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Editorial Comment

Rediscovery of the multi-tiered rental market

There seems to be a current over-reaction by property people, particularly valuers, to the claimed discovery of a multi-tiered rental market for commercial property. This discovery has been claimed since the realisation of a significant downturn in the direction of the commercial property market following on from the collapse of the sharemarket in October 1987.

As a consequence of the sharemarket collapse and the subsequent downturn in the economy there has been an over-supply of office accommodation and warehouse and industrial premises, causing intense competition among landlords for prospective tenants. Natural market forces have dictated that levels of asking rentals are being reduced in this over-supply situation and if lower rentals prove to be insufficient inducement to fill tenancy vacancies, landlords find it necessary to offer low cost or free interior fit-outs, rent holidays or even cash inducements to attract tenants to their particular premises. These circumstances cause considerable irregularities in the rental market when comparisons are made with tenancies that have only just commenced but which had been arranged in the extremely buoyant commercial rental market immediately prior to the sharemarket collapse. And comparisons will inevitably be drawn with existing rental levels for previously occupied premises. Hence the claimed momentous discovery, by some, that a multi-tiered rental market has developed. And valuers are being accused of being either misled by this multi-tiered rental market or of choosing to ignore it altogether. Valuers, it is observed, are adding weight to these accusations by disagreeing amongst themselves about the existence or effects of the claimed multi-tiered rental market.

In a market as imperfect as the property market inevitably is, it is not at all

difficult to produce a list of statistics which purport to show that a certain situation is fact. But in such an imperfect market, being as it is, influenced by a large number of players with widely diverse aims and aspirations and having differing opinions of current trends it is not at all surprising that some confusion will exist.

However it is important to reflect on what elements were present in the property rental market in the ever recurring cycle of a boom period before a bust. In the period 1984 to October 1987, there was an almost unprecedented boom in demand for commercial office and showroom premises and industrial warehouse and factory space. Prospective tenants competed with one another for available premises to such an extent that often very large sums were paid for so called "key money" or "lease goodwills" and often successful tenants agreed to lease terms which required their payment of items of operating expenses which had previously been strictly the responsibility of the landlord.

As a consequence of this very high level of demand, which occurred almost throughout the whole country, rental levels increased dramatically. In fact the rate of increase was so rapid that the incumbent Minister of Finance found it necessary to introduce rent control in the form of the Rent Restrictions Regulations 1984 under which rent increases were pegged to previous increases in the Consumer Price Index.

So what did this frantic market scenario produce? Inevitably a mix of rental levels from unprecedented new highs for new lettings in mainly new premises, large increases for existing tenancies prior to the introduction of rent control and later extremely modest increases when the Rent Restriction Regulations were introduced particularly for tenancies with infrequent review periods.

How, you may wonder, could valuers

possibly cope with such an impossible scenario and assess "fair market rents" for rental reviews? But they did and there was no comment, so far as can be recollected, of the inequities of a multi-tiered rental market. But clearly it did exist and to a greater extent probably than the present "recently discovered" (re-discovered) multi-tiered rental market.

Were the irregularities of the 1984-1987 rental market any less or any more difficult to rationalise than the irregularities in the 1988-1991 market. It is suggested they were not as:

1. The Rent Restrictions Regulations 1984 introduced a mechanism that artificially set a level of rental just as a "no reduction in annual rental" clause in a current lease may produce an artificial rental.

2. Prior to the introduction of the rent restrictions regulations 1984 and following their abolition, rentals were being reviewed for existing leases following the trends of "the market" for new letting rentals but with landlord and tenants or sometimes their arbitrators deciding on the relativity of those rental levels just as landlords and tenants or their arbitrators are deciding on the relativity of current rental levels now.

3. Some new leases were being taken up at the new "high" levels of rental then just as some new tenancies are being taken up now at new "low" levels of rental.

So as valuers, let us continue to do as we have always been required to do to interpret the market as it exists, so far as possible in an impartial and an independent manner and avoid the indignity of being seen to take a certain position in respect to a phenomenon which has recently been loudly hailed but which is definitely not new - the multi-tiered market.

Trevor J Croot.

The New Zealand Valuers' Journal
Annual Manuscript Competition
Conditions of Entry

The New Zealand Valuers' Journal Editorial Board offers an annual Award for a leading article to be published in the Journal.

The Award has a value of NZ\$1000 and shall be paid to the successful applicant who meets the following conditions:

1. The competition is open to any author of an original work based on research into or comment on a topic related to the valuation of real property and entries should be submitted to the General Secretary, New Zealand Institute of Valuers, PO Box 27-146, Wellington.
2. The article shall not have been submitted to any other journal or publisher prior to being submitted for entry into the competition.
3. The article shall not exceed 10,000 words including any equivalent space where illustrations, diagrams, schedules or appendices are included.
4. The manuscript shall be typewritten.
5. The author shall supply a short synopsis of the article, setting out the main thesis, findings or comments contained in the article.
6. The author shall provide a brief biographical note which may be published.
7. The closing date for submission of manuscripts shall be 1st April in each year and any winning article shall be published in the Journal.
8. Judging shall be by the Editorial Board and shall be on the basis of the relevancy, quality, research and originality of the article to the principles and practice of valuation. The judges' decision shall be final and binding. The Editorial Board shall not be bound to make an award in any year if no article meets an acceptable standard.
9. The winning manuscript shall become the property of the New Zealand Institute of Valuers and the author shall agree as a condition of receiving the award to pass copyright to the Institute and no reprinting of the article shall take place without the express consent, in writing, of the Editor of the *New Zealand Valuers' Journal*.
10. All unsuccessful applicants for the Award shall be advised.
11. The decisions of the Editorial Board on any matter relating to the competition and Award shall be non-reviewable and correspondence shall not be entered into nor reasons given for the decisions of the Board.

The Editor,

I would like to express my disbelief at the recent judgement of Justice Tipping reported in the September issue of *The New Zealand Valuers' Journal*. While my knowledge of this particular case is limited to the material reported in the journal, it appears to me that Mr Wall, on evidence presented to him at an arbitration, has concluded the existence of a multi-tier leasing market with respect to new lettings, right of renewal and rent reviews. Justice Tipping in his judgement, with particular reference to Lease Clause 3(j)(iv) of the Lease, lends his weight to this view. The judgement makes reference to the comparability of premises and Justice Tipping extends this concept to include the comparability of tenure and states "in other words, to get a truly comparable situations, one needs to look at premises as similar as possible to the subject premises in cases where the lessee is the subject of a rental review rather than the subject of a new lease or renewal of an existing lease."

How long will the valuation profession be forced to labour under the ill conceived notion that a rental review can provide any sort of better gauge of market rentals than a new letting? It seems to me, in simplest terms, that a new letting is a market transaction and a rental review is not. It will be noted that the lease document

apparently refers to a "current market rental" not a rental to be fixed by reference to other rental review agreements. It would seem some people have difficulty in interpreting the meaning of this phrase, particularly the word "market". This word in the broader valuing context has already been clearly defined.

For example, by substituting the word "open" for "current", and "value" for "rent" the definition of the term "open market value" as taken from Guidance Note 3 of the NZIV Asset Valuation Standards provides a useful guide. This phrase is defined as the price at which an interest in the property might reasonably be expected to be sold at the date of the valuation assuming:

- a willing seller;
- reasonable period within which to negotiate the sale taking into account the nature of the property and the state of the market;
- that values will remain static during that period;
- that the property will be freely exposed to the open market;
- that no account will be taken of any higher price that might be paid by a purchaser with a special interest.

How can an agreement between two contractually bound parties unable to pursue alternatives be regarded as a market

transaction. The notion that a single commodity, be it office accommodation, motor vehicles, a ton of wheat or whatever might be capable of having two or any number of potential markets or market prices, seems a strange concept to me.

Furthermore, the idea that rent reviews constitute the best evidence is fraught with practical difficulties. If rent reviews are to be based upon rentals achieved from prior rent reviews, then we must assume that rentals upon review will be fixed in perpetuity.

Do we accept rental levels fixed by virtue of ratchet clauses within the lease as constituting market evidence? Surely an absurd proposition.

Ronald Bernstein and Kirk Reynolds in their *Handbook of Rent Reviews* cover this issue quite succinctly where they state in Chapter 8.5:

...the prominence of rent review transactions has, in some cases, resulted in settlement becoming self generating with subsequent open market transactions not confirming the levels obtained. The quality of evidence arrived from rental transactions in terms of weight which can be attached to it when forming opinions of value will depend upon the circumstances of each case. As a general rule, however, the descending order of weight is open market lettings; disagreements between the valuers; determinations by Court under Part 2 of the Act 1954; arbitrator's award; determination by independent experts. Evidence derived from rent review transactions can never be wholly conclusive unless supported by evidence of open market lettings.

While sole reliance upon new lettings to determine a market rental might be regarded by some as being an extreme view, it has considerably more merit than reliance solely upon rent reviews.

Any other conclusion in my opinion only gives credence to our critics who describe valuation as a lunatic science. It is fortunate that the issue before Justice Tipping was not the question of what constitutes the best evidence in the rent review procedure, therefore his comments should not be regarded as setting any form of precedent.

Indeed I am aware of a recent arbitration involving a substantial Central Auckland office building that involved both the valuers and legal counsel, where all concerned specifically agreed that no inference could be taken from his decision.

yours faithfully

K G McKeown, Principal,

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Marketing Your Firm's Valuation Expertise

A Diagnosis and Prescription for More Business

by J S Baen & C S Croft

or many professional valuers, the office workload is all too often considered to be determined by external factors beyond the firm's control. The number of valuation assignments requested by clients logically seems directly related to the general level of real estate activities in the immediate area, such as the number and relative size of-

1. building permits being issued,
2. commercial lease review,
3. public improvements projects requiring condemnation proceedings,
4. residential and commercial loan originations,
5. insurance valuations,
6. foreclosures, bankruptcies, etc that routinely require the services of a valuer.

For the purposes of this paper we will contrast two hypothetical firms "A" and "B". The general attitude of Firm "A" is that their volume of business is dependent solely on the real estate industry's health and external factors beyond the firm's control.

It seems, however, that in every market there always appear to exist valuation firms that at every stage of each business cycle, have enough business that they are constantly growing and/or referring their excess business to trusted colleagues with other firms. During "good" times or "bad", Valuation Firm "B" always seems to operate at a comfortable level of optimal capacity.

For the purpose of this paper, we will consider the fundamental difference between Firm "A" and "B" and discuss differences in philosophies and approaches to ethically obtaining additional valuation business. We will also assume that the valuers of each firm are equally qualified and consistently produce valuations of the highest quality and professional standards. Likewise we will assume that Firm "A" and "B" prescribe to New Zealand Standard of Professional Practice and the Code of Ethics.

The Passive Approach to Marketing Firm "A"'s Valuation Expertise

After 15 successful years, "Theoretical" Firm "A" has built up a "significant" client list of satisfied customers and has

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Property

*University of North Texas, *UMnt teaching role is diverse, ranging from larger first year introductory property courses to advanced valuation methodology. He specialises in statutory valuation teaching*

relied on this repeat business as the bread and butter of their valuation business. In short, the firm has allowed the high quality of their professional work in the past to become the primary marketing tool for their future.

A careful review of the past year's

office receipts revealed the following diagnosis of the firm's primary sources of income on an annualised basis (Table A).

Further distillation of the data categorised the nature of the valuation assignments for the previous year into the following categories (Table A-1)

Table A

Source of Gross Income 'A'	Firm	Number of Projects	Number of Clients	Gross Annual Income In \$	/ of Gross Income
Repeat Business		180	8	364,000	70
Referrals from clients		50	4	93,600	18
Referrals from other valuers		30	3	41,600	8
New business Valuer generated		10	1	20,800	4
Totals		270	16	520,000	100
Number of valuers = 7 (Owner and 6 associates)					
Secretarial help = 2 and Office					
Annual Overhead (excluding valuer salaries) Net			=	182,000	37
income to firm for salaries			=	338,000	
Average income/valuer (includes owner)			=	48,285	
Average billing per project = \$520,000/270 = \$1,926.00					

Table A-1

Valuation Assignments and Sources of Income for Firm "A"	Gross Income
Existing Commercial	10
New Commercial Construction	22
Existing Residential	7
New Residential Construction	35
Existing Office	5
Office Lease Reviews	10
Land Valuations	11
	100%

The seemingly broad capability developed by Firm "A" is impressive, however, it should be noted that 57% of the firm's business involves new construction projects which can vary dramatically from year to year in a given area due to normal and sometimes harsh construction and business cycles. This, coupled with 70% of the income to the firm being derived from repeat business involving eight primary clients, puts Firm "A" in an economic environment that might be comfortable during "good" times, but strenuous during slow construction periods.

Table B-1

Valuation Assignments and Sources of Income for Firm "B"	Gross Income %	\$
Existing Commercial	5	6,880
New Commercial Construction (Referred to Firm "A")	0	0
Existing Residential/Flats	8	11,008
New Residential Construction (Referred to Firm "A")	0	0
Existing Office and Rent Reviews	10	13,760
New Office Construction	0	0
Land Valuations	12	16,512
Single Family Homes (63 total) (sources a-e)		
a. Real Estate Agent Referred	6	
b. Lender Requests (Mortgage Firms)	31	
c. Vendor Requests	3	
d. Buyer Requests	9	
e. Solicitor Requests	14	20,250
Subtotal Valuations		75,680
Consulting Work at \$75/hour (825 hrs billed)		
a. feasibility projects	2	15,136
b. marketing/rent study	1	8,256
c. post foreclosure valuation	4	6,880
d. court deposition	3	1,376
e. court appearance and research	5	12,384
f. miscellaneous	2	9,632
g. condemnation hearings	1	6,880
h. teaching valuation class at Lincoln University	1	1,376
		61,920
		137,600

Firm "B's Aggressive Approach to Marketing Valuation Expertise

Firm "B" is considered by many to be a "newcomer" and has only been in the valuation business for four years. Not having a built-up stable of clients, Firm "B" has had the opportunity and challenge to seek and accept valuation assignments having a broader range and scope and thus the firm is not considered specialized in a given area or type of property.

Table B

Source of Gross Income -Firm "B"	Number of Projects	Number of Clients	Gross Annual Income in \$	% of Gross Income
Repeat Business	10	4	27,520	20
Referrals from clients	6	6	16,512	12
Referrals from other valuers	1	1	2,752	2
New business Valuer generated	86	40	90,816	66
Totals	103	51	137,600	100

Number of valuers = 2 (Owner and 1 associate)
 Number of new valuation associates =
 Secretarial help = 1 (Trainee Secretary)

Annual Overhead (excluding valuer salaries)	=	41,280	30
Net income to firm for salaries	=	96,320	
Average income/valuer (includes owner)	=	48,160	

Average billing per project = \$137,600/103 = \$1336.00*

*Lower overhead as a % of total fees generated allows more competitive fees to be profitable for Firm "B" that would not be so for Firm "A"

The reputation for Firm "B", however, is one of reliability in terms of getting the job done without regard to how large or small the valuation assignment might be. Chances are good that Firm "B" accepts a few assignments at a below cost level of fees generated.

A review of their past year of valuation business revealed a different client profile from that of Firm "A". (Table B).

In further analysis of the valuation firm

"B", the previous year's activity of the relatively new firm revealed the following sources of income for the various services offered. (Table B-1)

A General Valuation Business Plan

Owners of the valuation firm should have a written business plan whose primary goals are to:

- 1 Meet or exceed the professional standards of practice,
- 2 Meet the needs of individual clients as well as the community at large,
- 3 Operate at an optimal, comfortable, and profitable level of efficiency in order to maintain quality of the valuation services rendered,
- 4 To turn away business that is not cost effective.

No one but the firm's principal owner can best decide the size, rate of growth and number of employees a valuation office should have. A "bigger" shop having more associates, employees and larger overheads, requires something more than

valuation skills. Management of people and marketing of additional valuation services offered to cover overheads and administration of the larger firm is certainly not for everyone.

While valuation engagements were once primarily relationship driven, in today's more competitive market all too often clients are more interested in the "cheaper" report which maintains a reasonable quality. This style of valuation reporting can give independent valuers and smaller firms having lower overheads the advantage.

The growth rate of any firm (if any) should not occur except in a natural, gradual fashion such that management skills and volume of valuation work required does not outrun the firm's owners' capabilities and financial resources.

Firm "A" for these very reasons has consciously or unconsciously opted for a larger shop with higher overheads and administration requiring little expansion or contraction of personnel during the various business cycles. The owner of Firm "A" has a comfortable lifestyle, enjoys his/her work, sets his own hours and has no plans for growth in the future. His/her business plan is in motion and working on the philosophy of "bigger" is better and bottom line profits are not the primary objective.

Firm "B", however, has a five year written business plan that calls for maximizing his/her valuation/consulting business volume capabilities and net income. On a limited budget he/she has created a flexible staff that can be added to or reduced according to the volume of valuation business generated.

A Marketing Plan for More Business

We will assume that both "Firm A" and "B" share the traditional modes of marketing their valuation business within the Code of Ethics and generally accepted standards of professional practice.

They both utilize the customary advertising methods such as advertisements in trade journals, telephone directories, etc. Likewise, each firm utilizes business cards and attractive signs at their places of business.

Salesmanship is often associated with real estate brokerage and the mere mention of the word somehow does not seem to fit conceptually with many valuers' self conceived notion of "professional practice". And yet, we all agree that sitting in the office waiting for valuation business to walk or phone in, is a good way not to remain in business for very long.

Internationally, other professions including solicitors, accountants, engineers and others, have in recent years been wrestling with what place professional marketing ("hard-sell" promoting) and advertising play in their industries.

The following are suggestions and techniques that can be considered for creating more business opportunities for professional valuers in New Zealand.

1. Prepare a Professional Resume (CV)-

Each time a valuer calls on a prospective client it is as though he/she is interviewing for a job. The fact is they are! An updated, professionally printed, resume can be used as a reminder to the prospective client of one's excellent qualifications long after the interview. The CV should go beyond the customary one or two page "Statement of Qualifications". Areas to be included in the document should include:

- a. Designations/professional qualification
- b. Degrees/education
- c. Specific valuation papers completed (by title)
- d. Other property papers completed
3. Related business papers completed
- f. Professional papers presented
- g. Research activities and articles published
- h. Partial client reference list with telephone numbers and type of service performed (or perhaps letter of recommendation from former client)
- i. Types of valuation services you offer.

A complete professional CV has many uses beyond a hand delivered formal introduction to a prospective client.

- a.. CV's may be mailed with a covering letter to persons known to be in need of valuer services. Prospective clients often appear hidden in the news articles of the morning paper. Examples include a person's name mentioned in association with corporate moves, relocations, litigation, plant expansions, etc.
- b. When volunteering your time to speak to community groups, CV's are helpful to those making your introduction (and quite often summaries about your professional background are included in newsletters prior to your speech).
- c. Solicitors, accountants and bankers often use the professional CV as a formal referral document which states your qualifications as an expert.

In summary, the properly prepared CV when prepared on the valuation firm's stationery can be a powerful marketing tool. Every member of the firm should always have one available in their brief-

case to supply to a prospective client. They build confidence, sell the firm, the individual, and cost pennies to produce.

2. Prepare a Sample of Your Work

A neat presentation that clearly portrays the quality of your work should be available for prospective clients to review. Samples of all types of your work can be an important bridge between what the client thinks they want versus the research product they may recognise. A client desiring a short and simple market valuation on a property may be willing and eager to request (and pay for) a more comprehensive report which supplies important economic and/or financial information about a particular property or market area. Educate and market your capabilities by showing them examples of what you and your firm can do.

3. Maintain a Daily, Weekly and Monthly Action Plan

In order to better organize your planned activities to achieve the volume of valuation work desired.

