
           Street.
                                      Start          End
Ranges: Capital Value                        to
           Floor Area..                100      to    120
           Net Sale Price ...                 to          ddmmyy
           Sale Date .....                    to          ddmmyy
           Input Date .                       to
                                      Choice         Choice
Options: Land Use .....          ..:  _          or
           Property Category.,                    or
           Wall                                   or
           Root a                                 or
           Age..                                  or
FI-Exit                  Maximum  of  three criteria-only
Tab-next FId AllD-Clr FId Ehter-Send Enquiry F9 Bill Ctrl FIO-Logoff Alit Index
```

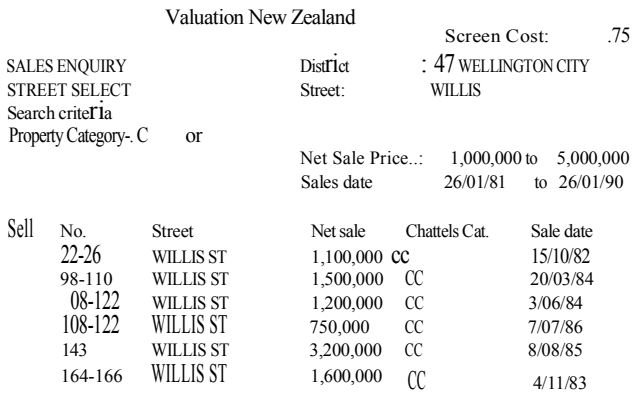
SCREEN 4. An "index" screen results when more than one property meets the users search criteria. To view each property in detail a user simply types <1> beside those of interest.

```
                    Valuation New Zealand
                                                -Screen Cost:       1.00
VALUATION ROLL ENQUIRY          Valuation l 14730 /34 200
                                Extensions
Street          70 LONG MELFORD RD          Date Revised...;   1/05/88
District ..... :  40   PALMERSTON NORTH CITYTBRAS Codes...:   111000
Occ1: VALENTINE ROBERT GEORGE-JT  78 Melford Road        PALMERSTON NORTH
0cc 2: VALENTINE MARION-JT
                          Capital Land      Improvements      Trees
Sec 2 Values...:          110,000   60,00 O   50,000
Special Values.
                          RATEABLE
Category..: R6      RESIDENCES BUILT 1960-69
Nature of improvements, .: DWG   0/B  B/T
FloorArea:          110 (SqM)     Use.   Residential      Age..1960/69
Land aarreeaa.      1499 (Sq.M.)  Zone .: Residential      Units.: 1
Construction.   : Walls..: Weatherboard     Reef. : Steel/Galy. Iron
Condition..  Walls..:Average                Roof.: Average
Certs. of Title,:    6   /   845    1   41   /        /
Legal Description: Lot 1 D P 17604

E1-Exit    -F2-Last Screen    F6-Sale Information
Tab-next Ad AItD-Clr FId Ehlte d Enquiry F9 Bill Ctrl F-10-1-ogoff AlitIndex
```

SCREEN 6. To carry out a sales enquiry a user completes one of the three panels on this screen. The example shows a search by street address.

```
                    Valuation New Zealand
                                                    Screen Cost:        0
ADDITIONAL
SEARCH CRITERIA              SALES ENQUIRY
Input:     District.....              47     Ward.....
           Street ..... :    .... `. WILLIS
           Street Number From...:          To.     9999
           Sales between.....        26/01/81 To,     26/01 /90
                                      Start          End
Ranges:  Capital Value ...                 . to
           Floor Area...                        to
           Net Sale Price. ,  ,  .. ,    100000D to     5000000_
           Input Date.....                      to          ddmmyy
           Production ..                        to
                                      Choice         Choice
Options:  Land Use.....                    or
           Property Category.          C   or
           Age.....                       or
FI-Exit                  -Maximum  of three_Criteria_only
Tab-next Fld AItD-ClrFld Ehter-Send Enquiry F9 Bill CtrlF10-Logoff Altt-Index
```



Valuation New Zealand

Screen Cost: .75

SALES ENQUIRY
STREET SELECT
Search criteria
Property Category-. C or

District : 47 WELLINGTON CITY
Street: WILLIS

Net Sale Price..: 1,000,000 to 5,000,000
Sales date 26/01/81 to 26/01/90

Sell	No.	Street	Net sale	Chattels Cat.	Sale date
	22-26	WILLIS ST	1,100,000	cc	15/10/82
	98-110	WILLIS ST	1,500,000	CC	20/03/84
	08-122	WILLIS ST	1,200,000	CC	3/06/84
	108-122	WILLIS ST	750,000	CC	7/07/86
	143	WILLIS ST	3,200,000	CC	8/08/85
	164-166	WILLIS ST	1,600,000	CC	4/11/83

(,Select Fl-Exit F4-New Search Criteria
Search completed, 00112 records read, 00006 matches found,
Tab-next Fld AltD Clr FRd Ehter-Send Enquiry F9 Bill Ctrl F10-Logoff Alt1 Index

SCREEN 9. An example of a property sales record.

SCREEN 8. As with valuation enquiries, an "index" screen results when more than one property meets the user's search criteria. To view each property in detail a user simply types <1> beside those of interest.

Valuation New Zealand Screen Cost 0

SALES HISTORY Valuation Ref 17270 / 4800-
Ditrict. 47 WELLINGTON CITY

Street.. . . . : 108-122 WILLIS ST Date of sale...: 3/06/84
Type of sale...: UNBLE Net Sale Price. : 1,200,000
Classification. 110 Chattels.
Land Area, . 1007 (Sq.M) Others. .
Cert of Title. ..: 6/ 955 / 45 TBRAS. 121500
Vendor/Buyer.
Nature of Imp..: OFFICE RETAIL BLDG
Legal Description: Lot1/3PT Lt4DP1Q83ETC CT95

Valuation	Capital	Land	Ratio
1/07179	930,000	840,000	1.29
01/07/84	1,600,000	1,500,000	.75

Land Description

Category. COM'L IAND & BLDGS IN CRD Age..... 1980-89
Zone ..... ;COMMERCIAL Walls ..... : Brick
Use: COMMERCIAL Wallscond:: Average
Floor. : 2320 (Sq.M.) Roof... STEEL.GALV.IRON
Units..: 20. Roof Cond..: Fair

F1-Exit -F2-Last Screen F6-Sale Information

Tab-next Fill AltD-Cir Fld Ehter-Send Enquiry F9 Bill Ctrl F10 LogoffAM Index

For further information on VNZ-Link please contact either your local VNZ office or Champagne Consultants:
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Computer models for valuation use now available

by Anthony Beverley, Leonie Freeman, Terry Boyd.

The authors of this article have been directly involved in the research and development of a comprehensive computer package for property professionals fort the last 18 months. Their project was described in the June 1989 issue of the Valuers Journal (pp 44/45). This article is intended to bring practitioners up to date on progress by describing the broad nature of the package which has been developed and which *is now available for release.*

The system aims to improve the efficiency and productivity of property professionals by providing practical computer based analysis tool within a desktop micro-computer environment that can be used simply and effectively by practitioners with little computer experience. The tools or techniques have been specifically designed to assist valuers and analysts to improve the speed, accuracy and precisions of the jobs carried out on a day-to-day basis.

The system consists of a series of autonomous valuation and investment feasibility study models for urban income producing property.

A major design objective has been to focus the system on providing the basic property evaluation techniques or methods used by practitioners in their everyday work, as well as the more advanced and sophisticated discounted cash flow and associated techniques. Each of the commonly accepted methods or techniques which have evolved within the industry for the analysis of urban income property, has been represented as a separate "model" within the system. The models provided within the initial release of the system are:

STATIC MODELS

GENERAL
Land Residual Model
Sale Analysis Model
INVEST. PERFORMANCE
Development Feasibility
Purchase Feasibility
VALUATION
Direct Capitalisation
Insurance Valuation
Land & Bldgs Summation

DISCOUNTED CASH FLOW MODELS

GENERAL
Land Residual Model

---- INVEST. PERFORMANCE
Development Feasibility
Purchase Feasibility
-- VALUATION - -
Cap.Mkt/Ded. PV shortfall

A feature of the package, and a major advantage over traditional spreadsheet systems, is the user-friendliness of the environment. Practitioners with little computer experience can easily capture the potential of the models and other utilities with very little down time in learning how to use the system effectively. The structural and design features which achieve this are:

- comprehensive menus the models and system utilities are totally menu driven.
