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IN THIS ISSUE

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JOURNAL

SEPTEMBER 1991

General Secretary: J G Gibson
Westbrook House, 181-183 Willis Street
PO. Box 27146 Wellington
Phone 847-094

Contributions with a biographical note of the author should be typewritten and sent to the Editor, PO Box 27146, Wellington, who reserves the right to accept, decline or modify material. Views expressed by the editors and contributors are not necessarily endorsed by the New Zealand Institute of Valuers. Copies of manuscript should be retained by the author as they cannot be returned. Deadline: two months prior. Business letters, subscriptions and advice of changed address should be sent to the General Secretary. The mode of citation of this volume of *The New Zealand Valuers'Journal* is (1991) N.Z.V.J. September page.

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The New Zealand Valuers' Journal is a refereed publication

Contents

Articles

Editorial Comment

The Ups and Downs of Lower Interest Rates

Ever since the beginning of the economic reforms introduced by the Labour Government in 1984, which became known as "Rogernomics", there have been promises of single figure mortgage interest rates which were to be the indicator of an improving economy and impending good economic health - the light at the end of the tunnel. While the current significantly reduced rates of interest are still not, at the time of writing (pre-budget) down to a single figure level, there is strong indication that this level may be realised soon after the budget announcement.

What benefits are being achieved by these lower rates of interest? For the average home-owner, who still represents a signficant proportion of the New Zealand population, it will mean a welcome reduction in monthly mortgage repayments. This should result in some increase in discretionary disposable income which could be spent in retail shops or restaurants, on replacement vehicle purchase, on upgrading the existing home, or on holidays and overseas trips. Such spending will provide needed impetus to those sectors of the economy.

To those who do not already own their home, there should be better opportunities for home ownership. Lower levels of interest have been partly brought about by the large volume of money now available through banks, building societies and other mortgage lending institutions which means that lower income earners are not now relegated to the end of a long queue for funds.

Lower interest rates mu st make home purchase more affordable, providing an alternative for those who regularly deposit part of their weekly budget into the landlord's bank account. As mortgage interest rates continue to reduce and house prices in the middle and lower price brackets remain stable, there surely cannot be a better time for first home buyers to seriously consider their options.

In the wider economic spectrum the lower interest rates must be providing much needed relief for businesses, particularly small businesses which provide jobs for more than 70% of the employed workforce in this country. Previous high rates of interest have been a disincentive to business expansion in New Zealand and it appears that one of the main economic strategies of the present government is to provide a platform for lower interest rates so that increased business investment and expansion will create more jobs. With interest rates continuing to go down, we must hope such business expansion does occur.

But what is happening on the other side of the reducing interest rate ledger? Those people who rely on fixed interest investments for their income have had their monthly or quarterly payment cheques slashed by possibly up to one third in the last few months and further reductions seem inevitable. To many people these interest payments will be providing supplementary retirement income and the lower interest rates will represent a significant drop in living standards. For some that may just mean postponing the purchase of a new car or an overseas trip, but to a significant number it will mean a serious drop in income at a time when the level of Guaranteed Retirement Income payments are under review and seem likely to be reduced through "means testing" for those who receive other supplementary income.

Another group who must have some concern for significantly lower interest rates are those endeavouring to provide for their future retirement. Future Government funded superannuation payments for people retiring from the workforce may no longer represent a comfortable standard of living but will more likely be only a basic safety net for those who have not been able to make provision for themselves. Consequently there is a growing awareness among the working population that some investment provision needs to be made - sooner rather than later.

Lower levels of interest seem to provide a distinct disincentive to beginning this savings regime but it must be remembered that the economy is presently experiencing the lowest levels of inflation for a number of decades and this is very signficant when considering effective rate of return from investments. An intermediate step obviously being taken by some working people who are considering their options for future retirement income and who have purchased their home, is to use the increased level of income becoming available from reduced interest rates to pay off their mortgages in a shorter time by keeping monthly repayments at the former level and saving on future interest payments.

Awareness of the need to provide for future retirement income has resulted recently in a noticeable increase in sales of smaller or medium size investment properties particularly commercial offices, warehouses or factories and residential flats and houses. Lower interest rates should make such investments more attractive and possible for a much wider cross-section of the working population but there has to be an awareness that such investments need careful management to ensure that the busines premises, flats or houses are kept fully occupied, that rental payments are made on time and in full, and that necessary maintenance is attended to. Purchase prices of such properties should be justified by a satisfactory return afterallowances have been made for the deduction of all landlords' expenses for rates, insurance, maintenance, management and payment of any mortgage interest. Except in special circumstances, the prospects for signficant growth in rental levels for these types of smaller investment properties are very minimal in the short term. Consequently the strategy of paying a price which requires the passage of time and high levels of inflation to produce a satisfactory level of income andreturn is no longer appropriate.

An investment alternative worth considering, for those with substantial amounts of capital who are prepared to take an active interest in their investments, is equity investment in a business. There is usually an element of risk, of course, but this is reflected in higher rates of interest than for fixed interest investment. There is also the satisfaction of having a direct involvement in an enterprise and perhaps providing some management or working skills which will benefit both the existing business and the new investor. There could also be significant future benefits to the country as a whole as on a reasonable scale such equity investment could provide more stable businesses and impetus for new employment opportunities.

Trevor J Croot.

Foreign Investment: Occupational Regulation Two Issues Affecting Valuers

An Address by Hon W Rob Storey, Minister of Valuation to the NZ Institute of Valuers Seminar and AGM held at Christchurch Town Hall on 22 April 1991

want to address two issues I know are ' of concern currently to members of the Institute and their clients regulation of the property market when foreign investment is involved, and regulation of the valuing profession.

Overseas Investment

A strong feature of the property market recently has been growing interest from foreign investors, which has sparked a mixture of responses.

There's been pride that outsiders are so attracted to our buildings and land they're prepared to pay considerable sums to share in them.

There's also been a response of protective nationalism, which has almost painted overseas investors in the light of hostile invaders.

It's up to the Government to put aside emotion and take a cool, rational look at the issue.

That's why I say that I recognise there is real substance to some of the public's concerns - but I also believe foreign investment is beneficial to the country and the economy.

The Government is trying to remove barriers to trade, rather than erect them, in all areas of the economy and the property sector is no exception.

Don't let us forget that some of New Zealand's major companies own not only business, but major landmark properties and forests, overseas.

That could be seen as giving New Zealanders a thin case if they're seen by other countries to be blocking investment in their own country.

In fact, at a time of recession, it seems tome that it's contrary to public welfare to refuse investment, especially if it means an injection of new capital and more jobs.

However, there is a need to set up proper safeguards.

Back in 1968 the Government recognised this by expanding the land settlement promotion and Land Acquisition Act to cover foreign investment in New Zealand property.

While Part Two A of the Act doesn't stop bona fide immigrants or overseas companies acquiring New Zealand land, they are subject to certain approvals and restrictions.

One of those restrictions is designed to prevent "undesirable speculation", while another is aimed at ensuring purchases of rural land are in the interests of the rural community and the nation as a whole.

My government is now reviewing the legislation with the aim of clarifying the controls on foreign investment in New Zealand law and establishing criteria that will reflect the view that foreign investment is welcome, providing economic and social benefit to the country can be proved where its economic and social benefit to our country can be established.

At the moment the plethora of red tape surrounding foreign investment in New Zealand land is confusing to the buyer. It can mean consents from no less than three areas the Overseas Investment Commission, the Commissioner of Crown Lands and myself.

Added to those difficulties is the fact that a wide range of government agencies are free to dispose of land under a range of different criteria.

This state of affairs means it's practically impossible fora government to keep tabs on exactly where the land is going and who it is going to.

What I'd like to see instead is a kind of one-stop shop so consent can be simplified and speeded up, but also more closely regulated and monitored.

Because the decision to sell New Zealand land to overseas interests is, essentially, a political matter, I believe the Minister of Lands should hold ultimate responsibility.

In other words, the policing of foreign land sales should be administered by a single land management agency which would hold decision making powers under ministerial direction.