Example: Call on three mortgage officers/solicitors/real estate agents per week who may be in need of valuation services.

4. Become active in at least two professional or service organizations within the community.

Example: The local branch of the Real Estate Institute, NZ Society of Accountants, etc.

5. Offer to teach, guest lecture, or speak - on the subject of real estate valuations at the local University or Polytechnic and to interested citizen groups. Don't assume the public understands what valuers are, much less what is involved in professional assignments and related services that valuers can provide beyond the typical valuation.

Example: projections, feasibility studies, market analyses, etc.

6. Co-operate with other valuers by offering data, assistance, advice when appropriate, and NZIV branch participation. Let them know you are a professional and excited about your profession. There seems to be more "joint" assignments between firms lately with large assignments being shared by multiple firms.

Example: Lincoln University currently has two highly respected valuation firms who have joined together to value the plant and equipment for the entire campus.

7. Be supportive of local real estate journalists and offer assistance. Commentaries and interviews on real estate sub-

jects that may be of interest to the general public and will indirectly lead to more valuation business.

Personnel Plan to Handle More Business

The owner of Firm "B" maximizes the use and flexibility of his office personnel plan by:

1. Hiring a "secretary" with the typing skills necessary for valuation reports who also has a desire to become a valuer. His/her "trainee" status increases their responsibilities to include research, customer relations, report writing (and review!), internal management, as well as needed secretarial skills.
2. Hiring valuation "interns" from the local Universities can allow the office to grow on a very flexible basis. Internship programmes provide educated, quality research assistants at a pace comparable to your business growth. These part-time valuation students can work vacations and after class at "below" market hourly rates and are good value for money! The

firm also is given a rare and non-committal view of a prospective graduate prior to graduation. Of course, the work must be closely supervised, reviewed and documented prior to utilization in any commercial situation.

The valuer, who is also an instructor or guest lecturer at the local University, has every opportunity to interview several qualified intern candidates each semester.

While Firm "B" cannot at this time justify more full-time associates (except at the risk of lowering net income), the owner has opted for a compromise that could very well lead to his/her goal of having five full-time valuers in the office within five years. The broad base of business which is highly diversified in terms of types of assignments will pay off in the future.

The owner of Firm "B" is very active professionally in his community. He often donates his time, advice and property related talents to various community groups. What are his reasons for doing so? He seems busy enough!

1. Genuinely help his community.

2. Raise the credibility and professional image of the valuer in the community.
3. Generate additional business contacts.
4. To informally meet and come to know potential employees, trainees and promising valuation interns.

Conclusion

Valuation firms should conduct frequent in-house analyses and profiles of their sources and types of valuation business in order to better assess their office competitiveness (profitability) and define where they are in the market, and more importantly, where they would like to be. The analysis of valuation assignments and sources of income, coupled with a firm's marketing plan for increasing their volume of work or a more stable stream of work, can be a valuable and healthy business practice.

Remember, include time and effort in local community projects and functions which do not immediately contribute to the bottom line! The future of your firm and the profession will be positively impacted over the long haul! A

Current Problems in the Valuation of Commercial Ground Lessors' Interests in New Zealand

by R L Jefferies

This paper is a corollary to a similarly named one I presented last year to the Taranaki Branch of the New Zealand Institute of Valuers' 50th Jubilee celebration seminar* which dealt primarily with residential ground leases.

I felt that paper stopped short of dealing with some of the crucial current issues particularly relevant to commercial and industrial ground leases.

The NZ Scene

I will start by briefly outlining the form of ground lease tenures we have in New Zealand, colloquially called "Glasgow" leases, and the factors leading to the current highlighting of commercial lessors' interest valuation problems.

"Glasgow" leases are (generally) 21 year perpetually renewable ground leases, whereby the lessees erect all buildings and improvements, with the rentals fixed for 21 year periods between renewals on the basis of a "fair annual ground rental" with-

out regarding the value of the improvements on the land.

The bulk of these leases resulted from land development programmes, reclamation and subdivisions undertaken by large landowners as a way of disposing of the holdings or sites, but creating a perpetual income in preference to selling the land. These leases originated in the

latter quarter of last century and continued as a popular form of title up until the 1960's. With the inflationary economy of the 1970's and since, they have fallen out of favour. Since the 1970's new ground leases have generally been leased on a terminating basis with rental review terms of five or seven years.

Glasgow leases are found in pockets throughout the breadth and length of 0

dney Jefferies B CA Dip'

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FOOTNOTES: 1. Current problems in Ground Leasehold Valuations, (1989) NZ Val. December p 18

the country, coming under the provisions of (now) the Public Bodies Leases Act 1969, which controls their creation, administration, and renewal procedures. The ground rental assessments are defined by the Act but are determined more within the framework of precedents set by arbitration awards and court decisions, and also highly influenced by local practices.

There are also a number of other similar leases, such as Maori reserved lands leases, Crown leases, local body leases and others under various enabling legislation, each with varying terms and conditions as to rental reviews, use limitations, freeholding rights, and some are terminating leases.

The bulk of the non-Crown leases are, however, held by church trusts, local authorities, port companies, and Maori incorporations and trusts.

The Valuation Problems

Valuations for rental purposes and market or mortgage valuations of the *lessees'* interests represent a significant proportion of both rural and urban valuation practice in this country. However, the valuation of *lessors'* interests have not been a frequent requirement, until quite recently.

The valuation problems, encountered in the past, have centred around two aspects:

- a. the determination of a *ground rental percentage* to apply to the land value at the date of assessment, to determine the "fair annual ground rental"; and
- b. the valuation of *lessees'* interests where the lessee(s) have paid for (but do not own) the improvements, - with many theories having been propounded for modelling the rationale of leasehold purchasers in determining the amounts payable for these interests, especially the rights to the perpetual renewals.

In the last two to three years, however, problems have emerged in relationship to the proper methods of valuing *lessors'* interests. It is the nature of these problems and the valuation of these interests that I want to examine. These problems have been highlighted by a number of factors which I wish to briefly outline.

Factors Highlighting Lessors' Interests

1. A number of trustees and beneficiaries of church and charitable trusts as well as Maori incorporations have become increasingly concerned with the effect that inflation and rising land values have had on the income return from these "locked in" investments. This has caused them to question the value

of these investments, to seek ways of improving these returns and to enhance the value of their investment portfolios.

2. Some of these lessors have sought to improve their income returns and to maintain the earning power of their investments by introducing freeholding policies which encourage lessees to buy the land. The proceeds are then re-invested in initially higher yielding commercial or industrial properties which provide more frequent rent reviews and capital growth for their investment portfolios. However, this has involved a "trade-off" of security for more frequent rent increases, but in the current commercial property climate in New Zealand the latter benefits are not necessarily being achieved.
3. The wisdom of these freeholding and re-investment policies have needed to be assessed by measuring the performance of each type of investment in terms of rental income, capital gain, the risks, the security offered (witness the recent boom/bust of the property investment market), and having regard to the long-term nature of these perpetual trusts. In addition, there are the moral, social, historic or ethnic values or attachments to these lands. In the case of Maori landowners there has also been the issue of the perpetual alienation of their lands which has irked them and for which redress is being sought under various claims before the Waitangi Tribunal.
4. Port reforms, introduced by the Labour government, have resulted in the formation of port companies to take over the operational aspects of the previous harbour boards and this has resulted in the transfer of vast amounts of non-port related (mainly reclaimed) leasehold land to the contiguous district and regional authorities (or in joint ventures).
5. Local government reform has resulted in the merging of many small local bodies into larger City or District Councils, many of whom have pockets of leasehold and other lands not specifically contributing to the objectives of local government. The value of retaining public ownership of these lands is being questioned.
6. The tightening of budgetary pressures on central and local government, coupled with the introduction of "user-pays" and "commercial" accountability, has required asset valuations to be undertaken. In the pressure to reduce the burgeoning

public debt, surplus assets have therefore come under close scrutiny. The validity of government, both at central and local level, to remain lessors of land perpetually leased for non-government related uses has been questioned.

7. Other government departments, Crown corporations and state owned enterprises (SOE's) have been forced to re-assess their asset values and to trim balance sheets and budgets. This has resulted in asset sales programmes, sometimes of the whole enterprises, and in particular surplus assets or assets not contributing to their corporate missions. Some of these assets have been lessors' interests in ground leases.
8. The previous National government's budgetary decision to increase land tax rates in 1981 to 2 cents in the dollar of land value, coupled with the huge subsequent increases in government land values as a result of the commercial property boom of 1985/87; and further coupled with the Labour government's decision to cease to exempt harbour boards (and thus the port companies) and local bodies from paying land tax; brought sharply into focus the need for a close look at the basis of apportionment of land values for land tax purposes. Both lessors and lessees were affected, particularly in Wellington where a government revaluation was carried out as at 1 May 1987, reflecting the height of the boom conditions. Auckland followed with a revaluation as at 1 May 1988, but not issued till November of that year, by which time the District Valuer reflected the severe downturn in the market, but not sufficiently to take the sting out of the land tax impact. Contributing also to the problem was the huge increase in the tax net resulting from the reduction of the exemption threshold to \$10,000 land value per taxpayer. This effectively meant virtually every commercial and industrial property was liable for land tax and many lessees and lessors not previously paying land tax were faced with increased outgoings in the retrenching post sharemarket crash economy. This led to a number of objections to Valuation New Zealand's valuations and the method applied to the assessment of both lessors' and lessees' interests in the process of apportioning land values for the respective assessments of land tax of ground leased properties. In 1989, the Labour government, beginning to bend

under pressure from all fronts, reduced the rate of land tax to 1.5 cents in the dollar for the 1989/90 assessment year, with a further reduction to 1 cent in the dollar for the 1990/91 assessment year.

9. The valuation problem was further complicated by the fact that these lessors' interests have rarely, if ever, sold in the open market. Most transactions which have taken place being transfers between related trusts, or when freeholded to the lessees. It is only in very recent times (this year) that various portfolios of these lessors' interests have been available "on the market", mostly quite unofficially, and in most cases lessors have been seeking the more profitable freeholding option. However, the market among commercial ground lessees is not particularly conducive to that solution at present! Some arm's length lessors' interests sales to third party investors have been concluded, but unfortunately "shrouded" in secrecy agreements, though one sale of five lessors' interests as a block in Wellington has now been registered² on the titles and can be analysed, but the basis of the actual price determination is not available.

The True Nature of the Ground Lessor's Investment

What lessors have as freehold owners of the title to any of these ground leased properties is *an interest* which is encumbered by the perpetual (or less commonly terminating) rights of occupancy of the lessees. Therefore the lessors enjoy only a part of the "bundle of rights" attached to the title. The most important right that of occupancy and use of the land is in the hands of the lessee. The only significant right held by a Lessor is the right to receive ground rental from the lessee(s) and the security (if any) provided by the improvements paid for by the lessee. In the event of non-payment of the ground rental the ground lessor has priority rights of re-entry, ahead of first mortgage and other claims a right rarely exercised, to my knowledge, - lessors rather bowing to opt for some form of rental deferment in genuine cases of lessee(s)' hardship (especially in the case of residential land). With the downturn in the New Zealand commercial

property market, the prospect of lessees walking away from leases, particularly vacant or redevelopment sites, which had their ground rentals reviewed during the boom in land values, increases this potential "downside" to these investments.'

The Value of a Lessor's Interest

The value of a *lessor's interest*, at any point in time, is the investment value represented by the present value of the future net rental cash flow from the ground rentals to be received in perpetuity (or in some cases over a long-term terminating period). This value is, however, invariably *substantially less* than the full unencumbered land value.

The value of a lessor's interest, *in market value terms* (on a willing-seller/willing-buyer basis), is what price a lessor could achieve in selling this investment for, to another "arm's length" third party investor. As these lessors' interests are rarely traded on the open market, this provides a problem for valuers to obtain market evidence as a basis of accurately assessing their market worth. This current valuation issue has been highlighted by the recent debate over the transfer of such interests from harbour boards to port companies and local government. Now acquired, the asset values of those local authorities are under scrutiny in the current environment of government requiring adequate returns on the market value of non-socially orientated investments of public funds.

This problem has also been brought into focus by a recent Wellington court case⁴ over the assessment of lessors' interests for land tax purposes, though this case was taken by a lessee, in objecting to Valuation New Zealand's apportionment of the Land Value appearing on the Government Valuation Roll (assessed as at 1 May 1987) for land tax purposes (as at 31 March 1988).

This has also been a serious issue for lessors, such as the harbour boards (now port companies), and local government lessors who became liable to pay land tax on their lessors' interests. In many cases seriously eroded the income therefrom, and in some cases the land tax exceeded the actual ground rental near the end of a long rental term. Fortunately, the Government exempt residential land from

the impact of land tax, but it remained a problem with commercial and industrial land leases until the 1990 Budget and the subsequent passing of the Land Tax Abolition Act 1990, which reduced the rate to 0.5 cents for every dollar of assessable land value for the 1991/92 assessment year, and abolishes it as from 1 April 1992.

Methods of valuation

Various methods are in use in New Zealand by valuers to assess lessors' interests:

1. Valuation New Zealand method:

The Department, to apportion the land values, first assesses the lessees' interests then the lessors' interests, and proportions the land value accordingly. The interests are assessed as follows (according to the explanation given in the *Tower Corporation* decision):

Lessees' interests:

- a. a value for the right of renewal expressed *as a percentage* of the land value (varies with the local market conditions); *plus*
- b. the value of the unexpired portion of the lessees' rental benefit to run calculated by taking the land value *times* the current ground rental percentage rate (rack rent or market rent); *less* the actual ground rental; *discounted* over the period to run at a market (effectively a monetary) discount rate.

Lessors' interests:

- i. the current or rack ground rent *capitalised* in perpetuity at a monetary rate of interest; *less*
- ii. the detriment to the lessor of the unexpired term (ie the same figure as the benefit to the lessee in (i) above is used); *plus*
- iii. the value of the lessors' right to review the rental in light of market values at the end of the current term allowed as *a percentage* of (i) and (ii) above (normally 5%).

2. Rental shortfall method:

- i. the current land value *times* the current ground rental percentage; *capitalised* at the monetary discount rate; *less*
- ii. a deduction of the amount by which the actual ground rental is *less than* the current ground rental (as calculated in (i) above); *discounted* at the monetary discount rate over the period to run.

2. A sale from Railways Corporation to CML Insurance which is analysed later in this paper.

3. Two recent Auckland examples of this are: (i) after a three year delay in bringing a renewal to a major arbitration hearing, the lessee did not exercise the right of renewal on receiving the Award, leaving an old and uneconomic building on the site, with a significant land tax and rating liability now resting on the lessor; and (ii) where the lessee went into liquidation during the renewal process and the mortgagee in possession did not consider it was worthwhile to proceed with the renewal and the lease lapsed, again being a redevelopment site with minor existing buildings.

4. *Tower Corporation v Valuer-General and Wellington City Council*, Wellington Land Valuation Tribunal No.2, Reserved Decision dated 25 July 1990 (LVP NOS: 87-90/89)

3. Yield method:

The actual ground rental is *capitalised* (in perpetuity) at an appropriate "yield" or (effectively) an overall capitalisation rate.

4. A discounting method:

- i. the actual or contract ground rental is *discounted* over the term to run at the monetary discount rate (appropriate adjusted for management, and lessors' outgoings and risk); *plus*
- ii. the reversionary interest in the future rental increase (at renewal or review as the case may be) is calculated by taking the land value *times* the current ground rental rate; *capitalising* this figure (in perpetuity) at the monetary discount rate (appropriately adjusted for risk, and the review term)⁶; and *deferring* that figure to the end of the term to run at a *real rate* of return (the monetary rate *less* an allowance for anticipated long-term inflation).

Examples of these methods applied to three typical commercial leases in Auckland each assumed to have a land value of \$1,000,000 of varying terms to run outlined below

Once the valuer has overcome the basic problems of assessing land values in the current market, has a defensible ground rental basis and arrived at a suitable discount rate (problems enough in themselves!), the methodology and appropriateness of each method of valuation needs to be examined carefully.

Method 1:

Step 1(i) treats the assumed current ground rental (if re-assessed) as a purely non-inflating cash flow in perpetuity. This is unrealistic, hence step 1(iii), as an attempt to adjust for this. Step 1(ii) simply adjusts for the rental shortfall to the next review adopting the same discount rate as used in the lessee's interest valuation. There

may well be sound reasons why a higher discount rate may apply to the lessees', or vice-versa, the lessors' interests having regard to their respective typical monetary opportunity costs and the risk differences having regard to the merging between current ground rental and the contract ground rental. Step 1(iii) is entirely arbitrary, a point made well by the objector in the *Tower Corporation* case, and which the Tribunal did not seem convinced about. It does not reflect the varying potential nor the term to run, unless a variable percentage is used. The use of a standard percentage as in the examples shows that the greatest addition is made for this factor immediately after a renewal, compared to the years leading up to a renewal where this potential becomes greatest. This is not logical. The method does not address the management and outgoings issues either.

Method 2: suffers from the same criticisms as for Method 1, as it is essentially the same, though expressed another way. All the risk and lessor's outgoings have to be adjusted for in the discount or capitalisation rate. There is no specific allowance for the lessors' potential in future land value rises.

Method 3: is reliant on a very subjective capitalisation rate, unless there are a lot of sales of similar interests with similar terms to run and risk factors (which there isn't). It is very difficult to allow adequately for variations in the potential for future rental increases in this method, and therefore is not reliable.

Method 4: is more complicated as it allows for the allocation of different risks to the components of value. Though the same monetary discount rate is normally used in *Steps 4(i) and 4(ii)*, these can be varied to adjust for risk, such as when the contract ground rental is very low and thus very secure, or alternatively when it is high such as in the case of some renewals during the boom, or to allow for other locational or security risks.

Step 4(ii) is an attempt to bring into focus the impact of the future rental increases, on the assumption that current land values are the markets' interpretation of all future benefits of ownership in *current real terms*. The use of the real rate to discount this benefit over the term to run assumes that the future increases in land values will move in relationship to inflation. If the location

Basis.

Monetary discount rate	15%pa
Ground rental rate:	9%pa
Long-term inflation rate:	5%pa
Real discount rate:	10%pa

Land value \$1,000,000

EXAMPLE:	(a)	(b)	(c)
Years to run	5	12	19
Contract ground rental	\$6000pa	\$15,000pa	\$85,000pa
<i>Method</i>	\$	\$	\$
1 (i):	600,000	600,000	600,000
1 (ii):	-309,913	-442,751	-33,538
1 (iii): [5% \times (i) + (ii)]:	14,504	7,862	28,323
Total	304,591	165,112	594,785
% of land value:	30%	17%	59%
2 (i)	600,000	600,000	600,000
2 (ii)	-309,913	-442,751	-33,538
Total:	290,087	157,249	566,462
% of land value	29%	16%	57%
3: Yield	02.5%=240,000	079/_214,286	@13.5%-629,630
% of land value:	24%	21%	63%
4 (i):	22,137	88,550	570,153
4 (ii):	368,348	186,041	93,963
Total:	390,485	274,591	664,116
%o land value	39%	27%	66%

(All calculations are half-yearly in advance, as is the common form of rental payment)

is such that there is a strong likelihood that land values will increase at a higher rate than inflation, then this real rate could be reduced appropriately, or vice-versa. When dealing with leases of shorter than 21 year review terms and/or with terminating leases the monetary discount rate (effectively used in this step as a capitalisation rate) can be reduced to reflect the improved form of investment (ie a 3 year rent review terminating lease may justify a rate of say 10%pa - see under a later heading and in Table 6).