- user friendly model structure each model follows a logical format comprising a label and prompt system; on-line help is available for each prompt. Comprehensive user manuals describe the format and structure, how to use and optimise the system together with the concepts and logic underlying each model.
- applications flexibility the user is able to carry out as simplistic or as detailed valuation/study as desired. This is achieved by a hierarchy of detail windows associated with each prompt or cash flow item within each model; the user can simply enter a ($) figure at the prompt or hit the relevant key to jump to the desired detail window associated with that prompt to build up the required figure. This figure is then taken back to the model as the prompt data.
- single or multiple time periods the system provides basic techniques which take no account of the timing of cash flows (Static Models) as well as the techniques which account for the timing of cash flows (Discounted Cash Flow Models).
- Risk/sensitivity - the models incorporate in a very practical way a sensitivity study which enables users to efficiently and effectively examine the likely range of outcomes or the risk element.
- educational aid - the methodologies underlying the system were extensively researched with a substantial input from practitioners. The system can serve as an educational aid: valuation or investment feasibility at the speed and level of detail determined by the user. The models and detail windows also act as a checklist to the type and range of cash flow items that may need to be considered for that particular job.
- powerful data storage system utilities provide archive and retrieval facilities to both internal and external storage devices. Previous jobs can be archived and retrieved, and active jobs can be re-worked without data loss.
- expandable development environment-the system has been developed on "Advanced Revelation" a powerful (4GL) development environment designed for microcomputer environments. The system runs on IBM micros and compatibles, under the MS Disk Operating System. The flexibility of Advanced Revelation ensures that further models utilities and features can be simply added to the package and menu systems at any future stage.
- single & multi-user the system runs on both single (stand alone) micros and on full multi-user micro-computer networks.

The intention in developing the package is to provide a series of computer based tools which will be used by practitioners on a day-to-day basis to provide an increase in the productivity and therefore profitability of the firm. The first release of the system is now available and interested parties are invited to contact the General Secretary of the New Zealand Institute of Valuers for details. A

IN THE LAND VALUATION TRIBUNAL
AT DUNEDIN LVPNo.188 & 189/88

IN THE MATTER of the Valuation of Land Act 1951.
IN THE MATTER of objections to revaluations

BETWEEN Richard George ALDERTON and JanRae ALDERTON both of Queenstown, Company Directors Oakland Finance Limited a company at Queenstown. Objectors
AND THE VALUER GENERAL Respondent

Hearing: 24-25 May 1989
Counsel: DW Parker for objector
Mr Donaldson for respondent
Judgement: Reserved judgement delivered 3/7/89

RESERVED JUDGEMENT OF TRIBUNAL
DISTRICT COURT JUDGE A.A.P WILLY & MR R. LORD

The objectors are the owners of a commercial property at Queenstown. They object to the valuation of that property carried out by the Valuer General pursuant to s.10 of the Valuation of Land Act 1951. The objections are pursuant to s. 19 and 20 of that Act.

The Valuer General has valued the land and improvements as at 1 July 1987:

land value	$1,035,000
value of improvements	$ 65,000
capital value	$1,100,000

The objectors contend for the following values:

land value	$700,000
improvements	$ 90,000
capital value	$790,000

Description of Properties

The properties comprise a total of 311 square metres and are contained in three separate certificates of title. They are situated on the north west side of Beach Street in the borough of Queenstown in the block between Camp Street and Rees Street. This is a one way street running in a north south direction. It is 0.15 km west by road from the Queenstown property and can be described as centrally located in the Queenstown commercial area. The properties are joined on both sides by retail shops. At the rear of the property is a dwelling and across the road is situated a tavern.

The site is relatively small and rectangular in shape. It has a

frontage on to Beach Street of 18.78 metres and its depth varies from 16.7 to 17.39 metres. The rear boundary is 18.77 metres. It has the benefit of a right of way over an adjoining section which provides access to the rear of one shop and also to the stairway to the first floor office premises.

Zoning

The property is zoned Commercial 1 under the Lakes Queenstown Wakatipu Combined District Scheme. This zoning allows for a wide range of retail shop usage to the ground floor and for office and accommodation usage to the first floor. The height restriction in this zone is 12 metres and the site coverage allowable pursuant to the scheme as at the date of hearing is 240%, at the date of the Valuer General's valuation it was 160%, but it was widely known that a scheme change was in progress allowing the increase to 240% site coverage.

We are satisfied on the evidence that in assessing value as at the date of the valuation the valuer needed to have regard to the proposal for increased site coverage.

Improvements

There are three separate retail shop premises on the land. One was erected in two stages, part of which is approximately 100 years old, and the other part approximately 20 years old. The other two shop premises were erected in the early 1950s. The gross floor area of the shop premises is 224 square metres. There is a lean-to of some 17 square metres and first floor office premises of 62 square metres. Construction of the older portion of the building is mixed concrete with roughcast walls and timber flooring and partly concrete block. The roof is corrugated galvanised iron as is the lean-to. The more recently erected shops are on a concrete foundation and flooring, the walls are predominantly poured concrete with timber joinery. The first floor office/flat has timber flooring, the roof is galvanised iron. The shops are utilised as follows.

Shop 1:	contains a storeroom with tea making facilities, the. lean-to area is utilised as a workshop. There are two separate toilets and the alleyway is utilised for bicycle storage as part of a bicycle hire business.
Shop 2:	contains retail premises.
Shop 3:	contains retail shop premises with storeroom attached.

The first floor is a self-contained flat/office. There are no toilet facilities for shops 2 and 3. They utilise the facilities attached to shop 1 by personal agreement.

The exterior condition of the shops is mainly tidy, but the older portion of shop 1 is nearing the end of its useful economic life. The interiors are generally in tidy order and decorated throughout.

Tenancies

Shop 1	is let for a one year term from 19 November 1986 at an annual rental of $21,800.
Shop 2	is let for a one year term from 30 April 1987 at a rental of $15,815.
Shop 3	is let for a one year term from 31 December 1986 at a rental of $27,600.

The first floor office/flat premises are let for a term of one year from 30 April 1987 at a rental of $7,800.The total percentage return on purchase price from these rents is 11.6% and the lessor is responsible for exterior maintenance and land tax. The leases provide for the tenants to pay a proportion of the rates, replacement insurance premium and interior maintenance.

That general description of the properties is drawn from the evidence of Mr Moore, a registered valuer, who gave evidence on behalf of the objectors. It was not contraverted in any material way by the witness for the Valuer General and we accept it as an accurate description. Mr Moore contends that the valuation of these properties as at 1 July 1987 was $790,000. He has reached this figure by two methods, first comparisons of sales evidence, and second by what he describes as an investment approach. This latter method is based upon gross rental income of $73,015 less an allowance for exterior maintenance and management, leaving a net rental income before land tax of $71,100. Mr Moore capitalises this at a multiplier of 9%, and the resultant figure is a valuation of the land and buildings having regard to its investment capability of $790,000.

In approaching the question of the proper values of these properties for the purposes of the valuation of Land Act 1951, we accept that the onus is on the objector to show that the Valuer General's valuation is wrong, see *Proprietors of Matauri v Valuer General (1981)* 2NZLR 585 at 591. Both Mr Moore and Mr Bodger, the witness for the Valuer General, supplied the Tribunal with details of purportedly comparable sales, some of which were the same in each case but unfortunately they were presented in different sequence. We will follow the sequence supplied by Mr Moore. He analysed 13 sales which he contends are comparable. They are helpfully summarised at P 14 and 15 of his written evidence. Analysis is expressed both in terms of a value per square metre and a value per metre frontage.

The Valuer General approached the valuation on the basis of a value per metre of frontage. He calculated this from evidence of recent sales. Mr Moore on the other hand converted his recent sales evidence to a value per square metre.