And I consider that guidelines should cover all the state's land dealings so all government departments operate under the same set of rules.

Clearly, anything that threatens to remove the value of property from the normal market forces and place it under legislated authority is going to make your work as valuers more difficult.

You might well ask how you are to appraise a property in an area with an already high level of foreign investment. You may ask whether normal market forces will apply, whether the Government will step in and limit potential buying interest to domestic investors, and whether the situation will change if the foreign investors dispose of some or all of their properties in the area.

My reply is to urge you to study the relevant part of the Act, keeping in mind its objectives. I'm sure that will give you a working understanding of when, where and how restrictions are likely to be applied. You'll see that the legislation in no way seeks to undermine free market principles, other than in very exceptional circumstances.

You all have access to the national property database operated by Valuation New Zealand, and you'll find analysis of the property sales data indicates transaction trends just as much as it indicates general property prices.

I must say I do appreciate the need to enhance the property sales database to clearly define foreign ownership and to recognise share transfers in property owning companies.

While the Government is prepared to apply the spirit of the Act, pending any revision, it has no intention of allowing its application to unduly intervene in the normal working of the marketplace.

Occupational Regulation

Talking about the changes the Government intends to make regarding foreign investment brings me to changes within your own industry.

At a time of dramatic change and upheaval within the marketplace as well as the profession, it is particularly important to make sure regulations match the demand placed on them.

The work of valuers is coming under intense public scrutiny these days.

The collapse of the property market and the severe debt problems this has created for lenders has regularly called into question valuers' work. Unfortunately, it's cases where the quality of the work or the ethical standards applied have fallen short of the norm that have captured the headlines.

The last four years have shown all too clearly what damage a valuer, caught up in the euphoria of a property boom, under psychological pressure from a client, or simply acting out of total self-interest, can wreak on the business sector.

While these cases are clearly in the minority, they forcefully demonstrate the enormous responsibility a registered valuer carries when assessing a property's value.

The very existence of your profession depends on the public having confidence in your work. That rests to a large extent on the public having confidence in registered valuers.

Because of the implications to the entire public, regulation is too important an issue to be left solely to the practitioners of the industry to look after. Yet you all have a vital role to play in maintaining and enhancing the work and influence of your Institute.

A review of this delicate balance between the valuing profession, the public and the Government began under a National Government almost a decade ago. That review acknowledged that while the existing structure of the Valuers Registration Board and the Institute had served its purpose well, it was no longer entirely appropriate for the property and business environment of the 80s.

The basic issue the review examined was whether the structure, with its compulsory membership of the Institute, and the Institute's fixed range of fees, was compatible with moves toward the free market and deregulation taking place in other disciplines.

The Institute was quick to take on board the need to remove the fee structure but I understand it is still uncomfortable with the idea of voluntary membership.

The Labour Government, ironically, took on board National's position and began drafting a bill around it, but found the task too daunting. Now it falls to us to, you might say, "grasp the nettle", though such a phrase misinterprets our intentions.

While we still see the need for change, we want to achieve that change through consensus.

I am fully aware of the strength of feeling the subject of voluntary membership has aroused within the profession. I ask you to think twice about this issue.

If we seek to introduce legislation designed to enhance the public's perception of the profession and its confidence in the work of members of the profession, can that legislation achieve its aims if, at the same time, it alienates those in the profession?

There's no doubt that compulsory membership served its purpose in the past by enabling a highly responsible and professional institute to be created, at a time when the term "valuer" was not necessarily a highly respected one.

But today we're in a society where compulsion to join an organisation appears a contradiction, because today the public is far more aware of what professional certification and qualifications means than it was when the Institute was first established.

However, because of the cost an individual can suffer through a deficient valuation or a rogue valuer, there is a clear need for a registration system that gives the public security that a registered valuer's opinion is reliable.

No one argues with the proposal that registration should be conducted and monitored by a wholly independent body.

The question is that, if a separate body that fully protects the public interest was established, how would its activities be funded, and has the Government the right to insist that you and your colleagues be members of the Institute before you can be registered and enter public practice?

I do not mean to imply any criticism of the important role the Institute plays in education, maintaining ethical standards or informing and representing members. But I challenge you to think again, about whether preserving compulsory membership of the Institute is completely justifiable in today's world.

The constraints of a short address have forced me to skim over two subjects which, on the surface, may seem unrelated. But when you examine the issues of foreign ownership of land, and regulation of your own occupation, you realise they both concern the way in which one interprets the meaning of the free market.

In looking at both issues I'm trying to find a way of seizing the advantages of the free market, while at the same time shrugging off its downside. There is another important issue closely allied to these two issues...and that is valuation.

Valuation New Zealand is a central agency which provides uniformity in valuation which has the advantage of not being susceptible to any hint of bias. While that principle is admirable, there will be some changes in the role Valuation New Zealand plays.

As a result of changes in government policy, Valuation New Zealand in future will devote only a very small part of its work to central government.

The majority of its work in future will come from local government...and central government will consider very carefully whether it should play a part in valuation.

The Government is delighted with its inflation record since it's been in office. But there's no doubt that in some ways that successful inflation record puts the heat on valuers.

In times of low inflation there's great pressure for valuations to be accurate and close to the mark - more so, perhaps, than in times when investment in property spells a sure bet for capital gain.

I appreciate the pressure the Government's success puts you under-but I can assure you we'll be doing our best to ensure that pressure does not ease up! A

BRING BACK THAT

GOLF COURSE

"a response of protective nationalism, which has almost painted overseas investors in the light of hostile invaders."

Reciprocity Agreement

The Royal Institution of Chartered Surveyors & The New Zealand Institute of Valuers

Whereas The Royal Institution of Chartered Surveyors (RICS) and The New Zealand Institute of Valuers (NZIV) see benefits to members of both professional bodies in setting up a Reciprocity Agreement, the RICS and the NZIV agree the following:

1. A Corporate member (Professional Associate or Fellow) of the RICS in good standing, who is a member of the General Practice Division may be admitted to Associate membership of the NZIV subject to:
   a. one year's residence and practice in New Zealand, the latter to be under the supervision and to the satisfaction of the New Zealand Valuers Registration Board. During this period, applicants will be required to maintain a detailed record of their experience.
   b. completion of an examination in New Zealand valuation law, and any other examinations considered necessary by the New Zealand Valuers Registration Board, on a case by case basis.
   c. having obtained registration (and to this end applicants may be required to have an interview with the Valuers Registration Board, to establish that the required level of professional knowledge and competence has been attained).
   d. a professional interview, conducted by the NZIV.
2. An Associate or Fellow member of the NZIV in good standing may be admitted as a Professional Associate of the RICS in the General Practice division subject to:
   a. one year's residence and practice in the UK, the latter to be under the supervision and to the satisfaction of an approved member of the RICS. During this period applicants will be required to maintain a detailed record of their experience followed by:
   b. a professional interview conducted by the RICS to test the level of professional knowledge and competence that has been attained.
   c. successful completion of the statutory valuations paper from the General Practice examination, and other examinations considered necessary by the RICS, on a case by case basis.
3. This agreement does not apply to any member of the RICS and NZIV who has been elected to membership of either body through a reciprocity agreement with other professional bodies. A

New President of Australian Institute of Valuers and Land Economists

The election of Keith Norris as National President of the Australian Institute of Valuers and Land Econmists was annouunced at the Institute's annual general meeting in Perth.

Mr Norris, a Sydney valuer, is a Director of the firm Sallmanns (NSW) Pty Ltd. As well as being a registered valuer, Mr Norris is also a solicitor and in 1988 collaborated with another Sydney lawyer, Lindsay Joyce, to write a book on professional liability *"Valuers Liability : ALossPreventionManual"*. MrNorris will be supported in his Presidental year by two Vice Presidents, Ray Westwood, a senior Government valuer from Hobart, and Alan Hyam, a Sydney barrister who practises in the area of property law. A

Valuers Registration Board

Board Prizes

The Valuers Registration Board prizes for the 1990 academic year have been awarded to:

AUCKLAND UNIVERSITY
G A Rundle of Auckland

MASSEY UNIVERSITY
H D Balsom of New Plymouth

LINCOLN UNIVERSITY
R G Baker of Timaru

The awards, currently $500 each, are made by the University Councils on the recommendation of the appropriate Faculty or Professorial Board to the students showing the greatest promise of being successful valuers.