The method is in effect a proxy for a full discounted cash flow method, assuming that, because of the long term rental period and perpetually renewable nature of these interests, a reversionary value at the end of the current term to run can be represented by capitalisation of the rent in perpetuity, rather than a series of 21 year cash flows. The use of a real rate of return, coupled with the reliance on the current land value, removes the nonsense of predicting future land values to arrive at future ground rentals only to have to discount them back again at a discount rate that must also allow for inflation. The simplicity of these assumptions are the method's virtue, and solidly based on urban land economics principles.

The Appropriate Discount Rate:

The differences in the approaches will depend on the appropriate rates adopted for the ground rental, the discount rate, and the real rate of return built into the calculations.

In the *Tower Corporation* case, the valuer for the objector used the same rate of 8.5%pa for both the current ground rental percentage rate and the capitalisation rate applied to the rack rental capitalisation in adopting *Method 2 (i)* above (effectively valuing the lessor's interest at the lease renewal date at 100% of the land value!). He agreed, however, with Valuation New Zealand's monetary discount rate but applied that only to the shortfall in rental in *Method 2 (ii)*. This was the essential difference in the dispute. He

also challenged the arbitrary nature of VNZ's allowance in *Method 1 (iii)*. After a three-day hearing the Tribunal found the objector's case was unproven. Not a very helpful decision in some ways as, though VNZ's assessment was in effect upheld, the Tribunal did not really bring down any helpful criteria to apply to this critical factor of the appropriate discount rate to apply, nor the appropriateness of the methods of valuation to be applied.

The recent sale (in June 1990) of the five lessors' interests in Wellington involved part of a group of properties which were the subject of a major Arbitration before McGrath QC as Umpire to determine their ground rentals for a 21 year renewal as from 1 April 1988. The total ground rentals amount to \$776,240pa being an award at 8.0%pa of land values totalling \$9,703,000. The sale is recorded in the Wellington Land Transfer Office at a consideration of \$5,742,387 and can be analysed a number of ways.

(a) Assuming the land values and ground rental percentage awarded by McGrath are still applicable as at the date of sale and that a "real" rate of return is 10%pa and adopting the methods as above, the following "returns" are determined (by trial and error spreadsheet analysis):

Method 1: 14.2%pa monetary discount rate
[5% allowance in *1 (iii)*]

Method 2: 13.5%pa monetary discount rate
Method 3: 13.5%pa yield rate

Method 4: 15.3%pa monetary discount rate
(Methods 2 and 3 give the same rate as there is no rental shortfall on these assumptions)

b. Assuming that land values have fallen by 15% since 1 April 1988, that the ground rental rate would now be appropriate assessed at 7.75%pa, and that long-term inflation is 4%pa, the following "returns" are similarly determined:

Method 1: 14.1%pa monetary discount rate
Method 2: 13.3%pa monetary discount rate
Method 3: 13.5%pa yield rate
Method 4: 14.6%pa monetary discount rate

Other variations of the assumptions could be used, but within a reasonable range of inputs the likely market indicated monetary discount rate that reconciles with

the price paid at June 1990 is 13.5%pa to 15.5%pa depending on the method adopted.

These rates compare to the average five-year Government Stock yield for June 1990 of 12.31%pa and the average first mortgage housing rate of 14.9%pa.⁷

Lessors' Interest Values Over the Cycle of Rental Reviews:

During a 21-year rental term of a ground lease, the lessors' interest values will reduce, when expressed as a percentage of land value, from a high point of 60% to 70% at the point of lease renewal, and reach a low point near the mid-point of the term, as low as 20% to 30%. The lessor's interest then begins to climb in value as the prospect of a significant ground rental increase at the next renewal impacts on the present value of this potential.

When expressed as a graph, the lessors' interests, as a % land value, follows an "s" curve over a 21-year cycle of terms to run as shown in Chart 1 (page 16), which is an approximation of the average "best fit" curve based on an analysis of Auckland "Downtown" and "Port" ground leases. (Individual lease variations are in some cases significantly different from this curve).

It also highlights the effect of the downturn in values since 1987, with some ground rentals having been fixed at the top of the market, with the subsequent decline in land values and ground rental percentage rates resulting in these lessors' interests representing a higher than normal percentage of current land value. In a "normal" market (if there is such a thing now-a-days) of a continually upward inclining level of land values, one would expect the curve to peak at the renewal date of the lease. This is the case in respect of Auckland Eastern Suburbs residential leases as shown in Chart 2. (p16).

In contrast, Chart 3 (p16) being Auckland 5-year rent review commercial and industrial ground leases, (many of them also being long-term terminating as well) shows a shallow curve between 60% and 70% over a 5-year term. This highlights the improved performance of and better investments that these more

Footnotes:

5. In this method the allowance for management (which is not insignificant) and other outgoings can alternatively be dealt with separately, based on realistic current annual estimates and capitalised at the monetary rate of return, and deducted from the calculation based on the contract ground rental. The problem that occurs in practice is that the land tax liability was not known before such an apportionment is made when being applied to the Government Valuation apportionment. Where the lease is near the end of the term and the land tax assessment is known, such as valuations for sale or asset purposes, this figure could exceed the present value of the rental to run. This negative effect is not taken into account or recognised by VNZ on the basis that any land tax impact is already decapitalised by market forces into the land value!

6. Or more simply by multiplying the land value by the ground rent % divided by monetary rate % • see article Current Problems in Ground Leasehold Valuations, (1989) NZ Val. December p 18.

7. Reserve Bank of New Zealand, Weekly Statistical Releases.

CHART 1
 AUCKLAND CBD COMMERCIAL & INDUSTRIAL
 Lessors' Interests as % of Land Value

0
 F

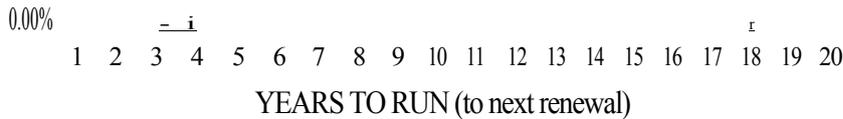


CHART 2
 AUCKLAND RESIDENTIAL
 Lessors' Interests as % of Land Value

0
 F

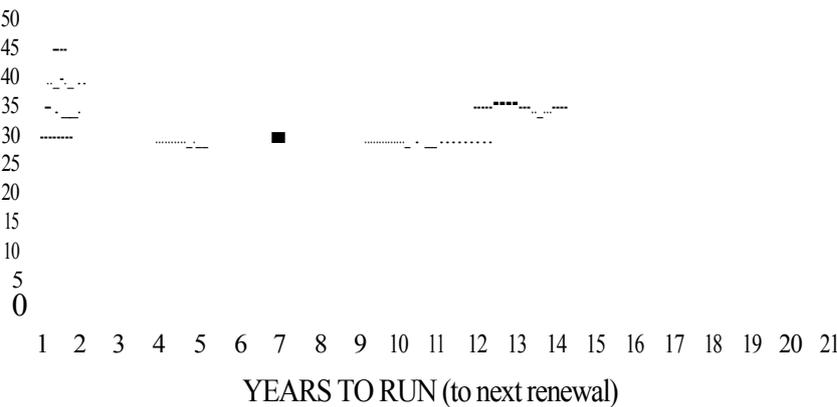


CHART 3
 AUCKLAND CBD COMMERCIAL & INDUSTRIAL
 Lessors' Interests as % of Land Value

0 70% 0-
 F 65% -



modern forms of ground leasing provide (made possible by the Public Bodies Leases Act 1969 introducing rental reviews at down to five-year intervals in new leases).

Freeholding Policies and Potential Capital Gain

When a lessee wants, or can be induced, to freehold the land by purchasing the lessor's interest, a price can usually be achieved which is substantially higher than the investment value of the lessor's interest. Sometimes the lessee is prepared (or is required under legislation) to pay up to the full land value if they want to own the land. The Land Act Amendment 1970, applying to Crown leases for example, provides for a deduction to be made, from the land value exclusive of improvements (with some limitations)', based on a fixed formula, quaintly called a "goodwill", that applies to the freeholding of certain crown leases. Some church and other charitable trusts have current freeholding policies which vary, but generally grant a freeholding allowance which recognises the term to run until the next renewal, resulting in between 0% at renewal and up to 35% (maximum, at mid-term) as a deduction from the land value in fixing the net freeholding price.⁹ However, these generally apply only to residential land with commercial or industrial leases usually freeholded at full land value¹⁰ or dealt with as special cases.¹¹ Some Maori incorporations, on the other hand, have freeholded their land at a premium above a land (or unimproved) value to their lessees.

Therefore, the lessor has a potential capital gain or profit on freeholding, - where *the lessee freeholds the land at a price in excess of the calculated lessor's interest*. Where there is a likelihood or possibility of this happening, it will tend to enhance the market value of the lessors' interests, even to a third party purchaser. However, the greater the incentives needed to attract lessees to freehold, the lower the added value of this potential! Making allowance, where appropriate, for these freeholding profit potentials over and above a calculated lessor's interest, makes the exercise a very difficult one. The degree of potential will vary from one locality to another and also depend on other factors such as potential site amalgamation of separately leased properties forming redevelopment blocks. or where land is leased to adjoining freehold owners.

The Value of the Lessors' Interests to Lessees

From the Lessees' point of view, there are

many factors which may impinge on whether they are interested (or able) to freehold, and what price they may be prepared to pay. Sometimes a premium may be attached to a lessee's opportunity to convert the property to a freehold, either to be rid of the ground rental liability and the future uncertainties that presents, let alone the enhancement in value and marketability created by converting from a leasehold to a freehold title. Many residential leasehold owners, who are emotionally attached to their "homes", frequently pay a premium (compared to the added value) just to own their own home as a freehold. Some commercial properties may be unattractive in the market as investments on leasehold land, ie Asian buyers who do not understand nor are interested in investing in other than freeholds.

Thus, a lower net building income capitalisation rate will normally apply to a freehold compared to a leasehold. When the "added value" of acquiring the freehold is calculated, the increased value and saleability may make freeholding "good business".

For example, the following shows the effect of a 1% difference in the freehold versus leasehold capitalisation rate on a large new office tower, hypothetically in Auckland.

Basis:	Years to run	16 years
	Land Value:	\$15,000,000
	Ground rental:	\$500,000pa
	Net building income:	\$5,000,000pa
	Freehold capitalisation rate:	8%pa
	Leasehold capitalisation rate:	9%pa
	Leasehold value:	
Leasehold Value:		
	(\$5,000,000-\$500,000) pa capitalised	
	@ 9%pa	\$50,000,000
Freehold value:		
	\$5,000,000 capitalised	9 8% pa
	Added value to freehold:	<u>\$62,500,000</u>
		\$12,500,000
The added value to the lessee, in this example is 83.3% of the land value.		
The <i>calculated lessee's interest</i> in the land (based on the Auckland situation, all calculations based on payments half-yearly in advance would be:		
(a)	Benefit to run:	
	[\$(15,000,000 @ 9%) - \$500,000]pa x P.V.	
	for 16 years @ 15%pa	\$5,448,899,557,711
(b)	of renewal:	
	say 25% x \$15,000,000 =	\$3,750,000
		71
	Say:	<u>\$9,240,000</u>
	As % of land value	62%
	Added value to the lessee:	
	Land value:	\$15,000,000
	Less lessee's interest (as above):	\$9,240,000
	Added Value:	<u>760,000</u>
	As % of land value =	38%

Clearly, in this example, the lessee could afford to pay more than the "added value" based on a calculated lessee's interest in the land basis. It would be unreasonable, however, to expect the lessee to pay the full \$12,500,000 added value on a capital value basis. The lessee would surely also look at the gain that the lessor would make.

The *calculated lessor's interest* in the land (using Method 4) would be:

(i)	Present value of rental:	
	\$500,000; a x P.V. for 16 years @ 15%pa	\$3,229,160
(ii)	Present value of reversion	
	(\$15,000,000, x 5 po	
	x P.V. in 16 years	\$1,888,795
		\$5,117,955
	Say:	<u>\$5,120,000</u>

As % of land value = 34%

Thus the lessor would gain (\$12,500,000 - \$5,120,000) = \$7,380,000 or 49% of the land value, just because the lessee may be in a position to benefit that much! No prudent lessee would hand that much profit over to the lessor, and a more *quid pro quo* solution is likely to result from negotiations where both the lessor and lessee will profit out of the freeholding.

The above analysis takes into account the effective added value of the building which the lessee paid for, and it seems fairer to arrive at a solution which deals solely with the respective interests of the lessee and lessor in the land value.

A "rule of thumb" which has been evidenced in these situations in Auckland is where the price is negotiated in the range of 50% to 60% of the difference between the lessor's interest and the land value. Applying a 50% difference in the above example indicates the following:

Lessor's interest:	\$5,120,000
Add: 50% (\$15,000,000 - \$5,120,000) _	\$4,940,000
Indicated freeholding price:	\$10,060,000
As % of land value =	67%
As a "freeholding deduction" _	33%

On this basis:

The lessee gains in terms of added capital value less freeholding cost: \$12,500,000 - \$10,060,000 =	\$2,440,000
As % of land value =	16%
The lessee gains in terms of added value in the land:	
\$15,000,000 - \$9,240,000 =	\$5,760,000
As % of land value	38%
But at a cost of:	\$10,060,000
As % of land value =	67%
The lessor gains: (\$10,060,000 - \$5,120,000) =	\$4,940,000
As % of land value =	33% >!

It would appear that in such situations that the lessor will "gain" far more than the lessee, as the lessor has the upper hand in agreeing or not to the freeholding. Clearly there is a point at which a commercially prudent lessee would not be prepared to

Footnotes: 8. ie the rental benefit discounted over a maximum of 11 years to run, and prescribing the rental rate and the discount rate applied (to be the same).
 9. The *Anglican Church Trust Boards* in Auckland, since 1976, have a policy that relates the freeholding allowance to the present value of the lessee's rental benefit to run discounted over half the period to run, with a maximum of 20%. This applies to certain qualifying residential leases only. The *Dilworth Trust Board* in Auckland has made a special freeholding offer in June 1990 to their residential lessees, with restricted single family houses use clauses, whereby they will be able to freehold at the full (unrestricted) land values less a minimum allowance of 10% increasing in the middle of the 21-year terms (according to a predetermined schedule) to 32.5% together with the option of a cash discount or terms payment. This offer expires at the end of November 1990.
 10. Almost invariably these have been at the full land value, irrespective of the term to run, and usually affected by other factors such as the amalgamation of redevelopment sites.
 11. One case in Auckland in December 1988, however, involved a lease with 17 years to run based on an old industrial use ground rental where the lessee/developer had obtained a specified departure for a multi-storey car parking building, which the developer was intending to sell off in unit titles. A freeholding price was negotiated which represented a discount of approx 35% on the full value of the land or approx 55% of the difference between the lessor's interest value and the freehold land value.

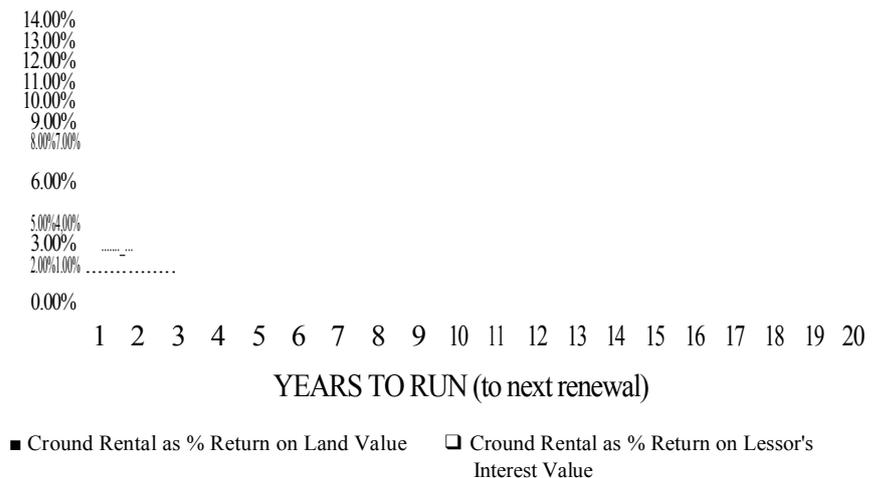
CHART 4
AUCKLAND COMMERCIAL & INDUSTRIAL Ground Rentals
as %'s p.a. of Land Value and Lessors' Interests

to freehold, where there is an unreasonable margin of "profit" to the lessor in freeholding. The deal needs to be potentially profitable to the lessee, however, who will nevertheless look at the benefits to be recouped in terms of total value (ie including any current or proposed buildings).

In the current market, where there is such little demand for redevelopment land, and where existing buildings are not using the land to its highest and best or most profitable use, the attractiveness of freeholding is constrained by the potential added value of refurbishing current buildings or in the longer term value for redevelopment when the market turns into the next boom phase.

It is therefore more likely that freeholding options will only be attractive to lessees with substantial buildings on their land, or where amalgamation and/or redevelopment is in the planning.

The above type of analysis is applied to the previous three examples to complete this discussion as follows:



negotiating with lessees, or making various freeholding offers.

Where the lessors are open to negotiation, many are not, taking a "take it or leave it" stance then there is the potential for lessees to negotiate a trade off of

The True Investment Comparison

When comparing the returns from investments in ground leases with other types of investments it is the *lessor's interest value* that is the proper basis to relate ground rental income to, not the freehold land value.

This is highlighted by the erroneous (and somewhat emotive) claims by some of the players in the current pressure for Maori leasehold reform.¹² The Maori "prescribed" leases do have their problems, and reform is probably justified, but they are not in that different a position to other lessors of leasehold land in New Zealand (putting aside the quite separate issue of how these lands came to be leased off on perpetual terms in the first place).

To make a valid comparison, it is really the internal rate of return¹³ on the value of the investment which is valid, not the income "yield" at any point in time.

However, turning to the simplistic income "yield" criteria which is being applied, let us look at the evidence from a recent analysis of both commercial and industrial leases as well as residential leases in Auckland.

CHART 4 (above) shows the "best fit" curve on an analysis of 21-year commercial and industrial ground leases in the downtown and port areas of Auckland. Ground rents as a percentage return on land value shows the effect of the boom in land values in the 1985/87 period and since falling backward. Leases with up to 13 years to run show a return of less

EXAMPLE	(a)	(b)	(o)
<i>Lessee's Interest</i>	\$	\$	\$
(i) Benefit to run:	309,913	442,751	33,538
(ii) Right of renewal	<u>250,000</u>	<u>250,000</u>	<u>250,000</u>
	559,913	692,751	283,538
As % of land value:	56%	69 ⁰ / ₁₀	
<i>Added Value to Lessee-</i>			
Land Value	1,000,000	1,000,000	1,000,000
Less: Lessee's Interest	<u>559,913</u>	7 1	<u>283,538</u>
	440,087	307,249	716,462
As % of land value:	44%	31%	72%
<i>Lessor's Interests 50% Difference</i>	<i>Land Value Less Lessor's Interest</i>		
Lessor's Interest: (Method 4):	390,485	274,591	664,116
50%(LV \$1,000,000 above) As	695,242	637,295	832,058
% of land value:	70%	64%	83%
As freeholding allowance:	30%	36%	27%
Lessors' Interest as % L.V.	39%	27%	66%
profit" on above basis:	31%	37%	17%

Clearly, lessors who are contemplating selling their lessors' interests will realise greater values for their interests if they can freehold to lessees.

This explains why lessors are reluctant to sell their interests on the open market, and are pursuing freeholding options, by

the lessors' potential profit to their own benefit in trying to conclude a freeholding that has an element of *quid pro quo* in sharing the benefits to both parties. Naturally neither can benefit without the other coming to a mutually beneficial agreement.