There was a considerable amount of evidence and cross examination directed to which of these two methods is appropriate and applicable to the valuation of properties situated in the retail shopping centre of Queenstown. We accept that the two methods can produce quite significantly different results. We accept that the per metre frontage basis for valuation is one commonly accepted in valuing commercial and industrial land in urban centres. We are not persuaded, however, that it is an appropriate basis for valuing commercial retail premises in the Queenstown commercial area. We accept on the evidence before us that the basis most generally favoured by land valuers, real estate agents and those contemplating investment in retail land in Queenstown is the square metre area method. This preference arises from the fact that there is only a comparatively limited amount of commercial land available for retail use and that land is subject to restrictive height and site coverage requirements. The practical consequence of these restrictions is that tall buildings are not permitted and therefore the land value of any site must be divided into fewer areas of usable building than is the case in many of the larger towns and cities throughout New Zealand. We are satisfied that the area method is the most commonly used as a basis for assessing sale and purchase prices and for fixing rentals of commercial properties in Queenstown.

Before embarking on an analysis of the sales data presented to the Tribunal, we think it appropriate to make some comments about the evidence presented.

We accept that Mr Moore is a registered valuer with experience in both rural and urban valuation. He graduated from Lincoln College in 1951, spent five and a half years with the State Advances Corporation and Rural Bank, and has been in private practice in the Queenstown/Alexandra area as a valuer for the past 12 years. During that time we accept he has had a wide range of experience in valuing commercial, industrial and

rural land in the district. He told us, and we have no reason to doubt him, that some 50% of this business comes from the Queenstown area and is urban based.

By coincidence Mr Moore had been invited to give his assessment of the market value of the property as at 1 June 1987. His valuation is produced as Exhibit A. It shows land value $650,000, improvements $125,000. He then gave an alternative valuation based on the net rental income of $73,630 which at 9.5% produced a figure of $775,000.

Mr Bodger we accept is also a suitably qualified valuer. He graduated from Lincoln in 1981 and has worked for Valuation New Zealand for the past eight years as a registered valuer. He is at present Manager of Valuation New Zealand's Alexandra office. He took up that job in January 1989. From September 1988 he had worked at the Alexandra office as a senior valuer. Before that he was the senior valuer at Palmerston North from October 1985 to September 1988. His early experience on graduating was as a registered valuer at Blenheim. He has participated in the revaluation of the Blenheim and Picton boroughs and Palmerston North city. He inspected the property the subject of this objection on 9 May 1989 and prepared his report as at that date.

Counsel for the objector complained at the outset of the case that he had received the Valuer General's report for the first time at 9.00am on the morning of the hearing. However, Mr Moore appeared to be able to overcome the difficulties caused by that short notice and no adjournment was sought.

Mr Bodger's evidence suffers from the difficulty that he did not carry out the 1987 revaluation inspection. That was done by Ms Dryden on 19 May 1987. Her valuation was not produced in evidence and she was not called to give evidence. We are therefore deprived of any information concerning the basis upon which she made her valuation, and of the data relied upon by her and her interpretation of that data. We understand that Ms Dryden was available to give evidence and we are obliged to record that we think it quite unsatisfactory that the Tribunal should not have before it the primary evidence of the basis upon which the valuation for which the Valuer General contends was in fact carried out. This places Mr Bodger in an extremely difficult position because he does not have a long experience of valuing properties in the Queenstown area and his views are given two years after the date of the inspection which forms the basis of the Valuer General's valuation. We are therefore driven to the position that where there is a conflict of opinion between the evidence of Mr Moore and Mr Bodger we must accept the evidence of Mr Moore. He has the local experience, and the benefit of having valued this property for sale purposes in June 1987.

We now analyse the evidence of comparable sales. Mr Moore submitted 12 comparable sales made during the period 1986 to August 1987. Mr Bodger submitted nine comparable sales reduced by agreement to seven. They were made during the period May 1986 to October 1987. The results of Mr Moore's analysis are set out in Appendix 1 to this judgement. The comparable figures for comparative sales data supplied by the Valuer General are set out in Appendix 2.

We do not think any useful purpose is to be served by attempting to reconcile the respective valuations because we have come to the view that of all the properties for which details were supplied only sales 3,4,6 & 7 (Valuer General's 6,5,7 & 1) are relevant. For the purposes of our decision we would make the observation, however, that the comparison set out in the appendices do illustrate that it is impossible to apply any precise arithmetical yardsticks against which to measure valuation of properties such as the subject property in this case.

In our view there are in addition to comparable sales a number of other related matters which must be taken into account in arriving at the value for the purposes of the Act. These include the rental value of the property, the purpose for which it is bought (is it for an investment as is or redevelopment), the business acumen of the buyer, retail trends within the shopping area concerned, the particular zoning requirements, and the related return on investment. In so far as Mr Bodger appeared to discount such matters as irrelevant and rely upon some arbitrary measure such as the metre frontage, we think he is mistaken. In our view whichever measure of value is taken it must always be subject to the over-riding requirement that the valuer exercises his judgement based upon experience in and knowledge of the locality and the particular type of property. In this Mr Bodger is at something of a disadvantage.

We take the view that with the exception of the motel site, sale 10, Mr Moore has made no significant errors in his calculations. The per square metre and per metre frontage figures arrived at by him are consistent with other comparable properties sold at about the time the government valuation was undertaken. We consider that Mr Moore has taken account of the relevant considerations prevailing which would affect the value that a willing buyer would pay a willing seller on the open market on such reasonable terms and conditions as a bona fide seller might be expected to impose. We consider that at the end of the day that it is the true test and refer to the dicta of Archer J in *Valuer General v Manning* (1925) NZLR 701 at 704 and the observations of Roper J in *Anderson v Valuer General* (1974) 1NZLR 604 at 609 where His Honour said:

> *It is elementary that in determining his valuations full effect must be given by the defendant to the definitions of capital value and improved value as defined by the Act. In Duthie v Valuer General, Stout CJ said: This definition is clear and specific, and it should be followed, whatever the result may be". The Chief Justice in that case was referring to the definition of "unimproved value" but his comment is equally applicable to the definition of "capital value". Both definitions related value to saleability at a hypothetical sale. Both definitions envisage, by implication, not only a reasonable and bona fide seller but also a willing and informed purchaser.*

In applying that approach to the facts of this case we are firmly of the view that we cannot ignore the matters referred to by Mr Moore on p 18 of his written evidence when he said:

> I suggest that looking at the valuation assessment on a per square metre basis is the only appropriate way to carry out the valuation assessment. Looking at the situation this makes it clear that for Queenstown the metre frontage basis of mass appraisal was inappropriate, particularly as the whole commercial area was certainly not ripe for redevelopment at the time of revision. The supply and demand for retail and office space at the time of revision was already showing signs of surplus supply and reduced demand, the metre frontage basis of assessment has given far too high per square metre rates, making possible redevelopment totally uneconomic. The Queenstown commercial area is comparatively small, height restriction of 12 metres at 240% coverage being peculiar to this small town. Metre frontage basis for mass appraisal is definitely suitable for large commercial areas in cities, however a per square metre basis is appropriate in Queenstown.
>
> Sales at excessive prices, whim, extravagance or compelling needs of purchasers should be disregarded. This means that the Gamble sales, the H & H sale should be regarded with great care, also the

two mall sales after revision date by overseas purchasers should also be considered with great care. The large sale of the White Star Hotel site, a prime redevelopment site is of considerable importance, particularly with hindsight now that the site has not been developed and in fact part sold for reserve purposes.

Where it is readily apparent that redevelopment within the town can only be undertaken in part because of demand for rental and office premises care must be taken to reflect this in any valuation assessment. The best indication in this case is sales of investment properties providing a reasonable level of return for the property investor.

Utilising the per square metre rates for the three 1987 sales in the mall, average rate of $2,690 per square metre. Less an allowance of 20%, $450, provides a rate applicable for Beach Street of some $2,240 per square metre.

Utilising the Beach Street sales, average per square metre $2,496, this is with double frontage, less than 10% for double frontage, $250, per square metre rate applicable to subject site $2,246.

This analysis includes sales subsequent to review date, sales at in my opinion excessively high prices, however I have utilised these as being some reflection of the market combining investment and possible redevelopment and redevelopment sites.