.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 orcomment on atopic 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 otherjournal 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.
12. The article may be on anytopic and the following are provided as suggestions only:
    Valuation of publicly owned assets; forestry valuations; lifestyle blocks-rural/residential property; valuation of chattels.

Is Key Money Rent?

A Study in Lower Queen Street Auckland

byJ A Jones

Introduction

This paper has a number of objectives. The most important of these is to determine if key money is rent. If it is not, what is it? Does the payment of key money influence the rent review settlement on the subject premises and does this influence spread to subsequent rent reviews of other premises?

In the writer's view however the most significant objective is to determine if key money phenomena is solely a matter for the valuation profession to grapple with or is it a manifestation of an erratic form of transaction whose roots are based in behavioural and/or economic theory which cannot, and maybe should not, be fitted into valuation practise as known today.

If the only consistent factor in the payment of key money is inconsistency then a perfectly good response from the valuation profession maybe not to attempt to codify it into valuation methodology.

At one time this was the case. Mr Broadfoot, then Minister in Charge of the Valuation Department said in 1954 that his officers regarded key money as "hearsay and place no reliance upon it"'

If the behaviour bringing about the payment is demonstrably "irrational" in terms of the retail premises leasing market an attempt to factor it into valuation practice may well be doomed.

Current economic theory broadly categorises markets into different sections. One is "efficient" where all parties have equal access to market information with the result that all information about the commodity is instantly factored into the price which will then assume marketprice within the systematic movement of the market itself. This means that subsequent price movements cannot be predicted on past behaviour. Is key money market "efficient" in these terms? In order to reach conclusions on the above matters subsequent sections of this paper discuss "key money" itself, analyse instances of its payment and attempts to gauge the affect on rent reviews. The closing section summarises the findings and makes recommendations.

Tony Jones has been involved in real estate all his working life and is currently employed with BeresfordAssociates, commercial property advisors in Auckland. He holds a Masters in Business Administration completed at Otago University in 1985 and he is currently undertaking a Master of Philosophy (Property) at Auckland University.

Section 11

Before any meaningful decision can be made as to the comparability of key money with rent we need to define rent and describe its primary characteristics.

The *obligation* to pay rent flows from *a right* to occupy land. Conversely the lessor has the right to rent for his alienation of the land. Modern writers see its as "...an estate, a proprietary interest in land..... [2]

Hargreaves' writes of the right and obligation, "Today in fact and in law, the lease combines the twin features of a contract and a proprietary interest in land...".

This proprietary interest typically provides the lessee with exclusive use of the land fora certain period having known commencement and termination dates.

Probably the single most important characteristic of a lease, and therefore rent, is the relationship of the parties, lessor and lessee to one another. The contract is solely between them, payment of money by the lessee for the right of occupancy and acknowledgement of the lessor's superior title, "...payment which a tenant is bound to pay to his landlord for the use of his land"." On these grounds payment to a third party is plainly not rent cost. Unless expressly agreed the lessee is not required to make any payment other than rent.

Key money.....is typically site related and necessarily business related.

Rental must also be certain: "Both parties mustknow the time when payment is due and the amount that will then become payable."' The sum itself is not necessarily known but the method by which it will be set in the absence of agreement at lease commencement mustbeknown with certainty. An agreement to agree is inadequate.

Rental paid is typically non-recoverable by the lessee.

Key Money What Is It?

Key money is commonly thought of as a form of good will attaching itself to the *premises* rather than the business *occupying* the premises which may have its own business good will as a trading entity. This then is the first characteristic of key money it is typically site related and not necessarily business related:

Key money is a lump sum payment made by the incoming lessee more often than not to the outgoing lessee rather than the lessor and in my view can generally be considered to comprise either or both of the considerations below:

(a) A sum reflecting any rental benefit between the contract rent and the notional current market rent for the premises bearing in mind lease term, conditions, and period to run to rent review or expiry. This amount can

THIS ARTICLE WAS THE WINNING ENTRY TO THE 1991 *NEWZEALAND VALUERS' JOURNAL* ANNUAL MANUSCRIPT COMPETITION

readily be calculated using Discounted Cash Flow (DCF) techniques based on logical analysis and is therefore useful to valuation practitioners.

(b) A sum of money to gain control of the premises, often for quite a different use than for which it is currently being employed. Recent examples of this change of use abound in lower Queen Street Auckland and include an ex sport store to a record store, a china shop from a duty free shop and a number of banking type outlets from a variety of retail operations. In my view this is the element of key money that Baum says "cannot be analysed in terms of a rent saving".6

Key money in either of its forms above is referred to by Speedy as a *pseudo-good wi117* 7 with the latter being in his opinion "technically an interest in land as it arises from an interest in the land". This view is supported by Whipple' . In offering no comment on the latter element of key money I believe Speedy reflects the nervousness of the valuation profession generally about the method of trying to reconcile, applying existing land valuation techniques, a sum for "key money" established by other commercial or economic reasons. This is not an unreasonable silence for how can a valuer be expected to know the background imperatives driving the decision to pay key money. These may include, but are not limited to, personal management objectives or arational business decision based on knowledge of the purchasing entities trading "breakevens".

Key money, unlike rental, may be recovered in whole or in part via a sale to the incoming lessee.

Key money, to some incoming lessees, may be the NPV of the "opportunity loss" caused by locating in a less favourable premise.

In order to gauge these imperatives the valuer must be privy to the business objectives and strategies of those who pay key money to control a premise. This, in my view, should not be seen to be part of his brief if only on the practical ground that as an "outsider" he is unlikely to be provided such information. This view is supported by Whipple'

Appraisal of key money falls neatly into the dichotomy of valuation (market value) by the profession for its own purposes and analysis which determines worth to the individual.

The differing imperatives, and financial strength, of a range of purchasers means that their opinions of "worth" to them as individuals will vary amongst themselves. (A later section shows how differing factors within the analysis process may also provide differing estimates of worth.)

Key Money

Having determined the two components of key money and the difficulty of arriving at its composition using current valuation techniques a review of the "players" (payers and payees) is in order.

Historically key money was typically paid to the lessor as a way to maximise his return during periods of shortage of premises brought about by legislation designed to control rents, ie the Tenancy Act. While some lessors still charge key money there appears to be a much greater likelihood of key money being paid to the outgoing lessee. (The nature of this "arm's length", from the lessor, transaction would tend to indicate an element of "benefit rent" less likely to be the case in a new leasing but does nothing to explain the basis of calculation of any premium over and above the benefit.) One wonders why a lessor would charge key money in lieu of a higher rent when this cannot be capitalised to determine the asset's market worth.

Key Money Does It Mean The Same Thing To Everybody?

An earlier section suggested key money was partly payment to gain control of a particular premise. If the use to which the premise is put is altered then the quantum of key money attributable to site control or "pseudo good will" is more transparent and may be the net of the total ingoing cost including stock, plant, business good will, etc, less any recovery upon sale of same. The alternative is a single sum for vacant possession. In the former case the entire net cost to the incoming lessee is key money with the outgoing lessee receiving consideration for the various elements of his business plus possibly a key money allowance and this possibly divided into the two elements earlier referred to. Both parties therefore have different perceptions of the amount of "key money" in the same transaction!

Key money may alsobe *implied* where the premises change ownership but do not suffer a change of use. In this case key money will not be readily identifiable to the practitioner for key money will be buried in the business good will by virtue of higher profitability due to the location, or the potential for same, under new management. In this case key money will in all probability not have been explicitly recognised in the consideration.

Key money can therefore be seen to have the potential to mean different sums to either side in the same transaction. Failing a single consideration for vacant possession considerable difficulty will arise for a third party valuer, to allocate the correct proportion of the consideration for premises control which cannot be reasonably determined as business good will. The ability to "solve" for the benefit rent is simple by comparison.