Footnotes: 12. "The Injustice of Maori leases At a time when the rental return on commercial property is more than 10 per cent, Maori landowners are getting an average return of 1.6 per cent. Its like having \$100 in the bank at 1.6 per cent interest. For every \$100 of land they own, Maoris receive on average \$1.60 a year rent, whereas other commercial landowners receive more than \$10. It is an injustice any landowner would be anxious to remedy." From a brochure *A Plea for Fair Rent* produced by the Maori Land Authorities Group, September 1990.

13. In some recent analyses of a sample of Church ground leases in Auckland, long-term historical Internal Rates of Return were found to lie in the range of 13% pa to 20% pa based on estimated lessor's interest values at the beginning and end of the periods reviewed(in excess of 21 years).

CHART 5
AUCKLAND RESIDENTIAL Ground Rentals
as %'s p.a. of Land Value and Lessors' Interests

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21

YEARS TO RUN(to next renewal)

■ Cr. Rent as % of Land Value

□ Cr. Rent as % of Lessor's Interest Value.

than 2%pa on land value. The average will, of course, depend on the weighting within each portfolio of leases chosen to study. For example, the approximate 190 leases in this study showed an average over all types and terms of 2.7%pa.

CHART 5 which shows the "returns" from Auckland Eastern Suburbs residential ground leases, where a smoother and not so dramatic, but still substantial, increase in land values took place during the boom of 1986/87, since haltering but having recovered and continuing to increase albeit more slowly. It shows that with leases with up to 14 years to run, the "return" on land value is under 2%pa.

Clearly, on this criteria, ground leases appear a poor investment but are they?

Both charts also show the "returns" based on the calculated lessors' interest in each case, with again the "best fit" approximation curve. This analysis clearly shows that these long-term 21-year leases show quite acceptable "returns" of over 9% to 10%pa over the initial five to six years of their terms. It is only when they are approaching five to six years from their renewal dates, that the returns fall below 2%pa. For over half of their terms (11 to 12 years) "returns" of below 5% to 6%pa are achieved. Again the average will depend on the mix of leases in a portfolio. The same Auckland commercial and industrial analysis example showed a 6.2%pa average "return". These returns are assumed acceptable, resulting from the valuation methodology applied, because of the offsetting impact of the prospect of substantial ground rental increases at the next renewal, as illustrated by the upward rising curve in the Lessors' interest values in CHARTS 1 AND 2 in the period leading up to the renewal date.

What is also clear from such an analysis is that these interests cannot be valued successfully on a simple income "yield". Just because some leases sell at a certain "yield" rate, this cannot be applied to any other leases which may have different terms to run, location and other factors to be considered.

Complications and Their Impact on The Valuation Process

Apart from the problems already discussed and the need to select an appropriate valuation methodology, there are a number of complications which arise in practice which I refer to briefly. Each of these, however, really deserves more research and analysis.

a. Allowing for the impact of different terms.

A number of ground leases are terminating and require slightly different treatment. If the termination date is very long-term the Lessor's interest is likely to only vary marginally from a perpetually renewable lease. As the termination date becomes closer, however, and particularly within a 21-year time frame, then the reversionary prospect of regaining the full freehold value becomes significant. Any improvements compensation provisions in the lease need to be considered too. Methods 1 to 3 will not adapt to allow for terminating leases while Method 4 will. The correct way to adjust for this in Method 4(ii) would be to discount the full land value at the real discount rate over the period to run, if within the final term of the lease; but if there are further rights of renewal to be exercised before termination it is more

appropriate to use a lower monetary discount rate as a capitalisation rate in the formula. I attach in Table 6 (p.20) an extract from a spreadsheet programme showing the tabular adjustments I have used for this factor in the valuations used in the Auckland analyses.

b. Differing rent review periods.

Similarly, a lease which provides more frequent rental reviews will need to be adjusted for two factors:

i. the lower ground rental percentage rate that will apply to the land value to determine the current ground rental; and

ii. a more attractive investment, best reflected in lowering the discount rate used as a capitalisation rate in the formula in Method 4(ii). See also Table 6 where adjustments are made for these variations.

The net effect on the lessors' interests should be to enhance their values compared to those with longer rental review periods.

c. Differing risk:

Where locational factors give rise to greater than normal risk, such as changing neighbourhoods, or lack of demand, then higher than normal discount and/or capitalisation rates would need to be used.

Other adverse factors which can affect the value of lessor's interests could be dealt with in a similar fashion and include:

- poor demand for alternative uses should the lessee not exercise a renewal;
- old improvements and uneconomic uses of the land where the lessee may not have the ability or capital to put the land into a higher use, which blights the neighbourhood, or for which there is no general demand due to current market conditions.
- historic designations on buildings, which restrict the ability of the lessee to utilise the land to its highest and best use, and brings unusually high restoration costs and or higher maintenance costs coupled with inefficient floor area ratios. This problem is likely to come before an arbitration over the proper basis of fixing the ground rental in such cases. The lessee could claim that the Historic designation precludes the lessor from giving any required consent to demolish the building and therefore acts as a restrictive use clause affecting the amount of ground rental that it k

BASIS: OF LESSOR'S INTEREST:	Ground Rentals as per Table below	(See below)				
	Real Discount Rate:	0.09				
	Monetary Discount Rate:	0.1 55				
	Valuation Date	30/3/90				
	Present Value of Rent to Run:	Rental per quarter, Disc 0 Monetary Disc Rate/4, over Term to Run, All Cales B.O.P. Factors				
	Reversionary Cap Rates	is Monetary Discount Rate for 21 yr Perp.: Less allowance for shorter rental review and Term.				
	Land value reversal	Ground Rental % Reversionary Cap Rate				
	Reversion:	P.V. of L.V. x Reversion Multiplier, disc ® Real Disc. Rate, to next Rent Review Date				
		Ground Rentals %s				
Term:	21yr	14yr	10yr	Tyr	Syr	3yr
Perpetual:	0.09	0.085	0.08	0.075	0.07	0.065
Terminating:	0.0%5	0.08	0.075	0.07	0.065	0.06
		Reversionary Cap Rates (RevCapRate)				
Term	21yr	14yr	10yr	7yr	Syr	3yr
Perpetual:	0.155	0.145	0.135	0.125	0.115	0.105
Terminating:	0.125	0.115	0.105	0.095	0.085	0.08
		Land Reversion Multiplier				
Term	21yr	14yr	10yr	7yr	5yr	3yr
Perpetual:	0.5806	0.5862	0.5926	0.6000	0.6087	0.6190
Terminating	0.6800	0.6957	0.7143	0.7368	0.7647	0.7500

TABLE 6

is "fair" for the prudent lessee to pay. Both the uncertainty over this issue, and the risk that a historic designation could be placed on buildings in the future, must have a negative effect on lessors' interests where such designations exist, are likely or a possibility in the future.

- Delays in arbitrations and the costs thereof including the loss of interest on unpaid ground rentals pending the award. Even so, a lessee taking the building rental but not paying any increased rental pending the arbitration outcome, could still walk away from the lease, quite legally. If the building was old and there was no immediate prospect of selling the interest in the lease or redeveloping the site due to market conditions, the awarded ground rental could so exceed the building rental income that the lessee could regard the negative effect as completely offsetting any value in the rights of renewal, and not exercise the right of renewal. The lessor then runs the risk of receiving the lessee's building and a substantially reduced rental return al-

beit regaining the freehold (less costs of demolition and site clearance), land tax and rating liability continuing!

d. Portfolio values versus individual property values

When valuing a portfolio of lessors' interests the question arises as to the effect that the mix of leases of different terms will have on the saleability and thus the value of the portfolio as a whole. In addition, some economies of management can be achieved, and the possibility of "working" the portfolio to buy out some lessees and freehold others to improve the land ownership parcels, especially if including adjoining sites in redevelopment locations, providing potentials that are not possible if leases are dealt with in isolation.

If there is a spread of property types, locations, lease terms and review dates, there may be some spreading of risk. A well spread range of lease review dates will provide a portfolio with a progressively increasing rental income, and be more marketable com-

pared with a portfolio where all, or the bulk of, the leases all come up for renewal at the same time. The latter may also give rise to the potential of lessee group action in "fighting funds" for resisting ground rental increases and thus not only delay the income flows pending the outcome of arbitration but also incur greatly increased legal and valuation costs, as well as loss of interest on the unpaid rental pending the awards.

e The complication of archaic lease terms

Some old leases which were created before the turn of the century have archaic rental formulae, such as the prescribed "five per cent per annum of gross capital value less the value of substantial improvements". These will always give rise to difficulties of the lease interpretation and provide ground rentals that are well below normal market levels at renewal. If the prescribed formula in the leases (or legislation) are interpreted to require the existence of the actual improve- 0

Footnotes: 14. Some of the prime Auckland Eastern Suburbs waterfront land at Mission Bay and Kohimarama is held under such leases (5% formula), and the Melanesian Trust Board as lessors has long had a policy of not freeholding such prime positions, except in most special circumstances.

15. However the Labour government belatedly announced before the 1990 election that it had decided to implement the recommendations of the Sheehan Commission of Inquiry Into Maori Reserved Lands (1975) as follows: (i) lessees will have the balance of their current terms plus another 21 years before the Government will decide what to do about future tenure; (ii) there will be a new statutory formula for rent of 6% for rural and 7% for urban land on an unimproved basis (lessees will be compensated by Government); and (iii) rent reviews will be at 7-year intervals not 21-year intervals. (Minister of Justice, press conference and associated Cabinet minute of 30.10.89; and 10.10.90 Capital Letter Vol.38 NO-39 (599).

Regression Analysis Application to Rental Assessments in Dunedin

by M Jackson

In Dunedin we have experienced steady growth in the retail rental market, a reversal of the trend presently being felt in some other main centres. This is evidenced by rental levels in the Golden Block area of the city having increased over the past year by as much as 20% to 30%. Some nationwide retailers have voiced their objections to these rental levels, citing the general economic downturn together with office and retail space surpluses in the main centres, as their primary reasons. One such objection included a "simple linear estimation" from an Auckland lawyer having about as much statistical validity as a "Gut Feel". The worrying part was that here was a lawyer who knew something about statistics and computers and was prepared to use it. If we as valuers cannot critically analyse these computer based statistical techniques and use them to our own advantage then we are doing so at our own risk.

In light of these objections we were moved to justify our own traditional valuation techniques. The problem was not so much in coming up with exactly the same figure but to support these techniques by some other method of assessment.

With the advent of computer software

packages, virtually anyone can perform a "regression analysis", but not everyone can analyse and examine just what the resulting equation and prediction mean. If a person off the street were to give you a price of a house or office block, what would be the first question you asked? Probably, "where did you get the information?" and "How was it derived?" You must be able to do the same thing when dealing with computer generated output. Probably the most basic (and most easily forgotten) assumption made when dealing with machines (from hand held calculators to main frame computer systems) is that the operator should know in the first instance, approximately what the answer will be. If this is not the case then too much reliance is placed on the machine and if any errors do occur they cannot be picked up and corrected.

I will attempt in Part One of this paper, to outline and explain regression analysis from a valuation perspective, in concept, procedure and statistical breakdown, then move on with two recent examples applied in Dunedin and their subsequent analysis. There are a vast number of very detailed analytical techniques that can be used (see Bibliography 1, 2, 3), but the

emphasis here will be on a few practical methods that can be carried out quickly while still offering relevant information on the fit and predictive strength of any regression study. 0

0 from previous page

ments and therefore actual use to take precedence; or where there are specific restrictive use clauses, then the lessors' interest will be even more depressed in value. The only hope (for the lessor) is to be able to re-negotiate the lease terms, but lessees will require fair compensation if their interests are adversely affected. Other solutions lie in freeholding to the lessees¹⁴ such as the Dilworth Trust in Auckland are currently attempting to do. The lessee, if able and willing to freehold, will always be prepared to pay far more for the acquisition of the freehold than a third party investor.

In many cases these lessors' interests would be such poor performers that they would have little or no prospective market among investors. How to value them is a real problem I have not yet had to address!

Conclusion

This paper has highlighted the current problems and issues facing valuers in New Zealand involved in advising lessors and investors as to the value of commercial and industrial "Glasgow" leases.

Though these leases have been part of New Zealand's property scene since early colonisation, it is only recently that the problems of the lessors and the value of their interests have been brought into the "limelight".

This has largely been triggered by changing economic conditions and land taxation policies. Though the latter has had a reprieve, the problems remain and are unlikely to fade until solutions to this form of unsatisfactory form of land tenure are resolved. Legislative reform of the leasehold system is however a "can of worms", which successive governments in New Zealand have been happy to have

enquiries about but not to initiate change or implement their recommendations's

Meanwhile the administrators, lessees, and valuers of these leases will have to grapple with the problems bequeathed to us by those pioneers who saw a dichotomy between land ownership and land use, and introduced the "Glasgow" lease and its variants to provide land desperately needed for rural development and urbanisation of this country.

Little did they envisage the long-term effects of inflation, economic developments, and the overlay of legal precedents, monetary and fiscal policy, which now impacts on the benefits of ownership of these leasehold lands.

I hope this paper has helped to cast some light on the current state of flux occurring in this important area of New Zealand land tenure, albeit from a somewhat narrow valuation aspect. A

PART ONE

The Concept Behind Regression Analysis

Most valuers have heard of "line of best fit". It is what we do every day when valuing anything. We simulate (or "draw") this "line" in our heads, by gathering as many current and comparable sales as are possible and ordering them relative to their price.

Every comparable property, including the subject property we wish to value, consists of a "bundle of theoretical rights". These rights, captured physically in terms of depth, frontage, area, title, etc are then modified, subjectively by location, interest rates, the general economy, etc. Each property then can be broken down into components of value, being either objective or subjective in nature.

When we describe the subject property as "good" or "poor" relative to our current and comparable sales evidence, we are in fact performing a comparative value judgement in our heads, we place or order the subject property on a line "drawn" in our mind. This line, made up of the current and comparable properties together with their respective sale prices is our own simulation of the market for the subject property as it exists today. This can be shown graphically by listing each comparable property in terms of its price (see Graph 1 below).

This is a simple graphical representation of what we do initially in valuing a property. When we next consider the property we wish to value we must find an approximate rule that models (or simulates) these comparable properties in terms of their sales price, onto which we can place the subject property. This rule is achieved by "drawing" an approximate "line of bestfit" through the known points, for example, Line A or Line B. It is easy to see that Line A provides the best approximation, or "line of best fit".

mation, or "line of best fit".

This is the important part! Why is Line A the best approximation of the data points? It is simply the line closest to the data points, or put even more simply it is the line that has *the least amount of deviation* between itself and the data points.

There are two ways of drawing this line (or curve):

- a. by hand (that is, in the mind), or
- b. by mathematical equation.

If we go back and study the history of depth tables we see this same situation. That is, which is better in trying to model a diminishing return on value in terms of depth, a hand drawn depth curve or a mathematically based depth curve. In John A Zangerle's *Principles of Real Estate Appraising* (Second Edition) 1927, at p 112:

"All depth curves in use, except three, until 1926 were adjusted to definite and fixed percentages of value which the projector thought certain parts of a standard lot should enjoy. These guesses, in most cases, were marked on cross-sectional paper and a line drawn through these points determined

100 150 200 250
Rental Area

the percentage for all other depths. Such table necessarily involved inaccuracies and irregularities."

In *Urban Land Appraisal* (1940) published by the National Association of Assessing Officers, in relation to depth curves, we find:

"Some of the better known rules have a mathematical character; others are simply smoothed curves which are based on no known mathematical formulae."

It should be noted, the depth curves that have remained most in use, have been the curves based upon a mathematical formula.

"Regression analysis" then does nothing more than "draw" a line that best simulates current market conditions in terms of known and comparable sales evidence. Since a computer cannot actually draw this line as we conceptually do in our heads, it gives us the next best thing, an equation of that line. This line may be straight, but it can also be curved.

The computer when performing a regression analysis, sees each property only as a group of objective (or physical) value influencing components, considered important for that type of property. It firstly links each property in terms of its price and physical characteristics and then, secondly, by finding (or drawing) the line with the least amount of deviation between itself (the line) and these known and comparable observations. It effectively orders these properties with respect to current market conditions, expressed usually as current market price. While any subsequent subjective assessment, if required, is still left to the valuer doing the study, this theoretically should have been incorporated into the initial comparable sale price figures.

This ordering can also be shown

graphically in an example (see Graph 2 opposite), where three comparable observations of rental amount are known, together with their rentable areas. When two lines of best fit are subsequently drawn, by hand in this instance, we see in the graph, that line (B) has the smallest amount of deviation between itself and the known observations (that is, X(1), X(2) and X(3)), in fact the line's total deviation is zero. It is therefore the line that best fits or explains, with respect to current market conditions, the three rental amounts in terms of their rentable area.

In regression analysis this line of least deviation is derived mathematically and we square these deviations because a negative deviation is equivalent to a positive deviation when expressed relative to zero (see Table 1). The computer then develops a line or curve, expressed as an equation, that shows the comparable property sale prices, in terms of their physical characteristics. The property to be valued is then broken down into these same physical characteristics and placed onto this line, that is into the regression equation.

Table 1

Analysis of Line A

Rental Area m2	Actual Rental	Line A Prediction	Deviation Amount	Deviation Squared	Total (m2) Deviation
50	\$100-00	\$150-00	\$50-00	\$2,500	
100	\$200-00	\$300-00	\$100-00	\$10,000	
150	\$300-00	\$450-00	\$150-00	\$22,500	\$35,000

Analysis of Line B

50	\$100-00	\$100-00	\$0-00	\$0-00	
100	\$200-00	\$200-00	\$0-00	\$0-00	
150	\$300-00	\$300-00	\$0-00	\$0-00	\$0-00

If a property of say 120 m2 were to be valued in terms of its rentable area, then the use of Line B would be the most appropriate and accurate. If the equation for Line B was:

$$\text{Rental} = \text{Area} \times \$2.00, \text{ then,}$$

$$\text{Rental} = 120\text{m}^2 \times \$2.00 = \$240.00.$$

this total square deviation not only allows the computer to mathematically develop a regression line by reducing this figure to as close to zero as is possible, but also allows us to statistically test the line in terms of its total deviation or error (see "Statistical Breakdown of the Regression Equation").

In summary therefore, regression analysis could simply be considered as a computer trying to explain or predict the subject property's expected price in terms of its physical and objective characteristics. It does nothing more than we would

do, if we were to value a property simply in terms of its physical characteristics.

An Overview of the Regression Procedure Relative to Traditional Valuation Techniques

When determining the value of some property (defined as an accumulation of value influencing variables or "bundle of rights") using traditional techniques, there are a number of general steps that every valuer will go through in his or her mind:

1. Determine the type of property to be valued and isolate out the main variables influencing its value.
2. Gather any comparable evidence of those same variables as they exist in the marketplace at the present time and, of their subsequent effect on value, measured generally as price.
3. Place or order these value influencing variables in terms of those value/price observations.
4. Ascertain the subject property's expected value by placing its own unique variables within that order of value influencing variables, that is, place the

subject property in relation to the other comparable properties and their associated value influencing variables.

If we look at the above as a general explanation of the traditional sales comparison approach to valuation, then we can show that the regression analysis procedure has many features in common with the traditional valuation technique, principally that the steps taken in regression analysis follow the same general pattern but in a far more objective and critical fashion, that is:

1. Determine the type of property to be valued and also which variables are likely to influence its value, normally done through correlation analysis. This step, in traditional valuation has had a tendency to be taken for granted. For example, when determining the rental

for a shop many valuers would simply reach for the traditional depth tables, and would do this possibly without even sitting back and actually determining what variables are in fact influencing shop rental levels.