The Valuer General agreed that valuation at Queenstown properties does present some unique problems, but nevertheless contends for a unit metre frontage basis. For the reasons we have given, we cannot agree. Approaching the matters as he does, Mr Moore considers:

Therefore valuation assessment is as follows:

Capital Value assessed on an investment basis	$790,000.
Land value 311 sq metres at $2,250 per sq. metre $699,750. Say	$700,000.
Therefore value of improvements	$90,000.

In our view this is the correct way to approach what is an unusually complex valuation exercised rather than to simply endeavour to apply a rule of thumb based upon metre frontage calculations. Accordingly we fix the valuation at

Land value	$700,000
improvements	$90,000
Capital value	$790,000

AAP Willy,
Chairman.

RE Lord
Member

APPENDIX 1

Mr Moore's Analysis

SALE 1:

Date of sale June 1986. This property comprises supermarket premises and is situated in the south west side of the Queenstown mall. It was sold for the sum of $1,000,000 and at that time was showing a 6% return on investment. This has recently been increased following a rent review to 11%. The lessor is responsible for exterior maintenance and land tax. It is described as a very good commercial site. Mr Moore estimates that the sale price can be apportioned as follows:

land	$850,000
improvements	$150,000

the land sale price is therefore $1,868 per square metre. The metre frontage price is $57,948

SALE 2

Date of sale June 1986. Location south west side of Queenstown mall comprising two storied retail shopping mall know as "The Trading Post", having a rental income of $90,252 showing an 8.2% return on capital of $1,100,000.

Sale price is apportioned:

land value	$850,000
improvements	$250,000
total	$1,100,000

That gives a land sale price of $1,855 per square metre and a metre frontage price of $57,197 per metre. This property is currently on the market for $1,100,000 and has been for some time. There are no buyers offering.

SALE 3.

Date of sale at auction April 1987, possession March 1988. The property is located on the north east side of the Queenstown mall and comprises the Power Board building and Pascoes Jewellers.

Sale price	$950,000
apportioned land value	$800,000
improvements	$150,000

The land sale price is $2,749 per square metre.

The metre frontage price $84,714 per metre frontage.

Comparable figures available from the Valuer General for this property per square metre price $2,750.

Metre frontage price $83,000.

SALE 4:

Sale date 20 August 1987, possession 30 October 1987, sale price $700,000. Location north west side of the Queenstown mall, utilised for retail shopping premises and a restaurant. Rental income $45,000 being 6.4% return on capital. The property was sold to an overseas investment company for long term development together with an adjoining site. Mr Moore apportions the sale price:

land value	$575,000
improvements	$125,000

per square metre price $2,846, per metre frontage price $88,140. This property has a government valuation as at 19 March 1987 of $700,000

SALE 5:

Date of sale 20 August 1987, possession 30 October. This is the property adjoining sale 4 and has been bought by the same purchaser.

Purchase price	$600,000
apportioned land value	$500,000
improvements	$100,000

Rental as at date of sale is $24,000 per annum recently reviewed to $30,600 giving figures of 4% and 5.1% return on capital respectively.

The sale represents $2,475 per square metre, $76,870 per metre frontage.

SALE 6:

Date of sale March 1987, located on the south comer of Camp Street and Cow Lane. The property is used for commercial offices. The rental as at the date of sale was $45,000 showing 8.8% on capital. The purchase price was $511,000. Mr Moore estimates that the price was inflated by 5% because it is a desirable corner site.

He calculates the land value at	$360,000
improvements at	$125,500
giving a per square metre frontage price of	$69,508

SALE 7:

This is an open space occupied as to one half by car park and as to the other half by a park. Sale date November 1986. Location is on the South side of the block bounded by Camp, Ballarat and Athol Streets.

sale price	$4,000,000

Mr Moore estimates that this should be discounted by 20%

because it has two corners. This yields a per square metre price of $1,833 or $2,291 if no discount is allowed.

The frontage price is $25,000 per metre for the Athol Street frontage and $58,124 per square metre for the Camp Street frontage.

SALE 8:

Sale date May 1986, location north side of Athol Street. The building is used as office premises. The ground floor is currently vacant.

The sale price was $199,000 giving a per square metre price of $1,036 and a per metre frontage price of $23,013.

SALE 9:

Sale date July1986. Property is situated in northern corner of intersection of Camp and Shotover Streets and is used for retail and office premises. Second floor apartments are proposed but not yet complete.

The sale price was $950,000 land only. Mr Moore allows a 15% discount for the corner influence. The net land price he considers is $807,500 which yields per square metre price of $983 and metre frontage price of $26,875.

SALE 10:

Sale date May 1986, located south western side of Queenstown commercial area. The property is utilised for motels.

The land sale price was $1,465,244 (existing government valuation $1,500,000).

Mr Moore allows a discount of 20% for comer influence and calculates the per square metre price at $1,480 and the metre frontage price at $27,500 for Shotover Street and $32,380 for Beach Street.

SALE 11:

A property which adjoins sale 10. Sale date June 1986. The property was purchased for redevelopment. The inital purchase price was $1,325,000 and was then on sold at $1,425,000 Current rental $201,300, lessee meeting all outgoings. It is currently showing an 8.7% return.

The per square metre price is $2,567.

The metre frontage price is $42, 500 per metre on Shotover St and $66,360 per metre on Beach Street. Mr Moore records this as a very high sale at the time made to an over-enthusiastic purchaser who had recently sold another commercial undertaking and wished to enter the property development business. The property was later on sold for $2,300,000 after substantial building development had taken place.

SALE 12:

Date of sale June 1986. Location Beach/Shotover Streets. Property consisted of two retail shop premises and a museum. The rental income is $68,340 showing a return of 4% on investment recently reviewed to $105,080 giving a return of 6.2%. The property was purchased for a combination of investment and possible redevelopment.

Sale price was $1,690,875 apportioned as to land value $1,450,000, improvements $240,875.

The government valuation is $1,700,000 in 1982 it was $400,000.

The per square metre price is $2,425. The per metre frontage price is Shotover Street $43,500, Beach Street $67,300.

Once again Mr Moore describes this as an inflated price paid by a highly enthusiastic purchaser. The property has been on the market for some time with no sign of any purchaser.

SALE 13:

This is the property subject of the objection. It was last sold in March at auction for $627,000. At the date of sale it had a rental income of $27,000 which was 4.3% return on capital. It has been subsequently reviewed and is now showing an 8.9% return. At the time of the sale it had a 1982 government valuation of $185,000. Mr Moore apportions the sale price as being

land value	$500,000
improvements	$127,000

Value per square metre $1,608, value per square metre frontage $35,050.

APPENDIX 2

SALE 3:

Mr Moore's sale 3 is the Valuer General's sale 6. He arrived at the same capital value as did Mr Moore and apportioned between land and improvements in the same way. His metre frontage valuation is $86,000 which compares favourably with Mr Moore's at $84,714.

SALE 4

This is the Valuer General's sale 5. The capital value is the same as taken by Mr Moore. This is not surprising as this was the actual purchase price paid for the property in August 1987. The Valuer General arrives at a figure of $103,000 metre frontage compared with Mr Moore's figure of $88,140. The difference is explained by the fact that the Valuer General has taken different values for assessing the metre frontage depending upon the section depth.

SALE 5:

This is the Valuer General's sale 4. Once again the Valuer General has taken the actual sale price as fixing the capital value but arrives at a metre frontage figure of $84,418 compared with Mr Moore's figure of $76,870. Once again the discrepancy is explained by the Valuer General's method of assigning different values to the front part of the section compared with the rear.

SALE 6:

This is the Valuer General's sale 7. He values the property at a capital value of $450,000 compared with Mr Moore's figure of $485,000. His metre frontage figure is $80,000 compared with Mr Moore's figure of $69,508. As in previous cases the discrepancy is explained by assigning different values to different parts of the section.