Key Money - The Valuation Imperatives/Problems

In my view there are two broad schools of thought on the importance and application of "key money" in rent review considerations. One side takes the "status quo" view of case unproven10 while the other argues the payment of key money should be recognised at rent review of the subject premises, and by implication other premises. This is not a new concern for back in 1954 valuers were concerned about the "flow on" affect when "fancy prices" were paid for a key."

The latter body of valuers approach the payment of key money as a sign of disequilibrium in the retail rental market.

They argue that a true market rent will dissuade new lessees from paying any key money and by extension that the payment of key money is a sign of less than a true market rent. Mr P Young of Robertson Young Telfer, a holder of the above view, points to the current disequilibrium in the office rental market where oversupply has caused lessors to offer inducements to lessees to take up their space as the reciprocal of key money.

Both payments result from market forces at work. He claims that as rentals in office space are adjusted at rent review to take into account the value of lessor inducements to take space so should the rental on premises where an inducement (key money) has been paid to the lessor to vacate.

He suggests that this can be achieved by "decapitalising" key money over the period until renewal and adding this amount to the contract rent to provide the true "market" rent.

Pure application of this approach would have the undeniable affect of driving up rent beyond that determined in at least onerelativelyrecentarbitration12 where the proponent of decapitalisation, perhaps unwisely, did not plump for the full affect of the decapitalisation on the grounds of conservatism and was criticised by the arbitrator for so doing.

I believe few would quibble with the basic premise of the pro-decapitalisation advocates that both key money and 0 lessor inducements are expression of a mismatch between supply and demand for retail and office space. It is at this point however I detect a divergence of opinion between valuers and I suspect that it is because they sense that the mismatch applies, at least in part, to the two different "markets" of *rental benefit* and *site control.* Put another way there is not a uniform view of what the "mismatch" means, particularly at rent reviews, and more particularly *how* evidence of key money payments should be applied to rent reviews for the subject premises, and by implication rent reviews for other premises. Should, for example, a key money payment for premise "A" be taken as evidence for a review on shop "B".

The more vigorous proponents of decapitalising key money argue that the total amount of key money is a manifestation of an implied rental benefit and therefore the rent is too low by the amount of the decapitalised value of the key money payment although Baum" holds that an assignment premium (key money) does not necessarily represent solely the capital value of a profit rent, and the valuer's analysis might be made worthless as a result.

Leaving aside for a moment the portions of key money that should be decapitalised the process of decapitalisation itself must be reviewed. This necessarily raises questions as to:

1. The discount rate to be applied.
2. The period over which the decapitalisation should occur.
3. The willing lessee willing lessor test.
4. Establishing the *net amount* of key money paid if the transaction is not on vacant possession or when the existing business is continued, under new ownership.
5. The prudent lessee test.

1. The Discount Rate:

Key money is typically paid by the incoming lessee but the decapitalisation calculation is invariably undertaken by the lessor at rent review with a view to a rental increase. This raises the questions of the discount rate to be applied in the NPV calculations. Whose "cost of capital"" should be applied? The *actual* percentage variance may not be much but there may be *a disproportionate* result depending on the rate applied. Why should either party be disadvantaged in the calculation by the application of either a higher or lower "cost of capital" of the other side? Recall that "worth" to the payer will, in part, be a function of its cost of funds which are not necessarily the same as the lessor's and possibly least of all a discount rate concocted by a valuer.

2. The Decapitalisation Period:

Valuation theory has it that office tenancy inducements should be decapitalised over the term of the lease, not just until the first rent review as neither lessor or lessee seem to consider that the sum of the lessee inducement will be entirely returned to the lessor by the subsequent rent review. Assuming key money is the NPV of the rental benefit portion of key money paid this should be expected to be extinguished upon the next rent review.

In other words while the economic principles may be similar to office tenancy inducements the consequences are of a much more short run nature at least with respect to any rental benefit portion of key money paid. To decapitalise the total key money paid over the balance of the lease, in my view, implies the acquisition of a benefit and/or asset having a life past the next rent review. Pure rental benefit should be extinguished at the subsequent rent review and cannot therefore be expected to have a life past that time.

The above is confused by any component of key money not able to be directly attributable to rental benefit. This amount is Speedy's "interest in land". It can be seen as a capital payment for control and therefore should be amortised by thepayor (incoming lessee) over his period of control of the premises.

Office tenancy inducements are a direct benefit to the new lessee and in my experience are not a tradeable commodity and carry over free without payment on assignment from one tenant to another. To the best of my knowledge they are not repayable to the lessor upon lease assignmentor sublease and exist over the term of the lease which makes the application of valuation methodology of this phenomena quite straightforward.

This is not the case with key money as it operates in a different environ ment where leases often, in comparison with office leases, change hands and upon each transaction it is possible (the state of the market dictating) for all, part, or more key money than that paid to be recouped by the outgoing lessee.

This means that any key money must be broken down into two elements, rental benefit and site control or "land interest", with only the first of these being decapitalised over the period up to the next rent review. If this process is not adopted and the premises are deemed at rent review to be "under-rented" by the decapitalised amount of *both* elements of key money a subsequent recovery of key money on sale of the premises will result in the economic nonsense of the extent of this recovery being seen again as "underrentedness" and again being decapitalised back into the rental at the next review.

Let me demonstrate by an example. Assume apremise changed hands a month prior to a rent review and a new rent was set at, say, $500 UMF partly on the basis of the inclusion of a decapitalised sum of, say, $100 UMF for the "site control" element of key money paid. Suppose the premises are resold the month after rent review for the same amount of "site control" key money (a matter of capital recovery as one assumes little rental benefit will be in evidence one month after a rent review). Does this imply a new market rent of $600 UMF overnight? Without wishing to labour the point would a series of three or four, or however many, sales at the same price over a few months raise the "market" rent by $100 per UMF on each occasion? Plainly it cannot.

3.The Willing Buyer Willing Seller Test:

Whether applied to willing buyers or willing lessees, willing vendors or willing lessors, this simply means that neither party is fundamentally ill-informed as to market conditions or is not under pressure of an order of magnitude to influence a decision. It implies a "level playing field" and avoids potentially misleading evidence being taken at face value.

Implicit in the above is an acceptance that sales and leanings are made on approximations of the highest and best use of the respective property.

A later section analyses key money payments to see if some broad categories of incoming tenant tend to overly influence the level of key money paid by virtue of their analytical capacity to decide "worth" to them and/or an increased ability to pay.

4. "Key Money" Where Use Of The Premises Does Not Change:

The quantum of key money consideration becomes very visible when a change of use in the premises occurs particularly if vacant possession is granted. In these cases advocates of key money are being provided with a sign of "under rented" premises and apparent "hard" evidence to the degree of "under rentedness".

What is not so transparent however is the amount of either ingredient in total "key money" when a premises changes lessees without change to the business operation. The price in this case will be a total of stock, plant, fixtures and fittings, plus a sum for business goodwill (a sum paid to the vendor in recognition of future profit "in excess of an economic rate of return for the capital and labour employed therein" 11)

Implicit in this goodwill figure, and in addition to the actual business goodwill, may be an amount for rental benefit and site control. The problem of setting the site control element of key money in this form of transaction is that this is indirectly factored into the business goodwill. Goodwill will behigher (standard of management and goods excepted) in a well located premises position than fora poorly located one in, one assumes, much the same proportion and possibly dollar amounts, as would be paid in key money for vacant possession. If this were not the case there would be no excess demand for Queen Street retail outlets as new shops would open in areas with lower pedestrian counts and not be disadvantaged in, if this is the determinant of demand, trade.

To the best of my knowledge rentals set on an objective (market) basis, not excluding Eichelbaum's *Modick v Giltrap16* recent arbitration, do not require the profitability of the lessee to be taken into account when setting rent at review. Even if the super profit upon which business goodwill is based is generated largely due to location nobody, again to the best of myknowledge, is suggesting the higher business goodwill caused by increased profit, itself a function of location should automatically attract a higher rental. Least of all that this should be calculated as the decapitalised difference in the growth of business goodwill. Undeniably there is a growth in the unrealised value of the sitting lessee's asset which upon sale will not be termed key money. This growth will not attract decapitalisation as "key money" at rent review.