2. Gather any current and comparable evidence of those particular variables and their effects on the dependent variable observed, that is value or price. This then makes sure that we are only using comparable sales evidence with respect to those value influencing variables determined in step 1 above.
3. "Regress" the value influencing independent variables to the dependent variables or value observations. This will not only ascertain whether or not the independent variables can be placed or ordered relative to the dependent variable but also, to what degree. The process of regression is the mathematical equivalent of what we already do in our own minds, that is determining the importance of each value influencing variable in relation to the price.
4. If a relationship can be established (to a reasonable degree) then a prediction of price or value can be achieved by placing the subject property's unique variables, expressed usually as "X(i)" variables into the "line of best fit" equation.

Statistical Breakdown of the Regression Equation: The Concept of Total Error

If theory states that any regression analysis simply minimises the sum of the squared deviations between the proposed regression equation line (or curve) and the actual or known values, then the amount of deviation there is, can also be considered a measure of the potential error in the regression equation.

The total potential error of a regression equation (y) is known as the total sum of squared deviations, or SST and is measured by the formula, $(Y_a - Y_m)$ where Y_a is the actual or known dependent variable and Y_m is the variables' means.

Any statistical analysis of a regression equation is then based upon the breakdown of this total error or deviation, into its two components through the following formula:

$$\text{SST} = \text{SSE} + \text{SSR}$$

where, SSE is the unexplained error or deviation and,

SSR is the explained error or deviation, that is "explained" by the regression equation. 0

Or more simply,

The total error of the regression equation = The unexplained error + The explained error.

The explained error (SSR) is that deviation allowed for in the regression equation and presents no real problem. It is however the unexplained error (SSE), which has not been accounted for in the regression equation and over which we have no control, that presents the real problem. It is therefore this value in relation to the total error that we must consider in every regression analysis study.

As is seen in the above formula, when the unexplained error (SSE) of the equation is small (and SSR is large) relative to the total error (SST), then the regression equations' independent variables are seen to explain a large percentage of the total error or deviation in the dependent variable. It is this unexplained error (or its converse explained error) and its ratio relative to total error that gives us our measure of the regression equation's fit and predictive strength.

An alternative method of explaining this concept is graphically (see Graph 3) where SST is equal to the total deviation from the mean of the known dependent variables, that is, $Y_a - Y_m$, SSE is equal to the deviation of the actual values from

their fitted values, that is, $Y_a - Y_f$ and SSR being equal to the deviation of the fitted values from the actual value mean, that is, $Y_f - Y_m$. Note that the notation used is primarily for the benefit of the word processing program where:

$$Y_a = Y_i$$

$$Y_m = Y$$

$$Y_f = \bar{Y}$$

The Measures of Fit and Predictive Strength

In most regression studies there are four practical measures that can be used to assess the fit and predictive strength for an equation generated by the regression process. All are based upon the breakdown of the total potential error (SST) into its two components, that is the unexplained error (SSE) and the explained error (SSR):

1. The Coefficient of Determination (r^2) where $r^2 = (SST - SSE) / SST$

$$\text{or } r^2 = SSR / SST$$

$$\text{or } r^2 = 1 - (SSE / SST)$$

2. The Adjusted Coefficient of Determination ($Adj\ r^2$) where

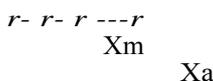
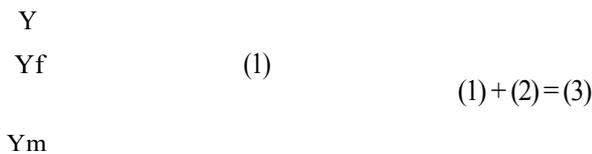
$$Adj\ r^2 = 1 - ((SSE / n - k - 1) / (SST / n - 1))$$

3. The F Test Statistic (F), where

$$F = (SSR / k) / (SSE / n - k - 1)$$

4. The Standard Error of the model (Se), where $Se = (SSE / n - k - 1)^{1/2}$

Graph 3



- Where (1) = SSE or the unexplained error
 (2) = SSR or the explained error
 (3) SST or the total potential error or (SSE=SSR) X_a = known dependent variable
 Y_f = predicted value
 Y_a = actual value
 Y_m = mean value

All four measures are primarily indicators of the overall fit or correlation of the model and, with the exception of number one also allow for the spread or variance of the errors' assumed normal distribution. Put more simply, the denominators reflect the fact that the accuracy of the model is dependent upon the number of observations initially made (n), with an associated allowance for the number of variables included in the model (k).

Part Two

Two Recent Examples

Two regression studies have recently been conducted in our practice in response to rental level objections. The first was a relatively simple extrapolation based upon rentable areas in a shopping mall complex in order to back up traditional valuation techniques when applied to larger shops in the mall. The second, a more complicated exercise (which we are still working on) to analyse, support and if possible predict retail rental levels in the central city area of Dunedin. Both exercises involve retail rentable areas only and while differing in complexity, the regression procedure and statistical analysis involved remains similar. The results of the regression studies are as follows (Tables 2&3 opposite, graphs 4&5 over page.)

General Points Relating to the Studies

1. Linearity

In the first exercise the rental amount was assumed to be linearly related over the range of areas studied. While theory states that extrapolation outside this range is unwise (see Bibliography 8 and 9) the strength of the relationship and low predictive standard error suggests that within reason, a certain level of extrapolation could occur. In the second exercise a far more involved set of variables were assumed and tested over a wide range of areas. Theory again would suggest that area, display area, quality, and pedestrian count would influence rental levels and that both area, and display area are positively related to rental levels but at an ever decreasing rate, therefore we were after, in mathematical terms, a double order quadratic function with the two XA^2 coefficients less than zero.

2. A Practical Point About Time

In our initial regression studies on the central city retail area, a time factor was allowed for by creating another independent variable of the year and monthly fraction of the year. This was then re-

Regression analysis for shopping mall complex

shop Nos	Area(m2)	Rent (pa)
1	168.00	\$31,920.00
2	78.00	\$14,820.00
3	97.00	\$19,329.00
4&5	169.00	\$32,112.00
7	78.96	\$15,792.00
9	112.00	\$22,392.00
10	112.00	\$22,392.00
13	73.00	\$14,604.00
14	147.00	\$27,936.00
15	78.00	\$15,600.00
16	72.00	\$14,400.00
17	64.00	\$12,804.00
18	54.00	\$10,800.00

Regression Output:		
Constant		1109.117
Std Err of Y Est		380.8916
R squared		0.997436
No of Observations		13
Degrees of Freedom		11

F Statistic:	4279.5020487
Adj R:	0.9972031245
St Error:	380.89169206

Shop	Area (m2)	Prediction
Shop A	307.00	\$57,770.96"
Shop B	253.00	\$47,804.38
Shop C	255.76	\$48,313.79

TABLE 2

gressed together with the other independent variables. Unfortunately the result showed that rental levels were decreasing over time. But the explanation was relatively simple. With such a wide range of rental levels and relatively few observations, we were seeing that most of the larger retail shops had their rent renewals and reviews at earlier dates resulting in the total rental amount seeming to decrease over time. This therefore is potentially a major problem in practical regression analysis studies, especially where the range of observations are limited. While, in our case, it may have meant a lessening of the objectivity of the study (see below) it was felt the overall results would be more accurate and plausible if at first we conservatively time adjusted the rental amounts. In this case a positive 10% per annum, monthly compounding adjustment was used.

I should also point out, while being of importance in the comparison of rentals, the time factor is not in fact a value influencing component of an actual

Multiple Polynomial Regression Analysis George & Princes Street Retail Rental Levels

Comparable retail Premises	Condition (Quality)	Retail Space Rent(pa)	Time Adj(10°9) Rental (10/90)	Area (Sq m)	Area (A2)	Quality ((F+D)*Q°°)l	Quality (^2)	Interaction	Ped. Count (1716/90)
Retail Area A(1/90)	+10%	\$121,673.00	\$131,108.26	303.76	92270.14	49.50	2450.25	15036.12	31.22
Retail Area 6(3/89)	-10%	\$102,454.00	\$118,959.89	361.69	130819.66	36.67	1344.40	13261.73	27.24
Retail Area C(3/89)	0%	\$122,562.00	\$143,493.25	406.00	164836.00	42.40	1797.76	17214.40	28.71
Retail Area D(1/90)	-10%	\$86,929.00	\$93,670.00	243.00	59049.00	36.18	1309.12	8792.18	31.22
Retail Area E(7/90)	+10%	\$59,890.00	\$61,399.70	117.60	13829.76	35.42	1254.58	4165.39	26.08
Retail Area F(8/90)	0%	\$114,051.60	\$115,960.30	438.66	192422.60	34.83	1213.13	15278.53	27.31
Retail Area G(5/89)	+10%	\$48,375.00	\$55,704.29	76.00	5776.00	25.23	636.75	1917.78	31.22
Retail Area H(8r89)	+10%	\$105,300.00	\$118,272.59	270.00	72900.00	42.90	1840.41	11583.00	31.22
Retail Area I(3/90)	+15%	\$102,950.00	\$109,107.40	343.97	118315.36	43.05	1852.91	14806.35	19.87
Retail Area J(3/90)	0%	\$172,000.00	\$182,287.26	564.00	318096.00	55.64	3095.81	31380.96	28.71
Retail Area K(1/90)	-10%	\$8,503.30	\$8,645.61	42.87	1837.84	1	4.33	205.35	614.3321.07

Regression Output:		
Constant		-75483.013756
Std Err of y Est		6503.0122154
R squared		0.9924361718
No of Observations		11
Degrees of Freedom		4

X Coefficients	87.791732206	-0.3563221294	3142.8447512	-51.74947915	8.0263045528	1986.723168
Std error of Coef	116.08926643	0.2305037985	2076.8033489	43.557247344	5.1799568547	584.6787777

TABLE 3

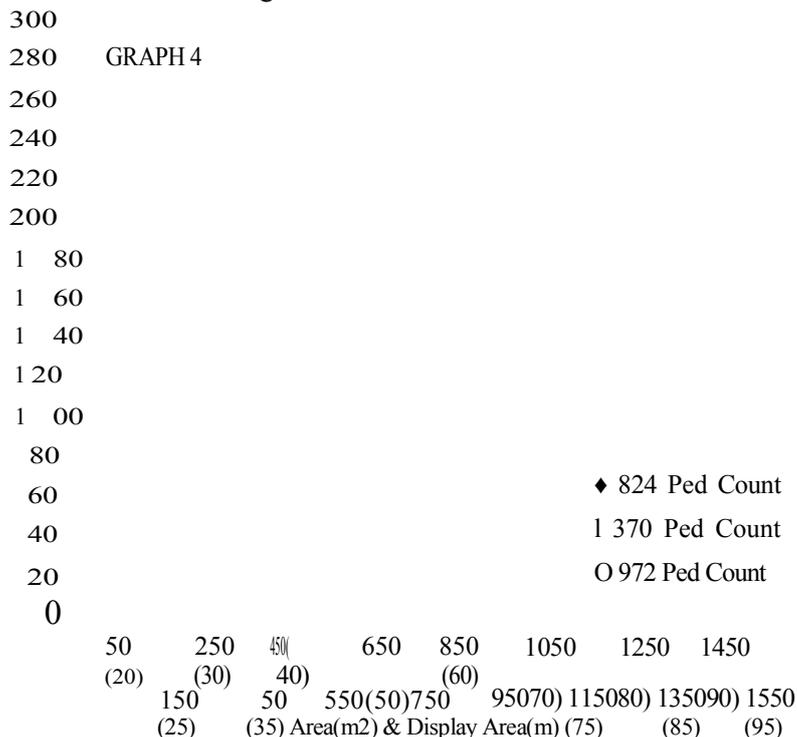
Property: Retail Area 2	Area(m2)	Area(12)	Display Area(m2)	Display(12)	Interaction	Pedestrian Count
Subject Property input Data:	56.98	3246.7204	19.88	395.095129	1132.59146	27.24
Computer Prediction:	\$33,595.06					

Statistical Analysis

	Indep Var 1	Indep Var 2	Indep Var 3	Indep Var 4	Indep Var 5
Student T Test Stan	0.7562433194	-1.5458405971	1.5133087843	-1.1880796494	1.5494925494
Critical T Value (95%):					
Overall F Test Stat:	87.472123536				
Critical F Value (95%):					
Adjusted "r2":	0.9810904295				
St Error:	6503.0122154				

PREDICTED RETAIL RENTAL LEVELS

Princes & George St 1/10/90



rental amount. That is when determining a rental for a retail area, the rental amount will be determined in relation to other comparable rents as at a specified point in time and no other. This may be considered hypothetical but it is also practically very important, since it underlies the "Current Market Value" definition. Therefore, in regression studies where only the components of value are being isolated and analysed, any time adjustment should, in theory, be made external to the study itself. That is, if we were to ask a retailer what factors he or she considers to be important in the setting of a rental level a whole range of answers may come forth, for example frontage, display area, area, pedestrian count, depth, turnover, interest rates, etc. What would not be mentioned is "time", except in the future context of the lease term and right of renewal dates.

3. The Analytical Value of the T Test Statistic

While being of use in very simple regression exercises, problems arise when dealing with relatively complex studies. When the number of independent variables increase in response to the increased variability of the dependent variable, a condition called "collinearity" may arise. This collinearity occurs where the supposed independent variables are in fact correlated or partially correlated with each other (a violation of a basic regression assumption) resulting in a wider range of estimated regression coefficients occurring in repeated samples.

While there are methods of ascertaining and reducing the extent of this correlation, for example a Correlation Matrix or Factor analysis, there is still no critical value above which we can say that this correlation will in fact cause problems. If you are dealing with highly correlated variables, then in theory, the one least correlated with the dependent variable should be removed.

Collinearity has two major effects on the analysis of the study:

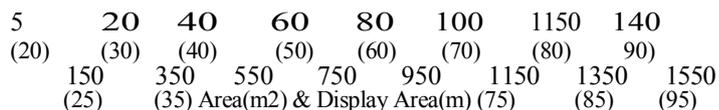
- A. An interpretation of the coefficients cannot be relied on for any slope or change analysis.
- B. The analytical value of the T test statistic cannot be relied upon, since the increased range of coefficients will usually result in a larger than expected variance or standard deviation, expressed finally in a lower T test statistic than may in fact be the case. There is also the added problem of Type 1 errors occurring (* times) as a result of the numerous T tests required. It should be noted that while affecting

the above, collinearity does not generally influence the fit and predictive strength of the overall model, except in highly correlated cases.

The effect of collinearity on the T test statistic is shown in the Central City regression study when tested for the significance of the interaction variable (see below).

PREDICTED RETAIL RENTAL LEVELS/M2

Princes & George St 1/10/90



4. The Use of the Interaction Term

Again in relatively large regression studies where the number of independent variables will usually be large, two (or more) variables may reinforce or interfere with each other, that is, they may interact in some way. The most common method of dealing with these interaction effects is by adding into the regression the

cross-product of the interacting terms. In our study, Area and Display area were suspected of interfering with each other, their cross-product was therefore added and initially a simple T test used to measure the suspected interference (or otherwise). The results were as follows:

$$\begin{aligned} \text{T Test Statistic} &= 1.549 \\ t(0.975, 4) &= 2.776 \end{aligned}$$

Normally we would conclude that since $1.549 < 2.776$, then at the 95% level of significance the interaction effect was not significant, but it was also seen that the removal of the interaction variable:

1. Decreased r_z to 98.78%,
2. Decreased Adj r_z to 97.57%,
3. Decreased the F Test statistic to 81.68,
4. Increased Se to 7,357,

and its addition had the opposite effect. We therefore concluded that possibly collinearity existed and was adversely affecting the T test statistic.

This was subsequently confirmed by a simple regression of the area and display area variables ($r^2 = 62.3\%$). The result of this was a reduction of the T test statistic by an increase in the variables standard deviation.

The interaction term was, as a result left in our study, since it not only increased the predictive accuracy but also the fit and correlation of the overall model.

5. Display Area Quality and Pedestrian Count

"Display area quality" is simply a recognition that not only does frontage and depth affect rental levels but also the quality of frontage and depth.

For example, a large retail premises which is presently of a high quality in appearance, was initially an old toy shop on two levels, which was subsequently renovated at the tenant's own cost. The rental assessment therefore had initially been based upon a poor quality shop, with subsequent renewals having allowed for the extensive lessee improvements. Given the above we allocated a 10% adjustment to its Display Area to reflect the condition of the shop when the rental was initially fixed. The quality percentage adjustments are as follows:

- Good: +10%
- Average: 0%
- Poor: -10%
- Comer site: +15%

While it has been found that frontage has a more direct effect than depth on value (the philosophy behind the depth table) we wished in this study, to remain as independent and as objective as possible and allow the regression procedure to assess the ideal frontage to depth ratio by

equating the display area (frontage+ depth) to the total rental amount.

"Pedestrian Count" figures are from the 1990, annual pedestrian count survey of the central city area and allow in the study for locational influences on rental levels. The square root of each count was taken primarily to minimise the differences between individual counts in any one area, and was also done as a result of having found that as we moved into the higher pedestrian count areas the individual differences in the counts were of lessening significance, as compared with the lower count areas.

Statistical Analysis of the Two Recent Examples

1. The coefficient of determination (r^2)

Both studies show high r^2 values indicating a strong linear relationship or fit between the dependent variable (y) and the independent variable (or variables). This is shown in our original formula as:

$$(\text{Large}) \text{ SSR} + (\text{Small}) \text{ SSE} = \text{SST}$$

or in other words, a large amount of the total error has been explained by the regression equation.

The higher r^2 in the central city retail study is expected since we would like to think that with every extra independent variable added, the amount of unexplained error would decrease. This is also the concept behind the Stepwise Regression procedure.

2. The Adjusted Coefficient of Determination (Adj r^2)

The adjusted coefficient of determination is a more detailed and accurate method of ascertaining the overall fit of the model in that it allows for the number of observations and variables included. The difference between the r_z figure and the Adj r^2 figure is the effect made on the study by the number of observations and variables used. The effect on a study with few observations and many variables is that the numerator in the Adj r_z formula will tend to be smaller (due to the increased number of variables, "k") than in the formula's denominator. The resulting Adjusted Coefficient of determination will therefore also be smaller.

We can see that in the shopping mall study the Adj r^2 figure of .9972, is only .0002 removed from the r_z value. Our conclusion is thus that the small number of variables included has not adversely affected the study and that possibly, due to the high correlation shown (in this case) the shopping mall rentals are not significantly affected by any other factors.

In the central city regression, if area alone was again used the difference between the Adj r^2 and r^2 values may well have been as small as above, but the values themselves would be lower.

We are therefore in a trade-off situation in that while increasing the number of variables will potentially increase the correlation and fit of the equation itself (as shown in the r_z figure), if the number of observations are not correspondingly increased, or at a high enough level already, then the overall predictive strength and fit of the model (as shown in the Adj r^2 figure, F test statistic and standard error) will decline.

We see that in the central city regression while the number of variables included is large, relative to the number of observations, the measures of the models overall fit and predictive strength have remained high, indicating the relevance of the number of variables to the effectiveness of the overall model.

3. The F Test Statistic

In the formulation of the F test statistic we see that it measures the ratio of explained error to unexplained error, adjusted for the number of observations and variables included. It thus again measures the overall effectiveness of the model in terms of the amount and breakdown of inherent error. A model that does not explain the data well and consequently has a low r_z and Adj r^2 value would therefore have a low ratio of explained to unexplained error and also a low F test statistic.

The F test statistic has a critical value above which it can be said that the model has significance in respect of its usefulness. In the Central City study, the critical value table for the F distribution at the 95% level, shows the overall models minimum critical value as:

$$f(5,60) = 2.37.$$

We can see that the F test statistic for the Central City study is above this minimum value ($2.37 < 87.47$) and together with the other ratio measures we can again conclude that the study is relatively accurate in assessing the overall relationship between the dependent and independent variables

The F test statistic is also of use in determining whether or not another independent variable should be added in terms of increasing the model's accuracy. Generally any variable that increases the F test statistic of the model should be considered worthwhile and included.