SALE 7:

This is the Valuer General's sales 1 & 2 and is the old White Star Hotel site which is now occupied half by a car park and half by public open space. We found the Valuer General's figures to be confusing. It seemed that the analysis prepared by Mr Bodger was inaccurate and he replaced it with figures given at the hearing. Both the Valuer General and Mr Moore have accepted that the value is the sale price less a discount for the corner influence. The Valuer General did not give us figures for a metre frontage comparison. The only comparison we have is on a price per square metre basis. Mr Moore considers that the figure should be $1,833 per square metre, Mr Bodger $1,890 per square metre.

SALE 11

This is the Valuer General's sale 8 & 9. The Valuer General fixes the capital value of this property at $1,900,000 for that part represented by sale 8 and $824,488 for that part represented by sale 9 a total of $2,724,488.

The metre frontage figures are Mr Moore $108,860 and the Valuer General $121,176, the difference is in the way in which the two valuers calculate the allowances to be made for section depth and rear access.

IN THE HIGH COURT OF NEW ZEALAND
(ADMINISTRATIVE DIVISION) DUNEDIN REGISTRY

UNDER	the Land Valuation Proceedings Act 1948 and the Public Works Act 1981.
IN THE MATTER	of an appeal against a determination of the Land Valuation Tribunal in Dunedin
BETWEEN	THE MINISTER OF WORKS AND DEVELOPMENT Appellant
AND	DAVID REID ELECTRONICS LIMITED Respondent

Hearing: 20-21 November 1989
Counsel: D L Wood for appellant
Barbara Hunt for respondent
Judgement:
18 December 1989

JUDGMENT OF THE COURT (EICHELBAUM CJ & MR J N B WALL)

BACKGROUND

The respondent company, which is Auckland based, is in business in the wholesale and retail sale of electronic goods throughout New Zealand, there being 21 stores nationwide. It has been in business in Dunedin since 1969, and from 1972 until 1986 its Dunedin branch was at 317 Cumberland S t in premises leased from successive owners. These compensation proceedings relate to the compulsory taking of that property for purposes of a proposed new police station. The respondent first received advice of that proposed action by letter from the appellant dated 13 August 1984. That and subsequent events will be referred to in more detail later in this judgement, but as from April? 1986 the respondent continued its business in new premises (again leased) at 359 Cumberland Street, a distance of some 200 metres from the previous premises. In the main that move was accomplished over the preceding weekend, but preparation by way of packing and shifting bulk stock had been taking place for some time beforehand.

LEGAL PRINCIPLES.

The appellant has not questioned the Tribunal's general approach to the assessment of compensation in claims under the Public Works Act 1981. As good a general statement of principle as any is that of Dixon J in *Commissioner of Succession Duties v Executors Trustee & Agency Co of South Australia Ltd* (1947) 74 CLR 358,373:

> *...the purpose is to ensure that the person to be compensated is given a full money equivalent of his loss...*

In *Russell v Minister of Lands* (1898) 17 NZLR 241 Pennefather J, delivering the j udgement of a full Court (Prendergast CJ and Denniston, Conolly and Pennefather JJ) said:

> *...if compensation is to be a reality, the Court must take into consideration all the circumstances, and see what sum of money will place the dispossessed man in a position as nearly similar as possible to that he was in before. This will not include what may be called sentimental losses, such as personal attachment to a particular spot; or compensation for money which had been expended on the land but which could bring no return, such as money spent in boringfor coal which had been proved not to exist, but only such a sum as will place him in a similar position financially .....* (p 253)

One further citation, which particularly draws attention to the concept of "full" compensation, will suffice. It is from the judgement of Woodhouse P and Roper J (delivered by Woodhouse P) in *Drower v Minister of Works & Development* (1984) 1 NZLR 26:

> *Jn the ordinary course of language the nature of compensation involves rendering something equal to what has been lost. It is the provision of recompense: cf Nelungaloo PtyLtd v Commonwealth (1948) 75 CLR 495 per Dixon J at p 571. And the word `full" has the added purpose of emphasising that a claimant is entitled to receive the complete equivalent of that which has been taken away from him. It implies a direction that the entitlement must not be whittled down in any respect.* (P29)

This last passage also brings out what one text, cited by counsel for the respondent, calls the principle of equivalence: that the owner's compensation should be equivalent to what he has lostbyreason of the compulsory acquisition. The same point was made in *Russell v Minister of Lands* at p 251.

THE CLAIM

The Ministry accepted items relating to stamp duty and legal fees, some expenses relating to the costs of the move itself, and some limited items relating to the cost of fitting out the new store, principally the cost of a security alarm system and signwriting of the new premises. At the present hearing counsel for the appellant said that to be consistent with his stance the cost of the security alarm system should not have been allowed as it constituted a capital item; but he did not seek to go back to the Ministry's agreement in this respect. The Ministry also agreed to advertising costs of some $4,800. In total the agreed items came to $12,313. The disputed items (summarised under their main headings) were as follows:

Expenses relating to the shift of premises
- mainly of employees brought in from outside branches to assist in the weekend move:

Additional costs of fitting out the new building, including cost of underfloor heating and new carpet:

Lost of profit on trading	19,759.00
Increase in rental	15,412.00
Additional legal costs	11,428.60

THE TRIBUNAL'S DECISION

The Tribunal was satisfied that the procedure adopted for moving the respondent's undertaking to its new premises was one resulting in the lowest claim for compensation. Being satisfied as to quantum the Tribunal allowed all the claims under this heading, which according to the Tribunal totalled a further $10,866.66 in addition to the items already agreed by the Ministry.

The quantum of the legal fees was not attacked; the Tribunal allowed these in the sum claimed. In regard to the costs of fitting out and equipping the new premises, the Tribunal was satisfied that the respondent had established its claims both as to liability and quantum, and allowed these in full, that is a total of $19,376.04. (There appears to be an arithmetical discrepancy here as the items claimed according to the list set out a p 17 of the judgement comes to $19,043.48 only.) On the claim for loss of profit on trading, the Tribunal accepted the respondent's case and preferred its evidence to the evidence given by an expert witness on behalf of the appellant. It allowed this item in full. According to the Tribunal the total award was $89,256.21 less the sum of $12,313 already agreed by the Ministry, an additional $76,943.21. However, the disputed items set out at ppl6 and 17 of the judgement total $79,659.69.

THE APPEAL

The appellant challenges the whole of the Tribunal's award. A number of separate grounds need to be discussed in turn. Some of them go to the whole award. Others attack individual items.

THAT THE CLAIMANT MOVED VOLUNTARILY Here the appellant contended that the claimant simply made a business decision to move; that its decision to relocate its premises was not caused by the taking of the land on which its business had hitherto been carried on.

We have already referred to the fact that the first notification was dated 13 August 1984. That letter notified the respondent that action was being taken to designate the site for purposes of a new police station, that formal notice of the Crown's requirement would be sent to all owners or occupiers "in the very near future" and that all occupiers would be approached "shortly", once the writer had obtained an approximate date for the commencement of construction. Clearly this letter conveyed an intent that the premises would be required quite soon, a connotation not altered by any subsequent correspondence or dealings.

The next step was a letter dated 7 January 1985 from the District Commissioner of Works. This notified the company that on 21 December 1984 the Crown had acquired the property at 317 Cumberland St for a proposed police station. Henceforth rent was to be paid to the Dunedin Police who would administer the property in the future. According to the notation of the Certificate of Title, the Gazette notice (quoted in the Tribunal's judgement) stated that the date of vesting was 21 February 1985. Nothing turns on this apparent discrepancy. As from 31 December 1984 rental was duly paid to the Dunedin Police. In terms of the lease, the rental was due for review as at 1 May 1985 but the Police did not make any request for a review. Mr Bremner, the sales manager of the Dunedin branch, gave evidence that although initially he had been told there was no urgency, it subsequently became clear that they would have to find alternative premises as soon as possible. He recalled that, it seems towards the end of 1984, there was a visit by someone from the Ministry (he could not recall his identity) who left him with the clear impression that the Ministry wanted the company to find new accommodation immediately. At the hearing before the Tribunal Mr Bremner was cross examined on the point, and the Ministry's property officer, Mr Sleeman, gave evidence to the effect that there was no record of any pressure being put on the company. On 8 August 1985 the Town Clerk wrote to the company with reference to the town planning formalities, advising that the Dunedin City Council had recommended that the property be designated as aPolice Station, and that the Council's recommendation had become the decision in the matter. The letter gave notification of rights of appeal. It had attached earlier letters dated 30 May 1985 and 1 August 1985 referring to the Council's approval to the site being used as a Police Station and to the District Commissioner's of Work acceptance of the recommendation that the land was to be designated as a Police Station.