The above is a circuitous way of suggesting that if the proponents of decapitalisation of the "site control" portion of key money carried the day they would then find themselves with the very real prospect of having to determine the increased profitability and therefore increased goodwill of premises sold on a non-vacant basis in order to establish an amount to be decapitalised. This is in direct contradiction to rental review theory as is practised today where lessee ability to pay is assumed and profitability is not a prime consideration at rentreview.

The Prudent Lessee Test:

Like English laws "man in the Clapham bus" who typifies the average citizen so the "prudent lessee"" exemplifies a normal tenant. Would a well informed completely typical individual pay key money if he knew the net result of this action would be to force him to pay it again in higher rent? He may well accept this for the rental benefit portion of the payment but I think not for the balance. He will be advised to treat the payment as a capital expense which may be recovered upon subsequent sale or written off in one way or another but not as prepaid rental expense. I do not believe that a prudent lessee would pay key money if he believed the automatic consequence of this action would be to end up paying for it again through higher rent at review.

Summary

In summary this section concludes that key money is composed of two factors, the NPV of any rental benefit and an amount to gain control of the site. Put another way, it is made up of a prepayment of rental expense, albeit to the departing lessee, and a capital sum for an interest in land.

Key money also fails one of the primary tests of rent in that it is generally a payment between lessees and not between tenant and landlord.

It is similar, but not the same as office tenancy inducements in that site control portion above is recoverable upon disposition of premises where tenancy inducements are not. Key money is typically a payment to the incumbent lessee from the incoming lessee and is consequently a receipt in the hands of the former with this process being capable of any number of repetitions between rent reviews. In my view to suggest that each lump sum transaction means a cumulative rental prepayment requiring decapitalisation does not hold up as the practical result would be artificially ever increasing rents. The more practical approach is to treat the non rental benefit component as the purchase of an asset or a right to occupy a desired retail premise. This avoids the accumulation of decapitalised payments for both components of key money to commercially daft levels.

Key money also fails one of the primary tests of rent in that it is generally a payment between lessees and not between tenant and landlord. Neither is it certain.

Section III
Analysis Of Recent Lower Queen Street Key Money Payments

Key money payments occur in many premier retail shopping areas where lessees are able to assign or sublease their occupancy rights. For the purposes of this review, the study has been confined to Lower Queen Street Auckland on the basis that there were a reasonable number of recent key money transactions within a fairly tight area of broadly similar quality premises (in rental terms). The objectives of this section include:

(a) An analysis of a number of recent instances of key money payment to outgoing lessees in an attempt to determine the relative proportions of the two elements of key money (rental benefit and "site control") in each payment.

(b) Measure the findings of (a) above against actual observation of rental growth in an attempt to gauge the impact of each element upon the subsequent rent review.

(c) A test of the degree of market "efficiency". Does the payment of key money follow a consistent pattern? Significant variations in key money payments indicate a market where not all players are equally informed or where there are not sufficient deals to aid in price equanimity.

Key money payments in this study range from early 1988 to early 1990 and it is necessary to understand the general (systematic) movement in retail premise rentals for lower Queen Street over this period. This enables a constant unit of measurement for the specific market (lower Queen Street) against which individual components can be compared. Once the systematic rental growth movement of the specific market has been adjusted into a monthly percentage growth it is possible to measure a likely rental benefit component in each transaction involving the payment of key money.

The following schedule of achieved rentals provides the basis of a calculated index of retail rental movements. It is not claimed to be definitive. It is however robust enough for the purpose of this paper. The periods are asynchronous with the longer period in eastern Queen Streetrental growth being felt to be preferable to

TABLE 3(i)

Premise Location	Date	$UMF (15m London)	Period Average	Calculated Rental Growth
Queen St East Side				
				36 month review period
62	5/87	236		
32	6/87	267		
30	7/87	290		
90	8/87	282		Total
36	11/87	242	263	growth = 58.5% Mthly = 1.4%
56	1/88	275		
36	5/88	312		
94	9/88	285		
110	9/88	400		
108	4/89	400	318	
44	7/89	285		
128	10/89	375		
112	11/89	362	355	
128	mid '90	374	374	
Queen St West Side				19 month review period
105	2.89	274		
109	2.89	300	287	Total growth = 35.7% Monthly growth 1.6%
27	9/90	372	372	

what could be a skewed sample on account of size which is a likely defect in the western side. A larger number of examples may refine the result. The table above demonstrates rental growth for the period mid 1987 to September 1990.

The above table also demonstrates the fewer rent reviews on the western side of lower Queen Street, probably largely due to the very high proportion of construction over this time a direct contrast to the eastern side. There is not sufficient evidence here to confirm a reduction in the general practitioners "rule of thumb" rental differential in favour of the eastern side of some 10 to 15 per cent but a trend does seem to point in that direction. I have adopted 1.4 per cent per month rental growth on the eastern side of lower Queen Street and, say, 1.6 per cent on the western side.

Determination of average systematic rental growth allows estimation of rental benefit by multiplying the contract rent of the subject premises by the relative growth factor for the period to the next rent review. Table 3 (ii) below sets out the results of these calculations. The calculations behind the table are fairly straightforward.

Given the previously calculated systematic rental growth this table clearly demonstrates that by far the largest component of key money is not a rental benefit that a "prudent lessee" may be prepared to prepay. Rental benefit in the knowledge that had there been a rent review on the date of possession the lessor would "factor in" the extent of the annual benefit into the reviewed rent. Put another way he would appreciate prepayment of the difference between contract market rent for what it is. This is not the case for the other portion of key money because given a decapitalisation regime for the total key money paid he would end up paying for the latter element again after the review.

The second most interesting element of the calculations is the relatively tight band within which the decapitalised rental benefit falls into when expressed as an amount per square metre per annum. Simple statistical analysis of the percentage of rental benefit and the actual amount in dollars per square foot per annum shows a much tighter distribution for the latter. See Table 3(iii) (opposite)

This tighter band can be expected as most of the variability has been knocked out in the calculations leading to the es-

Table 3 (ii)

Variable Discount Rate: 17.00%

Rental Growth pa E Side: 1.60%

Rental Growth pa W Side: 1.90%

Premise	Size M2	Date	Key money	Annual Contract Rent	Months To Review	Premise "Market" Rent At Sale Date	Gross Rental Benefit	Gross "Site Control" Key Money	$ "Rental Benfit:" Total	Discounted Rental Beneft Unitl Review	Discounted Rental Benefit Decapitalised Rent m' pa
'A'	64	Dec. '88	$200,000	$157,000	18	$75,851	$18,851	$181,149	9.43%	$15,731	$161
B'	45	March '88	$125,000	$31,300	1	$31,801	$ 501	$124,499	0.40%	$ 496	$130
'C'	177	Nov'88	$500,000	$164,000	29*	$203,071	$119,071	$380,929	23.81%	$88,966	$205
'D'	75	March '88	$130,000	$62,500	21	$92,798	$30,298	$99,702	23.31%	$24,533	$183
E'	111	July '88	$450,000	$143,900	17	$198,163	$54,263	$395,737	12.06%	$45,740	$237
'F'	106	April '88	$107,000	$ 78,000	9	$92,390	$14,398	$ 92,602	13.46%	$13,153	$161
G'	204	March '88	$230,000	$155,000	27	$257,653	$102,653	$127,347	44.63%	$78,257	$161
'H'	86	Oct'89	$355,000	$90,444	9	$104,333	$13,889	$341,111	3.91%	$12,688	$194
'K'	56	1989	$ 60,000	$ 75,712	15	$96,066	$ 20,354	$ 39,646	33.92%	$17,506	$248
'L'	46	Nov'88	$110,000	$ 51,900	24	$ 75,965	$24,065	$85,935	21.88%	$18,908	$205
'M'	61	Jan1990	$215,000	$ 51,100	7	$ 57,105	$ 6,005	$208,995	2.79%	$ 5,597	$161
Avge.	93.7		$228,200	$90,386	15.90	$120,935	$38,550	$189,650	18.02%	,$30584	$190.5
Std. Dev.	573.63 9		$147,164	$44,855	8.86	$81,759	$38,919	$126,991	13.55%	$28,998	$ 33.9

TABLE 3(iii)

	Percentage rental benefit	Dollar Per m2 of decapitalised rental benefit
Standard Deviations	13.55%	$33.9
Standard error of the mean	4.16%	$10.56
Confidence Interval at 95%	27.42% 8.62%	$19.91 - $15.49

tablishment of rental growth achieved.