4. The Standard Error of the Estimate

While all other measures mentioned 0

give relative values, the standard error of the estimate gives the actual value of unexplained error inherent in the model. While this may seem direct and to the point, if not seen in relation to the dependent variable or total error, this error value can be misinterpreted.

The standard error amount must be seen, at the very least, in relation to the dependent variable. A standard error of 10,000 should be seen as reasonable if the dependent variables are in the millions.

In our central city study while we see initially a high standard error amount this must be looked at in the context of the entire study, that is, a measuring of rental levels from \$20,000 to \$180,000. With the mean rental at around \$95,000 the standard error represents an approximate +/- 7.0% error term. That is, put simply, each dependent variable when initially explained by the equation, has on average a +/- 7.0 % unexplained error associated with it. This will increase when a predictive or expected value is required. Note that this is not a confidence interval. This is again shown in Table 2 where the standard deviation (SD) of the percentage differences in the actual and predicted values are derived. The result shows that the unexplained error of the estimate (as measured by Se) should lie between +/- 7.9% of the mean (which is approximately equal to 0) on average 95% (+/- 2SDs) of the time).

Residual Analysis Centre City Regression Study

Actual Rental (\$)	Fitted Rental(\$)	Residual	%ofrom Actual
131,108.26	129,788.34	1319.92	1.01
118,959.89	115,890.21	3069.68	2.58
143,493.25	136,856.03	6637.22	4.63
93,670.00	103,371.49	-9701.49	-10.36
61,399.70	61,555.78	-156.08	-0.25
115,960.30	118,037.30	-2077.00	-1.79
55,704.29	5,289.51	2804.78	5.04
118,272.59	116,826.83	1445.76	1.22
109,107.40	100,277.37	-1169.97	-1.07
182,287.26	184,260.14	1972.88	1.08
8,645.61	8,827.061	-181.45	-2.10
		Mean	-0.201,0
		S.D.:	3.96%

This should be considered in light of the traditional +/-10% used by valuers today and considering the wide range of rental types and levels involved in he study. I should also state that while theoretically this may be considered slightly inaccurate, a measure of practicality must be considered. If required the statistical analysis can be taken further, but if all reasonable evidence suggests that it is not required, then all we need do at this point,

is make sure that the model is sufficiently accurate for our purposes.

Conclusion

There are two primary uses of regression models:

1. Expected and Predicted values, and
2. Correlation and Trend analysis.

The first is the most commonly used with the second being somewhat forgotten in the rush to get the first. But correlation and trend analysis must always be subsequent to any prediction being made and, even considered in its own right, is a very powerful analytical technique. Trend and variable analysis are vital in any valuation office and the regression analysis technique not only gives a statistical based "line of best fit" but also a relative measure of the accuracy of that fit and of the associated variables. This occurs even before any predictions are made.

The regression analysis procedure forces us to objectively isolate and determine critically which factors truly influence value, not just accept another rule made in some other place for some other time. For example, in respect of the determination of rentals using depth tables, are we in a sense trapped by tradition into saying that retailers primarily place value on their premises firstly with respect to frontage and then with respect to depth. Do retailers, when determining the value of the premises for retail use, look at the shop in a two dimensional perspective of frontage and depth? If they do not, then why use a diminishing return depth table, originally the "Harper-Edgar Depth Table" (100 foot standard), used and developed primarily for determining two dimensional land values. I would suggest that after frontage the next most important variable would be either Display Area (that is ((2 x Depth) + Rear)) or more simply Area.

While not criticising diminishing return tables in concept, I feel that possibly more research is required to determine a shop rental table that more adequately expresses the factors that do influence shop rental levels. To say that the depth table is good indicator of rental value is only saying that in the past it has been the only measure used to calculate the rental levels. This is not only a circular argument but also a self fulfilling one.

In our Central City regression study I have used Area and Display Area (Frontage + Depth and modified by Quality) as possible indicators of retail rental levels and with reasonable success. In considering a table that attempts to model retail levels in terms of diminishing returns,

possibly the use of either Area or Display Area should be considered. Both are affected by diminishing returns after a certain point and would not only provide a more theoretically accurate method of modelling rental levels (in a three dimensional sense) but also be as easy to administer as the Depth tables used today.

Regression analysis should then, at the very least, be brought in to critically analyse and if possible support any traditional valuation figures. In our practice to date we have used the technique for both supporting traditional valuations and correlation analysis with reasonable accuracy. Recent examples have included:

CASE 1 (Shopping Mall equation)

Premises	Traditional Valuation	Predicted Value
Shop 1	\$58,320	\$57,800
Shop 2	\$48,060	\$47,800
Shop 3	\$46,032	\$48,300

CASE 2 (Central City Rental Equation)

Premises	Traditional Valuation	Predicted Value
Retail Area 1	\$77,248	\$78,405
Retail Area 2	\$35,140	\$33,595
Retail Area 3	\$114,000	\$108,706
Retail Area 4	\$75,000	\$80,964

All four measures of statistical analysis were satisfactory in assessing the usefulness of the models for both prediction and trend analysis. Regarding predictions probably the most important measure is the standard error (considered in relation to the dependent variable), but note that if the equation does not model the data sufficiently in the first place then no prediction can subsequently occur. Regarding trend analysis, O_2 , $Adj\ r^2$, and the F test statistic should be considered the main measures, in that they provide a relative measure of both unexplained and explained error.

Regression analysis therefore, should not be seen as some theoretical procedure that has no practical usage. It has, in fact, as discussed, many similarities with standard valuation techniques. The main difference is that in regression analysis the valuer uses a computer to objectively determine the majority of what he or she normally has determined in his or her own head. The final figure is still subject to the valuer's perception of the marketplace but the methodology used to arrive at that value is less likely to have any error associated with it, especially if arrived at by a separate method of assessment.

I should again reiterate the analysis used must be considered in a practical sense, there is no need to perform

Valuation Standards

The Role and Work of TIAVSC

by G J Horsley

The International Assets Valuation Standards Committee (TIAVSC) is now eight years old. Although in human terms that places the committee in adolescence and in earthly terms it is hardly measurable, those eight years have capped at least a half century of worldwide movement towards professional standards for valuers. With the shrinking of our planet today and the growing realisation that we share both a world community and economy it is especially important that valuers and the business community everywhere understand the role of the TIAVSC and the standards it establishes.

Substantial amounts of the world's economic resource are in fixed assets, importantly including land, buildings, machinery and equipment. Although there are certainly some individuals and enterprises with such wealth that the accounting for these resources may hardly be a concern, the majority of assets are accounted for and reported in some fashion. Unless there are common understandings as to how they are reported for financial purposes, confusion and misunderstandings are fostered. Experience also shows that absence of standards, or failure of standards enforcement provides fertile ground for misrepresentation, fraud and other abuses.

Development and application of valuation standards

It is likely that nothing in the recent history of the valuation profession is as

highly accurate statistical tests on the analytical measures where the type of study and its application does not warrant it. What is needed in regression analysis is a quick, easily understood methodology of procedure and subsequent analysis. I hope I have in the above given that.

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exciting, or as far reaching, as today's developments in the area of valuations standards. The valuation or appraisal bodies of about 30 nations are members of the committee and many have individually, or collectively in regional groupings, made particularly noteworthy strides over the past 10 years in the further development of local standards. Both causes and effects for these developments can be briefly reviewed.

Many of you are probably aware that, since the early 1980s, the Japanese Association of Real Estate Appraisers has participated with TIAVSC. The work of Mr K Ohkochi and Mr I Matsui on behalf of the Japanese Association of Real Estate Appraisers has been outstanding and has contributed to the dramatic achievements of TIAVSC in such a short time.

TIAVSC grew from the successes of the Royal Institution of Chartered Surveyors in the United Kingdom, and later that of other European valuers who were able to have valuation standards incorporated into the laws of the European Community in the mid 1970s. Simultaneous developments in Japan, Australia, New Zealand, Canada, the US and other countries and the growth of international business and investment activity, led to a distinct need for international valuation standards.

In less than 10 years TIAVSC has gained international recognition through the United Nations, published and distrib-

5. Brown RJ; *Best Predictive Model in Multiple Regression Analysis*, Appraisal Journal, October 1974.
6. Trippi RR; *Comparison of Linear and Nonlinear Models of Residential Property Value*, Appraisal Journal, October 1974.
7. Morton TG; *Factor Analysis, Multicollinearity and Regression Appraisal Models*, Appraisal Journal, October 1977.
8. McFarlane and Fibbens; *Regression Techniques*, New Zealand Valuers Journal, September 1990.
10. National Association of Assessing Officers; *Urban Land Appraisal*, 1940 Assessment Practice Series; No.2.
11. John A Zangerle; *Principles of Real Estate Appraising*, 2nd Edition (1927) Stanley McMichael Publishing Organisation.

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uted a full body of standards in the form of Guidance Notes and Background Papers, and increased international awareness to the adoption of common standards. Even where standards differ among nations, TIAVSC is available to identify these differences and to reduce market misunderstandings, both for participants and professionals.

TIAVSC is now a force to be reckoned with, but it needs the involvement of national standard setting bodies, and professional bodies such as the International Accounting Standards Committee, if it is to truly succeed in its objective of promoting worldwide acceptance and observance of valuation standards and procedural guidance in the valuation of fixed assets for inclusion in financial statements.

At any local, national or international level, standards must be understood as dynamic living guides for professional's practice.

They must be relevant to current market needs and reflective of basic principles of practice. They must become standards of the marketplace and of each professional's daily practice.

They must avoid dogma, yet be sufficiently understandable to be effective

and enforceable. They must be thoughtfully developed, yet responsive and timely in their formulation.

Most of all, standards must be made part of the daily lives of each appraiser or valuer worldwide. As they apply them and insist on their application by others, they increase the value of their endeavours and enhance their ability to serve society.

TIAVSC Standards.

The published papers of TIAVSC are prefaced with a booklet that introduces the Guidance Notes and Background Papers, includes a list of TIAVSC members, and provides an Index and a Glossary of terms for the remainder of the papers. In addition to country names, the names of representative organisations from each country are also listed.

GN 1 and BP 1 deal with the classification of fixed assets. They distinguish between Fixed Assets (those intended for use on a continuing basis in the undertaking's activities) and "Other Assets" which are classified as Current Assets.

Fixed Assets are then categorised as Tangible Assets (land and buildings; plant and machinery; fixtures and fittings; tools and equipment; and payments on account of tangible assets and assets in the course of creation), Intangible Assets (research and development costs; concessions; patents; licenses; copyrights; trade marks and similar rights and assets; goodwill; and payments on account of intangible assets), and Financial Assets (shares in group companies; loans to group companies; shares in related companies; loans to related companies; investments other than shares in group or related companies or loans; loans other than to group or related companies; and company's own shares). When serving as an asset valuer, the valuer is normally concerned only with the valuation of tangible assets.

GN2 establishes the standard for an Asset Valuer.

It specifies that such individuals must have "good repute", an appropriate degree at a recognised centre of learning or an equivalent academic qualification, and suitable experience and competency in valuing fixed assets in the location and category of the asset.

Special qualifying experience is recognised. Also provided for are standards in any State which does not have recognised academic qualifications or recognised bodies.

GN3 and BP3 provide basic standards for valuation of land and buildings. GN3 states "the basis of valuation of land and

buildings as fixed assets for financial statements must reflect the fact that these assets are in continuing use by the undertaking for the purpose of its current activities".

In accountancy terms the value of a fixed asset to an undertaking is:

- a. net current replacement cost, or if a permanent diminution in value to below net current replacement cost has been recognised;
- b. recoverable amount.

Net current replacement cost represents the cost of replacing or recreating the particular asset in its existing condition.

Conceptually, the valuer should approach the assessment of net current replacement cost of land and buildings on the basis of:

- a. value in the open market, or where a market value cannot be assessed;
- b. depreciated replacement cost. The basis of valuation will normally be determined by the nature and use of the property.

"Market value" often described as "open market value" is defined as: "...the price at 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".

When valuing land and buildings as fixed assets for financial statements, the valuer will normally report valuations on the basis I explained above.

However, for properties that are surplus to operational requirements and those held by the undertaking as investments, market value shall be estimated.

If for any reason there is a departure from these procedures, a suitable explanation should be embodied in the Valuation Certificate or Appraisal Report.

The Valuation Certificate or Appraisal Report is covered in GN4 and BP4. These emphasise the importance of setting forth in the report the specific nature of client instructions and the use the client proposes to make of the valuation.

These disclosures assure common understanding of the work product and

help avoid misinterpretations or abuses. Items normally included in the report include date of valuation; basis of valuation; information and assumptions; state of repair; plant and machinery (if applicable); taxation, stamp duties, registration charges, and other costs arising on acquisition or disposal; government grants; overseas properties; non publication clause; liability to third parties; property schedules; and a signed valuers certificate.

The BP states that draft copies of the report are sometimes submitted for review of factual content.

GN 5 deals with categories of properties held as Fixed Assets. It expands on GN 1 and BP 1 by discussing each Fixed Assets category. It distinguishes between non-specialised and specialised properties in dealing with owner occupied properties.

The former 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. The latter are those which are rarely (if ever) sold for a continuation of their current use except as part of a sale of the business in occupation due to their specialised nature. Examples of specialised properties include oil refineries, chemical works and traditional buildings in isolated or unusual locations.

Plant and machinery valued with buildings is covered by GN 6 and BP 6. These are identified as "building" service installations provided by the owner for the purposes of making the best use by the occupying business of the building and any open land lying within the cartilage of the property.

They are distinct from the plant, machinery and equipment which are used solely for the industrial or commercial processes carried on by the business in occupation. Generally no separate valuation of business service installations is required.

Valuation of depreciation to buildings is discussed in GN 7 and BP 7. Distinction is drawn between proportional allowances taken by accountants (historical cost accounting) and depreciation considered for valuation purposes.

In the latter context, depreciation is defined as "the measure of the wearing out, consumption or other loss of value of a fixed asset whether arising from use, effluxion of time or obsolescence through technology and market changes". GN 7 points out that "Assets may be stated under historical cost accounting either:

- a. at actual cost with or without subsequent depreciation, or:
- b. at a current or previous valuation, with or without subsequent depreciation, based either on the market value or the depreciated replacement cost approach".

Consideration of works of adaptations and fitting out is covered in GN 8 and BP 8. Both freehold and leasehold situations are included.

The GN provides two separate possible valuation bases in addition to historical cost.

GN 9 deals with the valuers relationship with the auditor. This GN was considered necessary because the separate professional tasks of auditors and asset valuers are frequently interdependent either wholly or partially.

The GN establishes guidelines for working with auditors, either as an internal or an external valuer. It also clearly distinguishes between the disciplines of audit and asset valuation.

GN 10 and BP 10 deal with the valuation of plant and machinery and GN 11 deals with depreciation of plant and machinery.

It emphasises that in some countries, legislation requires that fixed assets, current assets and assets that are neither fixed nor current be separately identified. Plant and machinery is normally considered a tangible fixed asset.

Valuation of plant and machinery should always be on a basis that conforms with the intentions of the owners of the undertaking and is compatible with that used for the valuation of the land and buildings in which the plant and machinery is located.

The standards states that where only the plant and machinery is to be valued, it should be on a basis consistent with that which would be appropriate for the land and buildings, had they to be valued. There should be a clear understanding between the client and the valuer as to the extent of the items to be valued as plant and machinery rather than as land and buildings.

GN 12 provides standards for valuation of work in progress. This covers building work of a capital nature which has commenced but has not been completed at the relevant date.

Valuations for security for loans is covered in GN 13 and BP 13. The GN specifies that for properties owned and occupied by the borrower, market value should be estimated on the assumption that vacant possession would be given on a sale.

For properties held as investments,

market value should have regard to any contracted lettings.

The standards establish that it is considered misleading to value a property for security for a loan on any basis other than market value, as this might be construed to mean that the property has a realisable value different from market value.

Forced sale value is not considered normally appropriate as the basis of valuations for security purposes.

The recently released GN 14 deals with assumptions and limiting conditions both in respect of the client's instructions and in the valuer's completion of his valuation task.

In addition to these GNs and BPs, TIAVSC also has various Background Papers covering leasehold interests, negative values; existing use and alternative use values; valuations having regard to trading potential; the valuation of rural assets; the valuer's relationship with the client and the valuer's relationship with other professional advisers.

Additionally, a discussion paper covers the effects of changing prices with particular reference to the valuation of fixed assets.

There has also been discussion on several proposed papers. They include *Environmental factors and pollution as they affect the valuation process*, *Unitisation and securitisation*, and the *Valuation of public sector utilities*. Other valuation areas and issues are under discussion and will result in additional GNs and BPs.

It is the intent of TIAV SC to anticipate professional areas where statement of standards is needed, and to react in a prompt and practical manner when needs are brought to its attention.

Blueprint for the Future

The valuation profession showed great vision when it set up the International Asset Valuation Standards Committee in 1982.

Few then anticipated the globalisation of the world's property markets, the recent movement towards a market economy in Central and Eastern Europe and increases in technology that now makes the work of TIAVSC so vital.

For those who believe in the self regulatory system, it is vital that the component parts mutually ensure that there is a proper understanding of the requirements of each sector.

Investments across frontiers is continually increasing, this is true in the context of East West dialogue, the invest-

ment activities of the World Bank and overseas investment by the institutional funds of many countries including Japan. The multi-national companies are expanding their activities.

In all these fields the investor is demanding common standards and the disclosure of more information. The profession did foresee these developments and are active in meeting the challenges.

The sovereign ability consists in knowing thoroughly the value of things. This maxim was set down by La Rochefoucauld in 1665.

Eighty years later, Benjamin Whichcote wrote: *Every profession does imply a trust for the service to the public.*

Then in 1833 Samuel Taylor Coleridge remarked: *Every true science bears necessarily within itself the germ of a cognate profession and the more you can elevate trades into professions the better.*

A century ago George Elliot commented: *The best augury of a man's success in his profession is that he thinks it is the finest in the world.*

These four quotations set the framework within which TIAVSC has considered its future.

As might be guessed, I believe that it is vitally important to know thoroughly the value of assets. Otherwise, decisions made on deployment of resources by investors and enterprises will be ill informed and inadequate.

Like any organisation that pursues collective excellence, TIAVSC has a clear picture of the business that it is in. This is the development and promotion of international valuation standards and the improvement and harmonisation of valuation reporting by business enterprises.

Three key objectives will determine TIAVSC's priorities for the next five years. These are:

- To develop truly international standards of valuation and reporting that meet the needs of the international property markets and the international business community.
- To develop valuation standards that meet the needs of developing and newly industrialised countries and assist with the introduction and implementation of those standards; and
- To identify where local or regional standards differ and to work towards greater compatibility between local or regional requirements (whatever their form) and international valuation standards.

Continuous Education: The Road to Enhanced Professional Practice

by A P Laing

The New Zealand Institute of Valuers has a membership of 2070 spread throughout a long and narrow country which comprises two main islands.

There are five major urban areas in the country each with a population of over 100,000.

However, more than half of the total population of 3.2 million resides in the top half of the North Island.

Thus for members to gather in one location for conferences and seminars is both expensive and time consuming.

Consequently the continuing education programmes which are best supported are those which are regional in nature.

New Zealand and particularly the valuation profession, has been exposed to the full force of economic change over recent years.

The valuation profession in New Zealand comes under pressure when the property market rises, being described as ultra-conservative if we are prudent, and if we happen to provide high valuations these are often accepted as representing our sound grasp of future trends. Any excesses are erased with time.

However when the property market falls, the problems valuers face are manifestly greater.

The 1987 share market crash triggered a substantial decline in the value of property in New Zealand.

Some doubtful valuation practice has been exposed and has resulted in professional misconduct complaints to the Institute.