The respondent gave evidence that it regarded itself as well located in its existing premises. Indeed, it said that it was completely happy there. The lessors had just completed extensive alterations and the respondent had completely renovated the interior of the building itself to suit its needs. Although it commenced to look for alternative premises towards the end of 1984 the company found it very difficult to find suitable retail space in the area. However, about a year later, fortuitously it learned that an old service station site further along the same street, at No 359, could be available. The company was able to find abuyer agreeable to purchasing the property and leasing the site to the company. On 13 February 1986 the company wrote to the district Commissioner of Works stating that it had found new premises, and that as a result of moving it would sustain losses under various headings including loss of income, increased rental, the cost of fitting out a new branch, advertising, direct costs of the shift, and legal fees. the amount claimed, some $95,000, was in fact quite close to the figure the subject of the final claim. There is no evidence of any immediate response to that letter. On 15 April, that is a week or so after the shift had taken place, the company again wrote enclosing a copy of the lease in respect of the new property, and stating that the company had moved in from 1 April. The letter sought approval to cease paying rental in respect of the old premises, which the company said it no longer required, with effect from 1 April. On 24 April the Ministry replied stating that the Police had approved termination of the existing lease as at 1 April. The letter concluded that as regards compensation, action was proceeding and there would be further advice in due course.

As was the case on the appeal, it was submitted to the Tribunal that the company moved, not because of any pressure from the respondent, but merely to suit its own commercial ends. The Tribunal did not accept that view. It accepted Mr Bremner's evidence that (as the Tribunal said, putting it at its lowest) some intimation was given to the company about the end of 1984 that the site would be needed by the New Zealand Police within the near future. That finding, based on a acceptance of the credibility of Mr Bremner, whom the Tribunal had the advantage of hearing and seeing, is not one this Court could upset, unless Mr Bremner's testimony was clearly at variance with contemporary documentary evidence, or other information of sufficient cogency to outweigh the advantages possessed by a Tribunal which has had the witnesses before it. Not only is there no such evidence, the whole tenor of the circumstances, in our view, is consistent with Mr Bremner's account and with the view of the facts accepted by the Tribunal. There was not only the visit by the Ministry of Works man of which Mr Bremner spoke, there was a consistent series of letters serving to buildup a picture of the new site for the Police Station as an established fact, and an inevitability that the company would have to move in the foreseeable future. Finally, there is the absence of any reaction from the Police or the Ministry of Works of the kind one would have expected had they or either of them thought that the respondent was over-estimating the urgency of the situation. No steps were taken to further the rent review which was due, nor was there any reaction to the company's letter of 13 February 1986 to the effect that the expenditure and losses it envisaged, estimated in a figure approaching $100,000, were all unnecessary and premature. On the company's side, the background of its well established and comfortable position at its existing premises, the potential disruption and expense of the shift, the risk of losing custom and the higher rent it would have to pay all reinforced the correctness of the Tribunal's finding that the company would not have contemplated moving unless seriously concerned that it would, in the relatively near future, be faced with eviction.

The respondent's case was that it exhibited cooperation, or reasonableness, in adverse circumstances. It would be unfortunate if a potential claimant had to put on a show of intransigence in order to safeguard its future rights to compensation. We are satisfied that the Tribunal's decision that the respondent did not move voluntarily, in the sense that that expression was advanced

on behalf of the appellant, cannot be attacked. Indeed, we entirely agree with it. Accordingly we reject the first main submission advanced on behalf of the appellant.

The next group of submissions have a common theme in that they all relate to the nature of the respondent's tenure after the lease expired on 30 April 1985. It will however be convenient to examine them under separate sub-headings.

NO EFFECTIVE RIGHT OF RENEWAL

The lease was for a term of six years commencing 1 May 1979. It contained a renewal clause in standard terms to the effect subject to the lessee observing and performing the lessee's covenants and conditions and giving at least three months notice prior to termination of the lease, the lessor was to grant a lease for one further term "of such duration as shall be specified in the schedule" at a rental to be fixed by agreement or arbitration. A proviso stated that this clause was to have no effect unless it was stated in the schedule affirmatively that a right of renewal was to appertain to the lease.

Since the schedule contained the answer "yes" opposite the heading "right of renewal", clearly the proviso was satisfied. the point of contention was that the schedule did not specify, in so many words, the term of the renewal available. The only reference to term in the schedule appeared under the heading of "term of lease". Against that heading there appeared the following: "Six years to commence on 1st May 1979".

It would have been tidier had there been a separate sub-heading "duration of term of renewed lease". However, reading the renewal clause together with the schedule item "right of renewal yes" there can be no doubt that the parties intended that there would be right of renewal.

The only term mentioned, as noted, is the six year term applicable to the original lease. Business efficacy (and common sense) demand the conclusion that the lease should be construed to the effect that the term of renewal was likewise for six years.

At the date of taking of the land (21 December 1984) therefore, the respondent's status in relation to the lease was that it was in possession under the original lease, that it had a right of renewal which could still be exercised timeously, and that subject to giving due notice it was entitled to a renewed lease which would ensure its occupancy until 30 April 1991. Putting aside the point which has been discussed under this heading, and disposed of in favour of the respondent, there has been no suggestion that provided proper notice was given, any ground existed enabling the respondent to refuse a renewal.

THAT THE RIGHT OF RENEWAL WAS NOT EXERCISED

On the appeal a great deal of emphasis was placed on this aspect. It is referred to only briefly in the Tribunal's decision. We are not in a position of course to know to what extent the same aspect was stressed at the initial hearing.

After noting that as at the date of taking the company had not availed itself of its right of renewal, the Tribunal simply said that this was for the reason that by then the Ministry's interest in the land had already become apparent, referring to the initial letters from the Ministry of Works dated 13 August 1984 and 7 January 1985, already mentioned.

In evidence before the Tribunal Mr Yallop, the respondent's secretary, maintained that the lease had been renewed; but the bare assertion to that effect was not supported by any document, or on any other basis. Nor did counsel feel able, on the appeal, to press the contention that there had been an implied renewal. Of greater attraction was an argument that there had been an implied agreement to lease. We doubt that the Ministry could have evicted the respondent simply on a month's notice, although the respondent's rights are more likely to have rested on an estoppel than any implied agreement. Having regard to the representations made to the respondent, at feast by conduct, we think that at a minimum the Ministry would have had to give the respondent a reasonable opportunity to find alternative premises.

So far as the contention of an implied agreement to lease is concerned however, on analysis no such agreement could assist the respondent because its term could not extend beyond such date as the respondent was required to move after reasonable notice, or alternatively when it found suitable alternative accommodation.

A further contention for the respondent was that it was entitled to relief against forfeiture under S 120 of the Property Law Act 1952. To the extent that it was suggested that we could or should grant relief during the course of the appeal, the point was hopeless, if for not other reason than that there had never been any refusal to grant a renewal, as ss (3)(c) of the provision requires.

We could not accept the argument that refusal to accept liability for compensation equated to refusal to grant a renewal which had never been requested. The existence, in 1985, of a right to make application under S 120 may however be of assistance to the respondent in another context to which we shall come shortly.

RESPONDENT'S STATUS AFTER EXPIRY OF LEASE

A fundamental contention of the appellant's was that after expiry of the lease, the respondent was simply a monthly tenant. In the absence of any renewal, or fresh agreement, express or implied, for a lease that must be correct as far as it goes but it is, with respect, an incomplete analysis. As already stated, before expiration of the time for opting for a renewal of the lease the ministry's actions had reasonably led the respondent to the view that it was inevitable that it would have to vacate in the short term.

The Tribunal's judgement does not deal with the point in detail, but having regard to the general way in which the Tribunal viewed the reasons for the respondent's decision to shift to new premises, and in particular the passages at page 4 and 8 of the judgement, we have no doubt that the Tribunal was saying, in effect if not in so many words, that the respondent decided not to exercise its right of renewal solely because it expected to have to move shortly.