Analysis was also undertaken in an attempt to establish casual relationships between the primary influences of deal date, premise size, and the decapitalised $m2 of rental benefit. No significant relationship between size and dollars was established although a fairly clear trend describing a parabola between date and dollars was seen.

Multipleregression analysis conducted with the independent variables of shop size, period to rent review and contract rent produced a correlation co-efficient of 0.676036.

This means the result of the analysis is not adequate for future predictive purposes as some 33% of the key money paid was due to another factor(s). In all probability this would be largely comprised of an allowance for lease length to run.

Should future investigation prove this to be the case it will reinforce the writer's view that key money contains an element of "site control".

Ability to pay was another variable subjected to analysis as a number of financial institutions, banks and building societies in the main have paid key money over the past few years. Table 3 (iv) below sets out the business occupation of the total key money not calculated as rental benefit and referred to earlier as a payment for "site control".

TABLE 3 (IV)

Payor	Calculated "Site control" element as a percentage of total key money paid
Building Society	99.6%
Retailer	97.0%
Retailer	96.0%
Retailer	90.6%
Building Society	87.9%
Retailer	86.5%
Retailer	78.1%
Retailer	78.1%
Airline	76.7%
Retailer	76.1%
Building Society*	66.0%
Retailer	55.4%

*This lease has a demolition clause

Given the size of the sample theresults here also may be arguable but the table does demonstrate that financial institutions are slightly more evident in the upper 50% of key money payers (and may have been even more so given a less defective lease in one case) although retailers of various persuasions are also well represented.

Conclusions

In Section II it was hypothesized that key money was not entirely rent but partly rental benefit and partly a payment for site control. This was demonstrated in Section III.

Key money failed to comply with the basic qualities of rent insofar as:

(i) Its uncertain nature.

(ii) Its more common relationship between lessees (as compared to lessor/lessee) notwithstanding the fact that key money has also been an arrangement between lessor and lessee.

(iii) There is no obligation to pay key money as there is to pay rent. The decision to pay key money involves a choice. This applies to payments made to either the outgoing lessee or the lessor in the case of a new leasing.

One of the objectives of section III was to gauge the relative proportions of key money attributable to rental benefit and/or site control.

This was achieved by applying a systematic monthly rental increase from the date of the deal to the subsequent rent review to enable the calculation of the rental benefit proportion of key money which could be decapitalised. Thebalance, by default, to be deemed site control, which in my view should not be decapitalised by virtue of the capital like nature of the payment. The results demonstrate very little relationship between the prime variables such as deal date, shop size, etc. What is clear however is that, on the average, some 82% of key money payments in the sample are related to site control and not a rental benefit.

Calculated rental benefits range from some $130/m2 to $250/m2 per annum which to a non valuer would seem to be within an acceptable band given varying

The decision to pay key money involves a choice

periods to the respective reviews. The site control elements are however some 400% greater than this range to say $520/m2 to $1000/m2 and I am forced to ask myself if a prudent lessee would be prepared to pay this amount certain in the knowledge that his annual rent upon review would climb by the decapitalised amount.

The inconsistency of key money payments does not provide anything like an adequate basis for prediction with the only apparent trend being downwards with respect to the per annum decapitalised per m2 amounts.

However the variability of the lump sum payments seems to reflect various payers analysis of worth to them rather than conformity with a market value. To this extent payment of key money is random with the last payment not providing much, if any, comfort on which to predict the quantum of the next payment. A "rule of thumb" criteria cannot be established on the basis of this review.

If one assumes the affect of key money payments on lower Queen Street rentals has not affected the rate of rental growth This view can be tested by calculating rental growth as per table 3(i) on, say, a per m2 basis and comparing this against the addition of decapitalised key money to the same base. For example, if we assume rental growth to be 1.6% per month for the last 2.75 years rental per square foot would have grown from some $960/m2 to $1600/m2 which is pretty much in line with the highest of recent leasings, ie HMV.

Compare this with the $1500/m2 if the average of each years discounted decapitalised rental is added to the base. (The base is calculated as the 1/88 rental of $270 UMF London.)

Given the relatively short time frame and small sample there is reasonable co-relation between the results of these two calculations above.

The same cannot be said for adding the annual average of the "site control" element of key money to the 1989 base. This produces a total of $5380/m2 which is plainly not reflect in market leasings.

Notwithstanding the frailties of sample size this is clear evidence that the "site control" element of key money is not affecting rental growth within the subject area but that the key money element is in reasonable accord with observed rental growth. 0

Fixed Asset Valuations for Local Authorities

by B Kellett

This paper examines:

- Statutory requirements for local authorities to have their assets valued
- Purpose of the statutory requirements • Future use of the valuations
- Local authority needs
- Valuation basis for local authority assets

Statutory Requirements

The Local Government Amendment Act (No 2) 1989 set a new direction for the management of local government in New Zealand. Part XIIA of this Act states that from 1 July 1990 every local authority shall prepare annual financial reports which "include an allowance for depreciation and a return on capital employed".

The Act also requires every local authority to "adopt financial systems and reporting and record keeping procedures that are consistent with generally accepted accounting

Brian Kellett, C.Eng, MIMechE, MIPENZ, is an Associate of Beca Carter Hollings & Ferner Ltd, where he leads their team ofPlant andMachinery Valuers: He is Chairman of the Northern Branch of the Institute of Plant and Machinery Valuers.

This paper was presented at the Institute of Plant and Machinery Valuers seminar held at Auckland on 16 March 1991

Key Money - continued from previous page

Section IV
Is There An Alternative?

In my view key money is not entirely rent in a different guise. Some is but the largest proportion of it is rather an "interest in land" or site control. Key money payments are a result of a mismatch between supply and demand and their continued payment is a function of anothermismatch between value and worth. The valuation profession grapples with the former and the payer establishes the latter.

There is a good deal of oil and water here and I don't think the problem will disappear until the environment in which such payments are made is changed. This environment is partly within the lease document itself and is reinforced by the valuation professions reliance on precedence.

To a layman there is a catch 22 quality to the argument of some senior valuers which essentially says that "as decapitalisation of key money has not been previously accepted as a valid evidence of market demand it will not be considered".

I believe however that the profession may avoid having to come to terms with the decapitalisation issue when more lessors alter the terms of their lease documents in such a way as to deny the possibility key money payments between lessees.

Key money only exists because the lessee can transfer his rights of occupation to a third party. Remove that right and you remove key money at a stroke. Taking away the long term control of the premises takes away the "site control" element of key money. It is naive to believe that lessors will not move to this form of lease in order to maximise rent and consequently the market worth of the asset. Market efficiency will see to it! !

An increasing number of leases in lower Queen Street are now structured on the shopping centre model where leases are personal to the lessee and must be returned by him to the lessor upon cessation of business with the incoming tenant taking up a new lease at a reviewed rental. Because the connection made possible by assignment or sub-lease between the two lessees is broken, key money becomes a thing of the past. As more lessors adopt this form of lease construction the problem for the valuer of mixing value and worth will be progressively removed. Decapitalisation will not be an issue even where key money has been paid because adequate market information will be available at review where new leasings have occurred at market rents where leases have reverted to the lessor prior to reissue. Put another way there will be ample evidence of new market leasings without the need to engage in decapitalisation exercises of doubtful value. A

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practices recognised by the New Zealand accounting profession as appropriate and relevant for the reporting of financial information in the public sector."