As a professional organisation we have two responsibilities: to the public to ensure the valuation "product" they buy is sound; and to members to ensure they are equipped to deliver an appropriate valuation.

These responsibilities demand the development of sound professional practice and it is my view that enhanced professional practice is developed by continuous education.

Undergraduate Education

Undergraduate tertiary education for new entrants to the valuation profession is provided at Auckland, Massey and Lincoln Universities.

The association between the profession and the Universities has become increasingly important, particularly in the development of the valuation discipline and the definition of a philosophy for the future of the profession.

Continuing Education

A continuing challenge is to ensure that the wider membership has access to educational opportunities appropriate to a rapidly changing profession. Members need to be encouraged or required to take advantage of education programmes to enhance their professional practice and to ensure that implications of changes in the working environment, particularly legal and financial changes, are understood.

The Market for Continuing Education in NZ

A recent survey of the valuation profession to gauge member requirements for continuing education (CE) programmes was carried out by Lincoln University (Croft 1988).

The survey indicated that:

1. 49% of the representative sample of 166 valuers contacted responded and of that number 59% had a university education. Of those, 61% held a degree qualification.

While the response to the survey was small it does however provide a valuable indication of the market, or the CE requirements of our members.

2. The Government or State Owned Enterprises section employed 35% while 31% of the total sample were employed in private practice.
3. The survey indicated valuers as a professional group spend a significant amount of work time outside valuation in areas related to property.

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The Institute, being aware of this trend, is widening its membership criteria in order to accommodate property interests additional to valuation. Continuous Education programmes must accommodate these wider interests.

4. The type of valuation work undertaken by the group sampled related to:

Rural	39%
Residential	30%
Commercial/Industrial	26%
Other	5%

5. Topics for continuing education ranked highest were project income appraisal and income approach valuation techniques, followed by the impact of technological and economic changes to the value of property.

Valuation techniques for specific types of property were also considered important.

6. There was strong support for regular provision of continuing education and for a regular publication with an educational function.

Regional seminars were well endorsed, but evening venues were not rated highly. Telecommunication linked seminars did not rate highly.

This result does contradict our experience in this field where we have had more than 200 members in 25 different locations participating in telecommunication nationally linked seminars held in the evenings during winter months.

The survey indicated a generally positive response to continuing education by

the valuation profession. The demand is there; there is a receptive climate; the challenge now is to develop the capacity to meet the demand.

Responsibility for CE

The role of the three teaching universities and the high quality of undergraduate professional pre-entry education has already been mentioned.

An opportunity exists to develop closer links with the universities by encouraging them to make available to members their expertise and facilities to provide CE opportunities.

Learning by example is the area in which the profession itself can be best involved

The provision of university education in New Zealand is undergoing major changes (Education Amendment Bill, 1990; Ministry of Education 1988) with matters relating to equity, accountability and equal opportunity being issues.

Now is seen as an appropriate time to foster partnerships with the universities who are, of necessity, seeking closer relationships with industry and commerce.

Learning by example is the area in which the profession itself can be best involved.

An important adjunct in successful continuing education will be the innovative and professionally successful practitioners.

The profession is its members and those members shape the profession. In common with the practice followed in accountancy seminars provided by the NZ Society of Accountants, leading valuation practitioners should be encouraged to be involved in CE programmes.

The valuable education resource available from other professions should be addressed. Associated professions, such as accountants and solicitors provide education programmes frequently suitable for valuers.

The reverse situation is also true. A further advantage of inter-professional programmes is the confidence which participants gain by interacting with a wider group.

Responsibilities of the Institute

The Lincoln University survey revealed a strong demand for further education in

"project income appraisal" and "income approach to valuation".

Because the valuation profession is a branch of the financial services industry, some cues for development and change can be taken from the developments apparent within that industry.

Traditionally the strength of valuers has been that of making and justifying valid comparisons within an existing market structure.

The weakness is that we have tended to do so with reference to the property market only and in so doing have failed to recognise trends observable within the wider commercial community.

This has been a particular problem when there has been a dearth of property transactions.

A primary aim of the CE programme must therefore be to educate members in the role of the wider financial services industry and how it impacts on their particular property section. The importance of dividend yields derived from the share market will be lost on valuers who do not have an adequate grasp of the workings of the wider financial services industry.

As the Institute widens its membership criteria to accommodate a fuller spectrum of property interests, the widening of the CE curriculum to accommodate the requirements of the wider membership will be required.

In summary, our education philosophy must be to provide an awareness of the financial services industry and provide a wider range of tools for income stream based valuations.

Mandatory or Voluntary Requirements

In other countries undoubtedly there are problems similar to ours in which generally the most able of our profession are those who attend education courses while the less able are absent.

The Institute is therefore currently addressing the issue of whether CE should be by mandatory or voluntary education. The Council has discussed this and established that an initial policy of voluntary requirements of 45 hours every three years be set with a policy of moving towards a similar mandatory requirement within five to six years.

To ensure that opportunities are available to members who practice in more isolated areas to enable them achieve the targets set, a "generous" set of conforming criteria is being considered and may include:

- private study

- technical meetings
- residential courses
- approved "in-house" programmes
- day conferences and seminars, including those with associated professional bodies
- written technical examinations
- authorship of articles etc
- branch meetings which include a lecture.

The Institute is considering adopting the Royal Institution of Chartered Surveyor's model for CE reporting which involves an annual voluntary declaration by each member.

The road we need to follow.... is that which provides and ensures we benefit from sound continuous education opportunities.

Conclusion

In this paper I have emphasised a close liaison with the Universities who have the educational philosophy and the teaching skills to provide the sound CE programmes we need.

I have also identified the need and advantages to be gained by involving members of our profession.

When considering content I have opted for a CE programme of sufficient breadth to accommodate the wider financial services industry and have also suggested supporting co-operative CE ventures with relevant professions within that industry.

The road we need to follow to ensure the valuation product we provide constantly improves and meets the public's needs is that which provides and ensures we benefit from sound continuous education opportunities. A

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Professional Opinion or Judgement Is That All?

by P J Mahoney

When asked to prepare and read this paper on the topic *Professional*

Opinion or Judgement Is That All?, I found myself in some dilemma as to whether in this presentation I should recite a lengthy list of all relevant cases pertaining to the accepted duties and responsibilities of the valuer and comment accordingly, or alternatively, should I consider this particular topic from the point of view of the client and layman and what he expects from our particular profession.

Upon further reflection and research, I rapidly decided that the case law on the subject has been well documented in many leading cases and text. Accordingly, what I will endeavour to do, is to submit to you for consideration and discussion some observations as to our particular role as professionals in giving advice.

Responsibility and Liability

The topic as such initially raises the inevitable question: to whom are we responsible and to what extent are we liable for our actions in giving advice or any failure on our part to meet acceptable standards? In this paper it is my intention to address and speculate as to the expectations of the instructing client, the public, and also our own profession as to what extent our role as practitioners in the art of valuation obliges us to meet.

In most areas of commercial activity throughout the Western World and particularly since the 1960s and 1970s, the voice of the consumer has grown in strength and numbers to the extent that most of our parliamentary or governing bodies have enacted legislation to provide protection to and to define the rights of the consumer.

For this noticeable change in social responsibility, some suggest that we can perhaps point the finger at that renowned crusader, Ralph Nader, in his prolonged battle and campaign with the Automotive Industry in America.

Has Deregulation Changed Anything?

In most judicial jurisdictions, we have all probably noticed the continuing trend towards commercial reform specifically in the areas of : deregulation, removal of

protection from monopolies and cartels, anti-trust legislation and the like. This trend I believe is a reflection of society's demand to protect consumers' interests with: a greater freedom in commercial activity and also an obligation on the part of the supplier to afford some undertaking or obligation with regard to the substance and quality of services or product provided.

The Professional

Addressing the topic in terms of the professional in giving advice, I believe that at the outset it is essential for us to define the word "Professional". In the broader sense, a professional can be described as one who undertakes an activity for financial gain. By this definition anyone of course who is employed would be considered a professional. However, in a narrower sense, a "Professional" means a person who relying on higher education or special skills obtains remuneration based on this specialist knowledge.

In a strict sense then, the Professional is a person "who applies advanced training in a complex, systematic discipline to meet the needs of the public". It is a fact then, that a professional as such in serving the public by bringing highly specialised skills to bear on the problems, imposes upon himself certain responsibilities. The lay person, lacking any specialised training to fully evaluate and understand the judgements professionals must make, therefore must of necessity trust the professionals to make decisions in his best interest.

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A professional therefore, is a person who displays considerable skill and competence in his chosen activity. Remuneration will follow as a by-product or recognition of the degree to which the skills demonstrated have been beneficial to the recipient.

The Law and All That

Accepting the premise that a professional has specialised skills and knowledge, to what extent therefore is he obliged to display and exercise this knowledge and skill in serving his craft?

The general principles of responsibility and liability under English and Common law, in respect of the valuer, have been well documented and recorded. In particular I refer to the decision of:

LF Goddard in Baxter V Gapp & Co (1938) where it was held that the valuer's first duty was to use reasonable care in coming to the valuation which he was employed to make and he must be taken to have held himself out as possessing the experience and skill required to value the particular property.

In the same judgement, the learned Judge also stated that:

"As we are all liable to make mistakes, a valuer is certainly not to be found guilty of negligence merely because of his valuation turning out to be wrong. He may have taken too optimistic or too pessimistic a view of a particular property. One has to bear in mind that in matters of valuation, matters of opinion must come very largely into account."

When the same case was taken to

Appeal (1939) All E.R. 752 the decision was upheld by Du PargLJ where he stated:

"It is of course quite clear that the mere fact that there is an over-valuation does not of itself show negligence. Gross over-valuation, unless explained, may be strong evidence either of negligence or of incompetence."

It was some 25 years later, however, that a significant case namely : *Hedley Byrne & Co Ltd v Heller & Partners Ltd* established a clear principle that a professional in giving advice owes a duty of care not only to his client but to anyone who might reasonably be expected to rely upon such advice.

Significantly this decision overturned the principles established in an earlier case: *Candler v Crane Christmas & Co* (1951) All ER 426, where the issue to be determined was whether a false statement in accounts and reports made carelessly but not fraudulently by accountants was actionable by a third party.

In this case the accountant's advice was acted on by a third party to whom the information had been shown for the purpose of deciding whether to invest money or not.

The question asked of the Court was whether the third party who made the investment in reliance on the accounts and thereby lost money, had a right of action against the accountants. In this particular case, the decision was that there was no right of action.

In his dissenting judgement, Denning LF quoted as appropriate to the issue then before the Court some interesting remarks passed nearly a century earlier:

"...building industry consultants now facing a legal quagmire.."

One of the greatest areas of concern is where the professional adviser provides services and advice outside their area of specific expertise.

"A country whose administration of justice did not afford redress in a case of the present description would not be in a state of civilisation."

The brief reference to these two cases is I believe important to us as professional advice givers, to enable us to fully comprehend our present role in our particular chosen area of expertise where valuation reports are often treated as much travelled documents. The valuer must accept and recognise that in preparing his report, there is the reasonable expectation that the report will be shown to and relied upon by another party.

A Changing Role?

In past decades, the role of the valuer, appraiser or chartered surveyor was generally clearly identified and the parameters of his work and expertise were reasonably well defined. However, the change in business patterns and competition among professional groups and disciplines has in recent times tended to see a merging or overlap of various spheres of activity and pecuniary interest. It is in this area of advice giving and representation that I

believe we must clearly identify our role and more importantly our competence and ability to provide advice outside our specific area of expertise.

Professional opinion and judgement is of course the usual defence catchcry of any professional who is challenged on his or her opinion. Such a defence may well be upheld provided the valuer/appraisers can clearly demonstrate that he not only possesses but also exercises the necessary special skills expected of one practising within his profession. But does one's responsibility really stop there?

In one or two countries, building industry consultants are now facing a legal quagmire as the number of law suits against them tends to grow. Law suits against professional advisers have, I understand, become endemic in the USA and there are clear indications that this trend is developing in the South Pacific namely Australia and New Zealand. Significantly, as a particular industry encounters a downturn and when the economy turns sour, what were formerly good clients often become litigious opponents who in some cases can be desperate to minimise their losses suffered on specific enterprises.

Sticking to the Knitting

One of the greatest areas of concern is where the professional adviser provides services and advice outside his area of specific expertise. Frequently we are poorly instructed as to our specific task and this can lead us to perform functions for which we are not specifically qualified but for which we could well be held legally accountable.

A reported English case in 1989, *Richard Roberts Holdings Ltd v Douglas Smith Stimson Partnership & Ors*, highlights the dangers of the professional stepping outside its specific area of expertise. This case related to a claim against an architectural firm which was initially commissioned to design a dye works for a manufacturing company. The firm subsequently found itself responsible for the selection of a tank lining.

After two years the tank lining became detached and the manufacturing company initiated proceedings against the architects claiming damages for a breach of contract and negligence.

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In the Judgement against the architectural firm, the court upheld the general principle that "a party could be held liable for matters o

which it had assumed responsibility even if it did not have the necessary expertise and even if this was known to the person relying on it".

If, as in this instance, an architect or other consultant ventures into a field in which he is not an expert, then rather than rely upon disclaimers, he should take a positive position and make a firm recommendation that specialist independent advice be taken.

In the words of one commentator "consultants of any kind would be well advised to stick to the confines of their craft or obtain advice from independent experts".

The responsibility of professional people to undertake their work in a reliable way is an obvious necessity in the commercial world.

The Courts Diverge

The responsibility of professional people to undertake their work in a reliable way is an obvious necessity in the commercial world.

However, the question often arises as to how far the responsibility extends and what is the extent of the reliability in financial terms. This has already been referred to in two of the earlier cited cases namely *Candler v Crane Christmas & Co* and the renowned *Hedley Byrne & Co* case.

However, a recent judgement of the House of Lords on the question of professional responsibility and the extent of liability is indeed most interesting. The decision delivered in the case of *Caparo Industries PLC v Dickman & Ors* dealt with the reliability of audited accounts.

The specific issue before the House of Lords was whether the auditor could be liable to shareholders or members of the public who relied upon the audited accounts of the Company and later found the accounts to be wrong.

Caparo owned shares in the public listed company Fidelity PLC. After receiving audited annual accounts showing a lower than predicted profit, it began buying further shares in Fidelity and later made a successful takeover bid. Following the takeover, Caparo sued the auditors, Touche Ross & Co alleging that the accounts were inaccurate and misleading in that they showed a pre-tax profit of £ 1.2

million when in fact there was a loss of £400,000.

Caparo claimed Touche Ross had been negligent and claimed it had purchased its further shares and mounted its takeover bid in reliance on the audited accounts.

The Judge who first considered the preliminary issue decided that the auditor could not be liable but this decision was reversed by a majority decision of the Court of Appeal. The auditor then appealed to the House of Lords.

The House of Lords in its decision was unanimously in favour of the auditor's appeal.

In its decision, the House of Lords held that auditors who failed to detect errors in the accounts of a public company are not liable to shareholders or members of the public who rely on the company's audited accounts in deciding to buy shares in the company. Liability for financial loss caused by erroneous audited accounts was confined to certain situations. Liability could arise when the auditor gave the accounts to a known recipient for a specific purpose, the auditor knew of that purpose, and the recipient relied upon the accounts and acted upon them to the recipient's detriment. Knowledge that some unidentified potential investor might rely upon the accounts in deciding for example to purchase did not mean that the auditor owed a duty of care to the potential investor, even if the investor was an existing shareholder.

The Law Lords in their decision appear to have reviewed the fundamental basis of liability and negligence and rejected the modern approach of extending liability to the public at large, in favour of the more traditional approach where the principle of 'proximity' appears to be most relevant.

One of the three reported cases supporting Caparo's argument was the majority judgement of the New Zealand Court of Appeal in its decision of *Scott Group Ltd v McFarlane* (1978) 1 NZLR 553. In this particular case, Scott Group made a successful takeover offer for a company, John Duthie Ltd, relying on the audited accounts. Subsequently it was discovered these accounts overstated the assets.

The majority decision from the New Zealand Court of Appeal held that Duthie's auditors owed Scott Group a duty of care and were therefore liable for breach of it.

Although the *Caparo Industries PLC v Dickman* decision is from such an eminent authority, decisions of the House of Lords are not necessarily binding on New Zealand Courts. At the present time therefore, the Scott Group decision re-

mains the law in New Zealand and binds New Zealand High Court Judges. The New Zealand Court of Appeal is however free to depart from its own previous decisions, but whether it will do so remains to be seen.

Conflicts of Interest

This can be a particular area of concern to many professionals and especially to those who render client services through corporations and partnerships of some size.

The prime object of fiduciary law is to safeguard the interests of beneficiaries.

The use and potential abuse of specific information available to the organisation can be of constant recurring concern. It is in this particular area of handling modern business and professional practices, that apparent conflicts of interest can provide some of the greatest difficulties particularly in reassuring the client and public that the individual client's interests are properly safeguarded. We are all no doubt familiar with example in our own country where the question of conflict of interest can arise in company takeovers and insider trading.

Without endeavouring or even suggesting to proffer any legal comment or advice on this particular issue, it is however important that we do understand the underlying principles of fiduciary relationships. As I understand the position, the prime object of fiduciary law is to safeguard the interests of beneficiaries in such a relationship. A fiduciary being one in whom the client places trust and can be described as:

One, who has power and authority placed upon him by another, such that he should be taken to have assumed so to act in the interest of such a person.

In today's more complex business world of inter-woven interests, the problem of maintaining this client relationship often results from the change in the structuring, practice and pursuit of various business and professional enterprises. Increasingly we are aware of financial and professional business operating through corporate or large partnerships, employing large numbers of persons offering a multiplicity of services to the client. In such a capacity these organisations can become the databank of information on a

scale not previously contemplated. The inevitable gathering of information by such businesses and the conduct of their diverse activities can wittingly or unwittingly give rise to conflicting interests. For this reason, that as the nature of functions performed by such organisations change over time, they can bring with it fiduciary responsibilities being expected and demanded from such an organisation.

Professional Confidentiality

It is generally well recognised that all professionals are subject to a legal and not merely an ethical duty to maintain confidentiality of information acquired from or about their clients when acting in a professional capacity.

However, conflict can and often does arise under the following two principal situations.

The first is where the conflict arises in relation to the fiduciary's duty of loyalty to his client. The general conflict of duty and interest rule require the professional to disclose to each principal if he is being remunerated by another. Also he must disclose any personal interest in the transaction. Failure to do so can of course carry quite severe consequences and in some cases it may constitute a criminal offence (Secret Commissions Act).

The crucial matter in such a situation is the nature of disclosure required to produce a fully informed consent by the parties. Disclosure should be of such a nature so as to fully appraise each client in turn as to the extent to which the professional adviser's actions on his behalf will or may be compromised. Each client must be informed to the extent to which the professional will by virtue of double employment, act and be capable of acting in that party's interests, given the possible conflicts which might arise a potential minefield for stockbrokers and some financial consultants.

The general rule has been expressed in an earlier English judgement in an agency case in the following terms:

Fully informed consent apart, an agent cannot lawfully place himself in a position in which he owes a duty to another which is inconsistent with his duty to his principal.

The particular phenomenon which often generates a conflict of duties, is the acquisition in one relationship of confidential information which, if available for utilisation in the other, could possibly affect the other party's consent to the professionals continuing to act in the matter. In such a situation, the professional must clearly indicate that his possession

of certain knowledge compromises his ability to act in the client's interest. The other party must be informed of this and the relationship terminated.

The second situation relates to what is often called separate matter conflicts. The issue here is usually one of the effects the possession of confidential information can have on the discharge of the professional responsibility to others.