Counsel for the respondent accepted that there was no direct evidence to support such a finding. In the sense that no witness for the respondent said as much explicitly, that is correct and it is a weakness in the respondent's position. Mr Yallop, as noted earlier, took the stance that the lease had in fact been renewed.

The only piece of direct evidence, at best exiguous, is the reference in the respondent's letter of 13 February 1986 to discussions the previous year when "it was agreed that we should commence looking for new premises even though our lease does not expire until April 1991".

The Ministry did not reply to contradict those assertions. However, the Tribunal's conclusion was justified as a matter of inference. Essentially the relevant evidence is that already analysed earlier in this judgement, in dealing with the Tribunal's findings that the respondent shifted not to suit its own commercial purposes, but under pressure from the Ministry. Indeed the two topics largely overlap. In short the respondent did not renew

the lease because in the circumstances it was pointless to do so.

The respondent's case on the point does not end there. If after 1 May 1985 (and before the respondent gave notice, in its 13 February 1986 letter, that it was proposing to vacate) the Ministry had endeavoured to evict the respondent at short notice, the respondent we are satisfied would have had an unanswerable case for relief under s 120.

Accordingly we are satisfied that the Tribunal was correct in approaching the question of compensation on the footing that but for the taking, the respondent would have had the legal right to remain in the premises until the second six year term expired, that is till 30 April 1991.

We do not need to consider the respondent's alternative contention based on equitable estoppel, except to acknowledge that that argument reinforces the view already expressed that if, during the period 1 May 1985-13 February 1986, the respondent had been compelled to apply for relief under S 120, it would have been successful.

For the sake of completeness we refer to one further argument of the respondent's. Counsel contended that the appellant was precluded from denying that the respondent was to be treated on the basis just set out, by virtue of an alleged concession by counsel for the appellant at the hearing before the Tribunal, recorded at p 31 of the judgement.

We do not accept that appellant's concession was relevant to the point at issue.

It was to the effect that in terms of ss (2) of S 66 of the public Works Act, and the identical subsection of S 68, the respondent was not a "willing party" to the taking of the premises. On the evidence that was plainly right.

Accordingly the respondent was not precluded from claiming compensation under those sections.

No more should be read into the concession than that.

QUANTUM

Having disposed of the points taken by the appellant which were of a pre-emptive nature, we now turn to those which relate more particularly to individual items of claim, or their quantum.

It was not in dispute that the respondent was entitled to compensation for disturbance; that is now specifically authorised by S 66 of the Public Works Act which provides for compensation for (inter alia):

All reasonable costs incurred by (the claimant) in moving from the land taken or acquired to other land acquired by him in substition for the land taken or acquired.

As to the principles to be applied, we need refer only to *Harvey v Crawley Development Corporation* (1957) 1 QB 485. Denning LJ (as he then was), referring to one of the statutory rules under the Acquisition of Land (Assessment of Compensation) Act 1919, said:

It leaves untouched the rule that everythng which is a direct consequence of the compulsory acquisition can be recovered under the head of "compensation for disturbance "(p493).

Romer LJ said:

It seems to me that the authorities to which our attention was drawn do establish that any loss sustained by a dispossessed owner (at all events one who occupies his house) which flows from a compulsory acquisition may properly be regarded as the subject of compensation for disturbance, provided, first, that it is not too remote and, secondly, that it is the natural and reasonable consequence of the dispossession of the owner (p494).

These principles, we are satisfied apply equally under S 66.

INCREASED RENTAL

The respondent accepted that had it stayed in its previous premises, the rent would have increased as from 1 May 1986. It claimed the difference between the higher rental it had to pay in the new premises, and a notional figure which was estimated would have become payable in the old premises. The claim was for a period of two years; effectively, from the date of occupation of the new premises until 1 May 1988, when a futher rent review would have fallen due under the previous lease. Taking the view that this basis was reasonable,the Tribunal allowed the item in full. We see no reason to differ from the Tribunal's assessment that the footing on which the claim was advanced was reasonable.

A theme underlying several of the appellant's points regarding quantum was that in an overall sense, the respondent became better off as a result of the move: in brief, because (it was argued) the new premises were superior both as to location and in their nature.

The Tribunal did not specifically refer to this point in dealing with the claim for increased rental, but no doubt thought it was unnecessary to repeat what had already been stated under a previous heading, to the effect that it did not accept the appellant's case in this regard.

The point hadbeen put to Mr Yallop in cross examination,but he had not accepted its correctness. The respondent's other witness, Mr Bremner, pointed out that the new premises were markedly smaller. Mr Wilson, a chartered accountant called as an expert witness for the Ministry, gave evidence on the subject, stating in general terms that the new premises were in a "more saleable" area, and pointing to the added advantage, to a retailer, of a corner site.

He was unable to quantify the advantage the respondent had obtained. Mr Sleeman stated that he "would presume that moving towards that area, moving to the North of Dunedin would provide the claimant with a much superior retail". It has to be emphasised that the actual move was for a distance of some 200 metres along the same street.

No doubt recognising the scantiness of the evidence on the topic, at the commencement of the appeal hearing counsel for the appellant sought leave to adduce further evidence on the topic. We declined that application, made orally without prior notice either of the applications or the evidence sought to be adduced. The transcript of the reasons we gave are attached to our present judgement.

Counsel for the appellant also invited us to inspect the area for ourselves, but we decided not to do so, feeling we might put ourselves at risk of substituting impressions gained on our observation for evidence which the parties had had the opportunity of testing in Court.

In summary, the Tribunal was left with the position where on the one hand, the claimant had proved a loss arising out of expenditure to which the respondent was put as a direct result of the taking, while on the other hand there was evidence, not accepted by the respondent's witnesses, of some unquantified advantage arising from the move to new premises.

In the circumstance we see no ground for disagreement with the Tribunal's conclusion (implicit, so far as the rental claim is concerned) that there was no sufficient basis for taking betterment into account.

BUSINESS LOSSES

A preliminary matter arises out of the wording of S 68 of the Public Works Act. It provides that business losses resulting

from a relocation made necessary by the taking shall (in the absence of agreement) -

...not be determined until the business has moved and (if the circumstances so require) until sufficient time has elapsed since the relocation of the business to enable the extent of the loss to be quantified...

The losses claimed related to the months of February, March and April 1986. The respondent's business did not move, or at any rate the move was not completed, until the first week in April. The appellant submitted that no claim lay in respect of any prior time.

We do not agree that "determined" should be given such a strained interpretation. We see no reason to give it other than its ordinary meaning, which in the context is "decided". The legislative intent is that claims for relocation are not to be decided until the claimant has actually moved. The section does not limit the period in respect of which compensation may be claimed, which may be before as well as after the relocation.

The method of calculation was as follows. Basically, it involved a comparison of sales for the three months in question with those effected in the corresponding months of the previous year, adjustment being made for difference in the number of available shopping days.

A further adjustment was for the increase in sales experienced by the respondent's branches New Zealand wide, involving an average increase of 28%. To allow for local variations however an increase of only 15% was taken. The final comparison showed a downturn in February to 92.73%, in March to 72.05%, and in April, a small increase to 101.45%. The loss claimed was the total deficit over those three months.

On behalf of the appellant it was submitted that a longer period should have been taken. After April, except for one month the figures consistently showed an increased performance. That of course was explicable on the basis of the national trend rather than necessarily related to enhancement attributable to the new premises.

The appellant relied on evidence given by Mr Wilson to the effect that a longer period should have been taken. After a careful analysis, the Tribunal felt unable to accept Mr Wilson's approach. While recognising that this is not a matter dependent on credibility, our own study of the evidence leads us to the same conclusion.

Further, we are of the view that the Tribunal was correct in accepting that the relocation brought about the downturn incurred during February and March and the failure to achieve results comparable with the rest of the branches during the three months in question.

The evidence was that during February/March the staff was packing stock and generally preparing for the shift, and one can readily accept that the store would present itself less attractively than usual to customers during this time, and that sales performance would be likely to suffer. In the figures, the downturn in performance during February/March stands out, and on the evidence could properly be attributed to the coming shift.