Objective Of The Act

The aim of the Act is to improve performance measurement and accountability of local authorities. In the past the public sector used cash accounting systems which showed how much had been spent or received but not the real cost of producing the service or the real value of the assets employed.

Local authorities are now required to adopt accrual accounting systems which show the value of property and equipment and include allowances for depreciation and appreciation. The new accounting systems will enable local authorities to monitor performance and plan for the future by assessing the success of various activities and allocating the appropriate resources.

Use Of The Information Produced

To enable an accrual accounting system to accurately show the true cost of output it should be based on a valuation of assets at a true value. The valuation will not only provide a basis for the accounting system but can also be used as a management tool for the following:

- to decide which facilities should be retained or disposed of,
- to determine future capital expenditure;
- asset management plans;
- basis for sale of business;
- asset basis for formation of Local Authority Trading Enterprise LATE;
- feasibility studies for potential business enterprises;
- the measure of security offered by Public Entities for the raising of loans;
- assessmentof rental or leasing charges.

Local Authority Needs

The value of fixed assets owned by local authorities usually represent a significant portion of the capital employed. It follows that depreciation amounts, which will be charged in each accounting period, will have a significant effect on the authority's cost of output. It was against this background that local authorities have made efforts to produce fixed asset registers which would show these assets in a full and complete manner as required by the Act.

Fixed Asset Register

The first stage of determining the value of the fixed assets employed is the compilation of a fixed asset register.

> The aim of the Local Government Amendment Act (No 2) 1989 is to improve performance measurement and accountability of local authorities

Some local authorities did not have accurate detailed asset inventories. Many acquired assets as a result of amalgamations and changes in boundaries. Asset transfer documents rarely gave information in sufficient detail for entry to an asset register. While this was not important when financial reporting was on a cash accounting basis the change to accrual accounting would require accurate inventories and valuations of the fixed assets.

Inventory Of Fixed Assets

The fixed assets of local authorities should be listed under the following three groups in the asset inventory:

- Tangible assets
- Intangible assets
- Community assets

Normally all tangible assets will be included in the assetinventorybutwhether or not intangible assets or community assets should also be included should be decided by the local authority.

Definition Of Fixed Assets

The New Zealand Society of Accountants defines fixed assets as assets that:

(a) are held by an entity for use in the production or supply of goods and services, for rental to others, or for administrative purposes and may include items held for the maintenance or repair of such assets; and

(b) have been acquired or constructed with the intention of being used on a continuing basis; and

(c) are not intended for sale in the ordinary course of business.

While this definition clearly applies to tangible and intangible assets it does not define community assets. Community assets therefore should be considered as an addition to the fixed asset register and not part of the register. The following gives some guidance to the type of assets which could be included in each group.

Tangible Assets

Tangible assets comprise assets which have physical substance and could include:

> Most valuers will be of the opinion that there are few fixed assets which cannot be valued

- Land
- Buildings
- Bridges
- Wharfs
- Dams
- Roads and hardstand
- Forests
- Water and sewage reticulation systems
- Street lighting
- Libraries
- Quarries and landfill sites
- Vehicles
- Plant and Equipment
- Office furniture and Equipment

Intangible Assets

Intangible assets are generally defined as long-term items not having physical substance and this group could include:

- Easements
- Patents
- Copyrights
- Franchises
- Licences
- Intellectual property
- Good will
- Discount on acquisition

Community Assets

This group of assets which are held by local authorities and are called community assets should be differentiated from other fixed assets.

The Statement of Public Sector Accounting Concepts (SPSAC) suggests that community assets can be characterised as being:

- used directly by the community at large;
- infrastructural;
- of an environmental or cultural nature;
- unable to be sold;
- non-substitutable.

These assets will be reported in the local authority's Statement of Resources but may not be reflected in the Statement of Financial Position. NZSA Exposure Draft ED/TGB-4 states that "community assets are to be reported in physical terms (eg number, size and quantity). In considering whether financial value should be reported for an asset, the overriding question is whether a value would have meaning."

Most valuers will be of the opinion that there are few fixed assets which cannot be valued in financial terms and that most community assets should be valued on the same basis as other fixed assets.

As the criterion which defines community assets depends on public policy the valuer should ask the local authority to specify which assets they require to be classified as community assets.

Degree Of Itemisation

The degree of itemisation of assets in the register should be considered carefully to ensure that future needs are catered for. Too much detail will make the register unwieldy. The level of detail should be adequate to show clearly the value of significant assets and should be easily modified to allow for future additions and disposals. Minor items may be grouped together and valued globally but the cut off point should be agreed with the local authority concerned.

Assets which attract different depreciation rates should be listed separately. For example, the following are some building services and fixtures and fittings which should be listed as individual items and not be included in the value of the building:

- Air conditioning and heating systems;
- Floor coverings;
- Fire alarm systems and sprinklers;
- Inner fixtures.

Valuation Basis

At present there is more than one basis for the valuation for fixed assets for financial statements but the Act did not give guidance on which basis would be appropriate for local authority assets.

It is common practice for assets to be carried in the financial accounts at either:

- Historical Cost, or
- Modified Historical Cost

In some cases government valuation of land and buildings have been used in local authority financial reports. One local authority published their accounts for the year ending March 1989 stating that "assets were capitalised in the books of account at their insurance indemnity value as determined by valuers... who were commissioned by council to do so". The use of government valuations and insurance indemnity values does not provide a proper basis for the valuation of public assets for reasons which are explained later.

Historical Cost

The value of assets in a historical cost accounting system are recorded at cost on the date of acquisition.

Historical costs and current replacement costs should include:

- invoice price net of any discount
- import duties
- broker's or agent's commission
- legal fees
- survey costs
- site preparation costs
- installation costs
- engineering and architectural fees
- freight costs
- commissioning and testing costs
- financing costs

Recoverable taxes (eg GST) should not be included in the historical costs.

Estimates will be required to assess the historical cost of assets for local authorities who do not have accurate records showing the initial cost of all of their assets.

The assessment of the historical cost can be done by first determining the current replacement cost of the asset and by using inflationary indices regress this cost back to the date of acquisition. Cost inflationary indices for building and civil construction material and labour in New Zealand can be readily obtained from Department of Statistics publications. Obtaining indices for assets sourced overseas requires more research but libraries and foreign embassies are good starting points for this search.

Having determined the historical cost and acquisition date for the assets the valuer can then apply appropriate corporate (or tax) depreciation to the assets and produce corporate (and tax) book values to incorporate in the asset register.

Modified Historical Cost

Under the modified historical cost system the NZSA Exposure Draft 50A recommends that long life assets such as land and buildings be revalued systematically, preferably on an annual basis.

The Draft also recommends that "The Valuation should be prepared in accordance with the New Zealand Institute of Valuers (NZIV) *Asset Valuation Standards.*

These requirements are necessary in order to provide the required degree of reliability before the Valuation can be recognised in the financial statements. The revaluation of a fixed asset should normally be at *net current value...".* The definition of *net current value* is given as "the price at which an asset might reasonably be expected to be sold at the operative date, less the cost of disposal that could reasonably be anticipated".

The NZIV Asset Valuation Standard relating to the valuation of fixed assets for financial statements is covered in Guidance Note No 3 as it applies to the Valuation of Land and Buildings and Guidance Note No 10 as it applies to Plant and Machinery. In brief these standards state that "the value of a fixed asset for financial statements is the lower of-

- net current replacement cost, or
- the recoverable amount.

The nett current replacement cost of land and buildings should be assessed on the basis of-

- value in the open market, or, where a market value cannot be assessed,
- depreciated replacement cost.

The nett current replacement cost of plant and machinery is usually assessed on the basis of-

- depreciated replacement cost, or, where suitable market evidence is readily available,
- the cost of acquiring in the open market a similar asset with the same remaining economic working life as the existing asset, plus an amount equal to the depreciated replacement cost of the installation of the existing asset.

The emphasis is on the open market value for land and buildings but on depreciated replacement cost for plant and machinery.