This principle was illustrated in the case *Black vs Shearson Hammill & Co* where a stockbroker committed his agents to encourage clients to purchase shares in a company on the basis of positive information made available about that company when he, in fact, was in possession of confidential information which indicated that the company's situation was in effect precarious. The stockbroker in this case was held liable for fraud.

The problem of non-use of confidential information can arise for a multiple service organisation in demonstrating that the information has not in effect been used. This can well apply where another department or person innocently performs a service or act which may give the impression that such confidential information has been used to advantage.

In another situation the valuer or appraisers may have possession of confidential information gained from another assignment which may be particularly relevant to the task at hand. The issue here is whether the valuer must reveal this knowledge or is it sufficient that he merely has an obligation to base his judgement on such knowledge.

In some types of fiduciary relationships, as part of the duty of care, the professional may be required to make available to the client all "relevant knowledge" including confidential information. If the professional is not able to do this and he obviously cannot where the information must remain confidential, then he should refuse to act. However, if he does act without complying with this duty he renders himself potentially liable in negligence for any loss suffered.

The obvious issue in these situations is whether the large scale multiple service organisation or professional practice should be permitted to avoid these potential liabilities through claiming a state of ignorance in the person or persons who actually provide the service to the client. At law, a company is one entity no matter how many and dispersed its various departments. A person who engages the services of a partner or employee acting as such engages the services of the whole

firm and not merely of the persons who actually render the service.

Trust a Professional

When one bears in mind the requirement of trust and loyalty as a pre-requisite to any professional adviser/client relationship, the maintenance of such trust and responsibility has to be weighed against the pursuit of the business interests of the organisation offering such services.

In this regard, the words of the late Sir Owen Dickson, Chief Justice of Australia, are indeed most pertinent:

Unless high standards of conduct are maintained by those who pursue a profession requiring great skill begotten of special knowledge, the trust and confidence of the very community that is to be served is lost and thus the function of the profession itself is frustrated.

The Profession's Responsibility

It will be apparent from the foregoing comments that as professionals we do have a responsibility and duty not only to the instructing client but also to the general public. If we breach this responsibility we let down our profession and thus deprive the public of trust in a body of professional people who can be relied upon.

Accepting the definition of a professional person as being one who applies advanced training and specialist skills to meet the needs of the consuming public, this then distinguishes the professional from the layman.

If lay people cannot fully understand the practices of professionals and therefore are not able to judge the correctness of their actions, the profession itself must set and maintain standards that will serve the public interest.

It is not in my view sufficient that the protection of the public relies solely upon market forces of competition and general acceptance.

It may well require that the profession itself should engage in some form of peer review to determine whether decisions made by members of the profession are to the benefit of the client or the individual.

Self regulation by the profession is therefore particularly important to the extent that we have a special responsibility and obligation to provide some degree of consumer protection to the public. Whilst we may well monitor and accredit educational institutions to maintain and improve the academic standards of graduates and future members of the profes-

A Commentary on Professionalism

by S L Speedy

The winds of change are sweeping throughout the professions. Competition has shaken them out of their 19th century attitudes in time for the 21st century at the end of this decade. It is time to reflect a little on the nature of professionalism and to see how it can retain its essence for valuers in this new age of open competition.

The idea of a profession is based on learning, skill and ethical conduct. Here we come across old-fashioned words like competence, experience, integrity, judgement and independence.

The traditional concept of the professions were those callings that 'professed' knowledge, hence medical practitioners, the clergy, teachers (or professors) and lawyers.

Since then accountants, engineers and similar university-trained occupations have claimed professional status. Most are fully justified, but occasionally each profession has had its embarrassments. Dickens wrote about unscrupulous lawyers, nevertheless their wide knowledge and general standard of conduct has made the occasional black sheep all the more prominent.

Because their job is often to be an advocate for their client, seemingly re-

luctant to establish ethics committees to discipline members who act against the best interest of the profession and the public, and provide guidelines as to minimum standards and report content - is this enough?

I believe that in current times with more sophisticated business practices, expanding areas of expertise, an ever present desire to service clients in a fiercely competitive market, there is a real danger that the practice of our particular profession along with many others, can so easily become merely a business whose success may be measured solely by dollars and profit.

We therefore need to remind ourselves that the purpose of a true professional is to serve the public interest. This may well require a return to self restraint which has always been the essential discipline of any profession.

Whilst a business person may act in a professional manner, he or she is not

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regardless of the truth, their ethical standards, have at times, brought them in to opprobrium.

Combine that approach by turning some of them into politicians and you have a recipe for trouble. By the very nature of business, it is not a profession, yet it employs professionals to help it in its objectives and some have higher standards than some so-called professionals.

Although the Courts have long accepted the professional standing of Institute members, valuers can be said to have finally 'arrived' when the Universities accepted that valuation was an appropriate subject for study within their hallowed

halls to degree status. Yet this in itself is not enough.

Indeed it is only the beginning, knowledge is only a pre-requisite, it is the use of that knowledge with skill, competence, integrity and judgement that lies behind the idea of professionalism. It is the end result that concerns the clients, the Courts, and the public. It is their acceptance (or rejection) of members as individuals or as a whole that must in the long run be the true test.

The word professionalism has more than one meaning, which in itself leads to a certain amount of confusion. On one hand it means that someone is being paid

obliged to do so. A professional however is not only expected but obligated to do so.

The essence of a professional therefore, is one who acts independently of his own self interest.

In conclusion, I believe that as professionals in practising our particular craft, we have a clear obligation and duty to:

- The client - to display integrity, total independence and objectivity and provide well documented and researched opinions.
- The public - to satisfy it that we are a professional body and that our members have the necessary training, skills and discipline to carry out their particular tasks.
- The profession - that we as members clearly demonstrate in our everyday professional work, that we do provide independence, integrity and competence which are absolute prerequisites to justify recognition as true professionals. A

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for doing a job that others do as a calling or without thought of financial reward. The clergy are at one extreme and footballers are at the other.

Doctors used to be grouped with the clergy as being a calling, but the modern system of 'pay up, no tick' has lowered the status of some to being closer to that of a business, albeit a 'professional' business. The Olympic amateurism of obvious well paid athletes has only helped blur the distinctions between unpaid and paid performers (or professionals). Whether All Blacks should make something on the side out of their 'amateur' game has exacerbated the effect that economic pressure is having on today's ethical standards.

It was, at first, a shock to hear a journalist at a recent Institute function freely admitting to being biased. He acknowledged selecting only those news items he considered newsworthy for his readers. In answering a question about bad property news, one journalist pointed out that his job was not to cover up the true situation. And neither should he. Journalism does not claim to be a profession, often priding themselves on being a trade. In endeavouring to promote the interests of of the valuation profession this journal will not hesitate to publish unpleasant facts or fair criticism.

A professional journal must have higher standards than the 'press'. Yet the editor is still free to decline to publish anything he thinks unsuitable. Freedom implies choosing. Choice is often a matter of selecting the wheat from the chaff. Valuers must also make choices.

That brings me back to the crux of true professionalism to which valuers aspire. Ethics require professionals to conduct themselves in a manner appropriate to their profession.

Their work must be tops, their knowledge must be comprehensive, up-to-date and, of course, skilled, competent and truly independent. Lack of true independence has been recently blamed for some bad loans.

Professions require dedication and hard work. Those who wish to succeed in their profession must like doing what they do. This lightens the load. They must respect their calling and be enthusiastic for it. That is one of the secrets of success.

My personal definition of 'work' is doing what I don't like doing. It follows that most of my time is spent doing things that are not really 'work' to me. On the other hand merely because I am not paid for doing a job does not make it any less 'work'. As so often happens, far too much

of my time is spent in doing what someone else wants me to do. This can be fun, or it can be very hard work depending on my own attitude. Just to make the point, I put statistical and tax returns in this latter category.

Booms cover up the sloppy performance of people, investment decisions, and governmental and other administrations. Downturns in the business cycle and keen competition give excellent opportunities to improve professional performances. Most of those who have responded to quick 'cheap' jobs have found the folly of their way. But there are always some who never learn.

Because high standards of performance must be placed at the top of the list of criteria of professionalism, those who profess to know what they are about, should in fact know.

Integrity means more than doing your homework. For valuers it does not mean putting you client's interest above all else, because the valuer's real 'client' is the truth. As Shakespeare put it:

*This above all. to thine own self be true,
And it must follow, as the night the day,
Thou canst not then be false to any man.*

It is in the performance of each individual member's work that reputations of

professional competence are established. Neither 'registration' of members nor in membership to the Institute per se is enough.

Indeed it is the other way round. In the end our profession earns its reputation from the quality and expert advice competently and independently given by its members.

By your work and conduct you will be personally judged; and by your work and conduct the valuation profession will also be judged.

Each and every member has that personal professional duty and responsibility to maintain the highest standards of competence and integrity by the very act of 'professing' to belonging to our profession.

When the next changes occur, there must be no lowering of individual standards, and what is more there should be no occasion to do so.

Standards must gradually improve as new techniques and methods are found to make reports and valuations better for the end-users.

The essence of professionalism is knowledge and this means keeping up-to-date. To help members achieve this objective is one of the *raison d'etre* of this Journal. A

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To help keep your quarterly copies of the Journal in a tidy and readily accessible reference library, the NZIV is now offering its members a special *NZ Valuers Journal Binder*.

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Databases - What Are They?

by A J Senojak

The following is a brief introduction to some of the concepts of a database and its application to property valuation.

Definition

A database is a collection of data which are shared and used for multiple purposes. Any one user does not perceive all of the types of data in the database, only those that are needed for his or her job.

An excellent example of a database is Valpak, a sales retrieval system with which most if not all New Zealand valuers will be familiar.

Information associated with the property sector has become increasingly important as the market attempts to correct an over investment of funds and an historical surplus of accommodation. Computers must play an important part in this process for whether one is valuing, managing or selling properties or has some other role, you are dealing with large volumes of data in conjunction with a changing market place. Information on sales, rentals, analysis worksheets and suchlike are required quickly, efficiently and in many different formats.

At present, and similar to the Valpak programme, the Institute of Valuers have developed a package designed for the query and retrieval of rental information called Rent Pak. However, if your office requirements are most extensive than this package has to offer, in addition to the requirement for sales, building outgoing and other priority information, you may well consider the development of an "in-house" construction quality database.

Despite the initial outlay required and the inherent problems associated with getting a program developed specifically for your company, this may well be a satisfactory option in your particular situations. Obviously considerations such as the size of the firm and level of detail required in your database have to be evaluated together with the costs and installation horizon.

Aran Jon Senojak (BPA;NCB) is a registered valuer with Darroch & Co. Limited and presently specialises in the valuation of Auckland Central Business District property. He has a keen interest in computers and their application to property consultancy.

The Valuer's (or Management) Role in Development

Valuers need not be concerned with the technical aspects of database design as this is the domain of the programmer. The valuer must however be able to clearly communicate to the programmer the data required and the manner in which it is to be represented and retrieved from the database.

This is often complicated by the fact that different users use different names for the same data item, for example, categorisation of property as "commercial" or "office" which invariably refer to the same type of building. A high degree of precision is therefore needed in representing the data.

In essence it is up to individuals to ensure that the data they need are truly represented in the database, correctly defined, appropriately organised and protected.

Why, change from your existing system?

A traditional filing system has a high level of "redundancy", in other words, the same type of data is stored in many different places.

Secondly, a traditional file system is inflexible as requests for information to be grouped in different formats cannot be easily handled. In other words, the data cannot be processed in new ways without

restructuring, for example your current rental schedule which has insufficient room for a column covering concessions in the central City.

The real key to understanding how a database works is the concept of "data independence".

To illustrate this concept, the writer finds it easiest to think of a database as a central and sacred storage unit.

Everyone has access to it, though in doing so they do not alter the database records.

In other words, data independence occurs when the programs work independently of the data and vice versa. In a practical situation, a valuer may extract several rentals, however, importantly the original information is intact and secure so that the next user can query the database without any restraints.

Summary

In summary, the database in my opinion does have considerable application for valuers. This can range from a simple solution for a small practice to a highly complex and fully integrated property information database for larger offices. So whatever your circumstances, if you, like most valuers, wish to avoid the frustration of endlessly searching through paper documents for that missing piece of evidence, take heart and as a solution consider the possibility of a database. A

Housekeeping Tips for Computers

The following 'Keypoints' are obtained from the computer magazine Interface. They are part of a regular Column providing Tips for Business Users on a wide range of useful issues. The following article focuses on Backing Up data stored on your computers.

BACK UPS

Backups what are they? Why bother? Are they really necessary? How are they created? If you have ever asked one of these questions, read on

Experience has shown many new computer users get confused by backups, and often think that mystery and magic surrounds them. In simple terms, a backup is just a copy of the data that is stored on the storage device (be it hard or floppy disk) that is used daily.

It is just like transferring a song from a record to an audio tape. The record stays intact, and the audio tape contains a copy of the song.

Backups can also be copies of program disks and these copies are usually made before the program is used. The copies are for daily use and the master disk put into storage as the backups. However, this does not apply in all cases as

some programs will ask for the master disk, for identification of a licensed user, at irregular intervals.

Backups of your master disks should still be made, unless they are copy protected.

Therefore, backups are a must. They provide security by being able to replace lost data. Sounds simple, but data can be lost in a number of ways: human error, theft or burglary, and computer malfunction.

Creating a backup is dependent on: the operating system of the computer, the storage device on or in the computer and the storage device the backup is made on. If you cannot find and/or cannot understand the information in your manuals relating to backups, get your supplier to help you compile a checklist for backing up with clear concise instructions on how to complete one.

There are some basic guidelines which can be followed for all systems:

1. The backup disks should be rotated in three sets a set being the number of disks required to hold the information being copied to them. Label your sets clearly eg Set A disk 1, Set A disk 2. Change the sets each time to ensure that if anything goes wrong in the backing up process, you still have your last set. There is no security in using just one set all the time.
2. Only you can decide on the length of time allowed to lapse between backups, according to how important that work is to you and how difficult it would be to recreate.
3. If you have some information that you are about to print copious reports from - eg end of month on an accounting systems - do a backup before you print.
4. Always do a backup before any end of month rollover in an accounting system.
5. A monthly set of backup disks should also be used to create a complete backup each, and this set should be stored offsite (the bank safe is a good place).

Hot off the Press Statistics Information

The Department of Statistics "hot off the Press" information is now available via Starnet.

Starnet is a similar linkage system to that currently offered by Valuation New Zealand which enables your computer at your office to link up using VNZ Link and a modem with the large database of property information held by Valuation New Zealand.

Hot off the Press is a news release service offered by the Statistics Department that provides the latest statistical information to subscribers.

This information covers a wide variety of topics of significant social, economic and business interest.

These releases summarise down the key information tables and an informal

commentary on the significance of the data is provided. This information is vital to business planners and decision makers as well as researchers, teachers and the media.

Currently the information is embargoed until release, and is then mailed or faxed to subscribers.

Subscribers can nominate which releases they wish to receive and the method of dispatch. Currently, fax transmission is the quickest option, but still takes many hours, especially when there are problems on recipients' fax machines.

The solution then lies with Starnet. The Department of Statistics is now offering us data via Starnet and will currently dispatch Hot off the Press releases to all subscribers who select the Starnet option,

immediately the embargo is lifted. This means that Starnet subscribers will be amongst the first to receive the key information. A bulletin board in Starnet will keep users apprised of the release timetables so they can log on and receive the information at the appropriate time.

Statistics Department subscribers must join Starnet to enjoy this enhanced method of receipt. Starnet users who wish to receive this key information must subscribe to the Hot off the Press service.

All enquiries regarding this new source of information should be directed to:

Department of Statistics,
Kevin Eddy or Margaret O'Sullivan.
PO Box 2922.
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UNDER the Land Valuation
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IN THE MATTER of the North
Auckland Land
Valuation Tribunal
in proceeding
LVP No 429/88

BETWEEN The Valuer General
Appellant

AND ALAN R KERR, JOHN VIVAN
KERR, GERALDINE E KERR
and COLLEEN A KERR all of
Whangarei, occupations unknown.
Respondents

JUDGMENT OF TOMPKINS J
AND MR JOHN WALL

The Appeal

The Valuer-General has appealed under s 26 of the Land Valuation Proceedings Act 1948 against a decision of the North Auckland Land Valuation Tribunal delivered on 4 August 1989.

The owners of 10 units held under the Unit Titles Act 1972 located in Commerce Street, Whangarei, had objected to the land values assessed to each unit in the Whangarei City revision valuation as at 1 July 1988. In each case the basis of the objection was that the land value was too high.

At the hearing before the Tribunal the objectors were represented by their valuer, Mr J F Hudson. The appellant, the respondent before the Tribunal, was represented by the District Valuer, Mr R J Malone.

In its decision the Tribunal allowed the objections by amending the valuation roll by substituting the land valuations as assessed by the objector's valuer.

The objections were thereby allowed in full. It is against that determination that the appellant has appealed.

There were no appearances before us on behalf of the respondents. One of the

respondents had written to the court advising that the reason for his not being represented is that he could not afford counsel. Since the hearing before the Tribunal some of the then objectors have sold their units.

The Property

Annexed as a schedule to this judgment is a plan showing the location of the units in relation to Commerce Street. The separate properties comprise principal units A to J, and accessory unit 1 on unit plan 101481, being a unit title development under the Unit Titles Act 1972.

In addition, as shown on the plan there is what is described as "common property", being property common to all units and over which the owners of each have common rights. These units are off Commerce Street, a warehousing, light industrial location within reasonable proximity to the Whangarei central business district.

The following table shows the Valuer-General's land value and the objector's land value for each unit. The latter, of course, became the roll value pursuant to the Tribunal's decision.

	Val. General's Land Value	Objector's Land Value
Unit A	\$55,000	\$34,000
Unit B	\$32,000	\$19,000
Unit C	\$24,000	\$16,500
Unit D	\$24,000	\$16,200
Unit E	\$24,000	\$15,900
Unit F	\$24,000	\$15,600
Unit G	\$24,000	\$15,300
Unit H	\$24,000	\$15,000
Unit I	\$24,000	\$15,000
Unit J	\$24,000	\$17,000

As it will be seen from the plan, unit A and unit B have a frontage direct onto Commerce Street. All the remaining units have their access to Commerce Street over the common property.

The Basis of the Valuation

"Land value" is defined in s 2 of the Valuation of Land Act 1951 as meaning the sum which the owner's estate or interest therein, if unencumbered by any mortgage or other charge thereon,

might be expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a *bona fide* seller might be expected to impose, and if no improvements had been made on the land. The task therefore is to assess what might shortly be described as the market value of the land without improvements as at 1 July 1988.

Section 3 of the Unit Titles Act 1972 enables the registered proprietor of an estate in fee simple to subdivide the land into:

- "(a) Two or more principal units; and
- (aa) Such number of accessory units (if any) as the registered proprietor may wish; and
- (b) Common property being so much of the land as is not comprised in any unit."

Thus the owners of each of the units A to J also hold an undivided share as tenants in common in the common property.

It follows that in assessing the land value of each unit there must also be included the value, if any, to that unit, of the undivided share in the common property.

Unit Differences in Land Value

It was contended by Mr Hudson in his evidence before the Tribunal that there should be a difference in the land value of units C to J inclusive to allow for the difference in the distance of each unit from Commerce Street. Those differences are apparent in his valuations as adopted by the Tribunal and shown on the above schedule.

There was no specific evidence from either valuer on this issue. Mr McGuire submitted that the Tribunal should have accepted that there should be a difference in the land value for this reason only if there were proved to have been a cogent reason for doing so.

Not only did neither valuer express an opinion in his evidence-in-chief, there was no cross-examination on the issue either.

Under s 6 of the Unit Titles Act before the unit plan is deposited there must be assigned to every principal unit, and every accessory unit, a unit entitlement to be fixed by the Valuer-General or a registered valuer on the basis of the

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