Accordingly, we are satisfied that the Tribunal's decision in allowing this item in full should stand.

FITTING OUT AND EQUIPPING NEW STORE.

Counsel for the appellant made a general submission that the Act does not enable compensation to be made for what he described as capital items. We do not accept that as a correct approach. The question is one of compensation for loss. If the claimant has reasonably incurred an item of expenditure attributable to the taking of the land, prima facie that is compensable loss. However, in regard to items of capital expenditure, measurement of the loss may require an element of betterment to be taken into account.

One issue under this heading can be disposed of briefly. The appellant challenged liability for the light fittings, but the Tribunal's finding on the topic at p 19 of the judgment stands on its view of the credibility of the respondent's witnesses and is not open to challenge. We do not find it necessary to say anything further.

Only two items, in our opinion, give rise to substantial questions. The first related to carpet. The respondent was unable to move the shop carpet, which was glued down. The Tribunal allowed the claim for a complete new carpet, without deduction. We do not consider that that is sustainable.

The question is what the respondent has lost. If the existing carpet was six years old, consideration would need to be given to the extent of its remaining life, and its value; or the loss incurred by the respondent by having to purchase a new carpet earlier. Assessment of the respondent's loss should have taken place on those lines.

Somewhat similar considerations apply to the other major item, the underfloor heating. We do not see any reason to question the Tribunal's finding that the nature of therespondent's business required such heating, but again the issue is of loss suffered by the respondent.

In its previous premises, the underfloor heating system had been provided by the owners and at any rate in theory the rental previously paid should be regarded as including a component in that respect. Subject to evidence as to the life of the system it would appear that the respondent has lost the benefit of having that heating system for the remaining five years it would have been entitled to occupy the premises. It has now had to pay for a new system, but will have the benefit of it for the term of its present lease, ten years.

Accordingly, there is an element of betterment to be set off against the respondent's expenditure.

While in each case we have reached the view that the Tribunal assessed compensation on a wrong principle, we lack the evidence on which to make an appropriate assessment ourselves.

Failing agreement as to a proper figure, we shall have to remit the case to the Tribunal for a rehearing limited as to the quantum of these two items.

Alternatively, if the parties consented we should be prepared to make that assessment ourselves, and would give leave to both sides to call such further evidence as they saw fit for that purpose. An earlier fixture would be possible in Wellington than in Dunedin if the parties so agreed.

CROSS APPEAL INTEREST

Section 94 of the Public Works Act authorises the Tribunal to award interest at such rate as it thinks fit. The Tribunal stated that it would have been prepared to look favourably at a claim based on the respondent's overdraft rate if the company had in fact incurred such an outgoing.

It said that alternatively it would have been prepared to consider interest on the basis of the company's "earnings rate on its funds" on the basis that the money employed in paying for the relocation costs could have been earning the company profit in its business.

However, in the absence of sufficient evidence, the Tribunal decided that the only safe course was to allow interest at 11%.

That of course is what is commonly referred to as the Judicature Act rate, and as the Tribunal stated, is awarded in a range of litigation.

The company has lodged a cross appeal against that finding and prior to the hearing of the appeal obtained an order from the Court granting it leave to file further evidence relating to the rates of overdraft interest payable by the company to its bankers from 1986 onwards.

That evidence shows that the average rate applicable to the company's overdraft facility with its bankers between April 1986 and the present time, has been just under 21%. Unfortunately the evidence does not specify the proportion of time for which the company was in overdraft. The new affidavit states that during that period "the respondent has operated its business on overdraft" but annexes a letter from the bank saying that "for the majority of that period" the company has been in "a borrowing mode".

Whether, in the context, "majority" means 51% or 99%, we are unable to tell. We would not be justified therefore in assuming that the expenses sustained by the respondent as a result of its relocation have been outstanding on overdraft for the entire period or something very close to it. In the circumstances we have concluded that we must put aside that method of assessing the respondent's loss and instead approach the matter of interest on the basis of the loss sustained by the company in not having those funds available for investment. On that basis we allow 15%.

As to the date when interest should commence to run, the Tribunal selected 8 June 1986 being the date upon which the respondent first advised the Ministry that it would be claiming interest. We think with respect that the correct basis is the date when the losses commenced to run. However, as that must have been earlier than 8 June 1986, and since it was the appellant rather than the respondent who complained about the commencement date, subject to one qualification we propose to let that date stand.

The qualification is this: so far as the claim for increased rental is concerned, the loss in question was incurred progressively over a two year period commencing 1 April 1986. We propose to adjust this as follows. Treating the total award as $x, interest will run on that figure as from 1 April 1987. For the period 8 June 1986 to 1 April 1987 interest will run on $x minus $7706, the last figure being one half of the rental claim of $15,412.

CONCLUSION

1. To the extent that the appeal relates to the expenses concerning the carpet and the underfloor heating, it succeeds with the consequences set out earlier. As to these aspects, leave is reserved to bring the appeal on for further hearing before this Court, on the conditions set out earlier, if both parties consent. Alternatively, if the parties are not in agreement, on request the Court will make a formal order that the matter be remitted to the Tribunal for further hearing on the terms of this judgement.
2. The cross appeal as to interest is allowed. The appellant is order to pay interest at the rate of 15% on the amounts and for the periods stated.
3. During the hearing it emerged that there appeared to be some arithmetical discrepancies in figures set out in the Tribunal's decision. As requested during the hearing, the parties have since submitted a memorandum reconciling the figure and recording that the correct total of the disputed items as accepted by the Tribunal in its decision, should have been $76,943.30 (before addition of interest and costs of hearing). We do not imagine that in this regard any formal order is required by reserve leave to bring on the appeal for further hearing so that the arithmetic of the award can be corrected if required.
4. We deal with costs separately; in all other respects the appeal is dismissed.

COSTS

The items in respect of which the appellant has been successful (but in respect of which it is to be anticipated that the respondent will be held entitled to some recover) are $10,845 and $3,219 respectively, a total of some $14,000 out of a total of disputed items of about $77,000.

In the circumstances the amount of the award of costs before the Tribunal will be reduced by $1000 to $7000. In this Court, while the appellant has been partly successful, it has failed on the more major points of argument. The respondent also succeeded on the cross appeal.

While awards of costs are not expected to provide a full indemnity to the claimant, they should be made on a more generous basis than adopted in ordinary civil litigation: *Minister of Works & Development v Cromwell Farm Machinery Ltd* CA 147/84 judgement 9 June 1986. Taking all factors into account, we allow the appellant costs in the sum of $6000 together with the reasonable travelling and accommodation expenses of counsel relating to attendance at the hearing of the appeal, the figure to be settled by the Registrar in the absence of agreement.

APPENDIX

RULING OF THE COURT
(EICHELBAUM CJ AND MR J N B WALL
(20 NOVEMBER 1989)

At the commencement of the hearing Mr Wood on behalf of the appellant has applied for leave to adduce further evidence on the appeal, relying on R 696 of the High Court Rules. It is true that under sub-clause 3 the Court is given "full discretionary power" to hear and perceive further evidence on questions of fact, either orally or on affidavit. No notice of the application has been given.The evidence which the appellant seeks to adduce is expert valuation evidence as to the respective values of the two sites in question. The issue of betterment in relation to the site was squarely before the Court at the initial hearing and there was every opportunity for either party to call evidence on the point if it wished. In view of the wide terms of sub-clause 3 we would not regard that aspect as determinative, but it certainly affects the exercise of the Court's discretion. Furthermore, an application made in this manner deprives the opposite party of any opportunity either to prepare for cross examination of the deponent, or to seek leave to call evidence in rebuttal. The proper manner to make such an application is that followed by the respondent in relation to a different matter, that is to make application pre-trial and to support it with an affidavit or a brief of evidence indicating the evidence sought to be adduced. Those steps would, if the application were granted give the opposite side fair opportunity of meeting the new point. In the circumstances, in the exercise of the Court's discretion the application is refused.

Solicitors for appellant: Crown solicitor, Dunedin.
Solicitors for respondent: Russell McVeagh McKenzie Bartleet & Co, Auckland.

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