The reason for the different approach to net current replacement costs is that the sales of similar items of plant and machinery having the same remaining lives is uncommon whereas the selling price on the open market for comparable buildings orparcels of land is morereadily available.

The recoverable amount is the amount that can be received from the continued use of the asset over the remainder of its useful life plus any residual net realisable value.

The valuer will take into account the existing use of the asset when determining net current value.

If an asset is not being used for the purpose, or to the capacity, for which it was designed and built then the netcurrent value will be based on an asset designed and built for the existing use.

Government Valuation

Many local authority properties are designated for a specific use (eg parks are restricted for recreational use only). The value for government valuation purposes is based on the market value subject to the designation. The designation can be regarded as a restriction on the use of the property. In which case it has the effect of reducing the value.

However, consider an example of a local authority acquiring land required for use as a water reservoir. Compensation would be based on the value of the land

> The emphasis is on the open market value for land and buildings but on depreciated replacment cost for plant and machinery.

with all its potentialities assuming the designation does not exist. Conversely if a local authority decided to dispose of land designated for use as a reservoir the designation could be uplifted prior to the sale.

The writer's opinion is that for designated land it is the replacement cost on the open market, and not the government valuation, that gives a true value of the asset for financial reporting.

Insurance Indemnity Value

Although the use of insurance valuations may save some costs the results can be misleading and do not accord with generally accepted accounting practice. Generally the use of insurance indemnity values fail to provide a proper basis for the valuation of public assets for the following reasons:

a) Building and structural assets are tied to a particular site and location. The suitability or otherwise of the location affects the market value but is ignored by the insurance indemnity value.

b) The remaining useful or economic life of the asset together with the future likely maintenance costs directly affects the market value but is not typically taken into account in an insurance valuation.

c) The current market demand for the asset or its suitability for the designed purpose is not taken into account in the insurance valuation.

d) No account of the rental value of the asset is included in an insurance indemnity value but is generally crucial to its market value.

Insurance Indemnity values are typically produced in order to meet the requirements of the Earthquake and War Damage Act 1944. Indemnity Value is the Reinstatement Estimate reduced by depreciation factors established from the asset age and condition.

The Reinstatement Estimate is typically the estimated cost of rebuilding the property including the use of currently equivalent building materials and techniques and such additional costs as are necessary to comply with an Act of Parliament... or By-Laws of governing Public Assets for the valuation of Local Authorities.

Insurance Indemnity certificates may be produced by architects, quantity surveyors, engineers as well as registered valuers.

Not all of these groups are qualified with respect to market valuations.

Conclusion

Assets which are carried in the accounts at historical cost quickly become undervalued because of the effects of inflation. It is, therefore, recommended that assets which have a long functional life should notbe carried at historical costs but should be revalued regularly.

Along with annual operating costs the depreciation allowances applied to the value of fixed assets provide the entity with the basis for measuring the cost of its outputs.

This cost will then be used as the basis for establishing the proper price to charge for the outputs or services. The cost of outputs is also the mechanism by which efficiency comparisons will be able to be made between other public and private sector organisations producing like services. It is important that the approach to assetvaluationsbe made on comparable bases in accordance with recognised standards endorsed by the relevant professional bodies. A

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Foreign Investment in New Zealand's Rural Sector

by R M ottra m

Next to the welfare state itself, probably no other topic engenders the emotion and taps at the very heart of what we believe to be our sacred right than the question of overseas ownership of parts of rural New Zealand.

Yet just as we accept the now urgent necessity to cut back in our expenditure and roll back the cost of welfarism in NZ - with all the painful changes in attitude that that requires so too are New Zealanders coming to terms with the reality that as a primary producing nation we are seriously undercapitalised.

The benefits of foreign investment to New Zealand can be considerable.

From an economic point of view freer lfows of capital improve the efficiency of both the economy investing and the economy receiving the investment.

Take the example of a country like Japan with the comparative advantage of advanced technology combining with a country like NZ whose relative expertise is in natural resources.

The combination provides a benefit to both countries unavailable to either country on its own, and yet Japanese investment into NZ has declined in the last two years. In 1989 NZ was the only country out of Australia, USA, Canada and Ireland to show a decline in a year when global Japanese investment increased by 44%. Comparison of investment between these five selected countries in relation to trade, GDP and population indicates that NZ is either the lowest or second lowest recipient in all cases.

New Zealanders are coming to terms with the reality that as a primary producing nation we are seriously under-capitalised.

If NZ attracted its proportionate share of investment, annual direct investment would amount to between US $300-400m, compared with the current level of US$100m.

A great deal of misinformation is disseminated that overseas investment somehow dilutes a country's sovereignty. There is absolutely no evidence to back up this claim.

World markets are becoming increasingly integrated and all countries are becoming more dependent. Foreign investment therefore has to be a positive rather than a negative factor given this powerful international trend.

And from an employment perspective the benefits are very obvious.

A Taiwanese investor immediately comes to mind. He recently bought a debt-ridden property in the Bay of Plenty for $1.2 million.

The debt in the property at the time was $ 1 in. To date he has spent $1 million upgrading and restocking. He has built another home on the property. All the capital expended has been spent in that community. In short he has revitalised the rural community-given it areal kickstart so badly needed.

The fencers, the builders, the farm manager, the stock agents the stock firms, the fertilizer company and soon. They've all benefited. The only funds he can take out of the country are tax-paid funds he's a real contributor.

A Japanese consortium comes to mind. They've purchased a station in the Central North Island. It is the first of probably five or six stations they will buy. Their objective is to build their own meatworks, develop their own breed of stock and process the meat for the Japanese market.

In both cases we're talking long-term investors. On average a 10% or less return in the short to medium term will satisfy them. In the long term who knows what innovation and development they will introduce to lift that return- not to mention local employment.

Despite popular mythology we do not hold world preeminence in agricultural technology. Those investors bring with them technological advances that can only benefit productive capacity overall not to mention their highly sophisticated management techniques.

Frequently the investor wants to produce to export back to his country. Again the benefits for New Zealand need little explaining.

Before I outline some of the impediments to foreign investment in the rural sector and focus on these negative issues that need to be addressed, it may be helpful if I profile for you from our experience the overseas investor, what he's looking for, where he comes from and what he in return wants from New Zealand.

Roy Mottram is co-proprietor of New Zealand Rural Investments Limited. He is a director of Bay Milk Products andRangitaki Plains Dairy Company and has been involved in New Zealand;'shorticultural expansionfor a period of ten years. During the last two years in his rural investment company he has serviced genuine enquiries from offshore interests seeking long term investments in New Zealand.

Again, some sacred "cows" or myths will be dispelled in this process.

Currently the rural investors come in the main from SE Asia, Japan and Europe. They are highly successful, capital rich individuals or members of consortia. To date they are not large in number because, contrary to popular belief, the rest of the world is not queuing up to buy into NZ's rural land.

Few even know where we are. (My partner and I have made six overseas trips in the last 12 months marketing NZ we do not sit in our Queen St offices with a drafting gate!)

Despite popular mythology we do not hold world pre-eminence in agricultural technology

Those who do know NZ and have knowledge of the lifestyle and aesthetic benefits are frequently put off by the negative press we receive with regard to changes in public policy and perceived inconsistency in policy direction. (We are repeatedly asked if policies will change again!)

And so it is the tenacious and determined overseas investor who places NZ on his list of potential destinations.

I emphasise these are discretionary

This paper was presented at the NZIV Seminar held in Christchurch town hall on 23 April 1991

investors weighing up several options in several countries. Put another way, we're competing for their investments - primarily against Australia and Canada. And I must add, to the European investor we are 36 hours away Canada, a mere 6.

To the investor intending to export NZ grown product, distance is undoubtedly a negative factor but frequently outweighed by the sheer beauty and tranquility of the NZ rural landscape once they arrive.

Not so, however, the difficulties this investor finds in dealing with our producer boards.

Many Asian investors have retail or wholesale businesses at home. Their dream of producing highly specialised primary produce for their markets at home is shattered by the intransigence of the single seller closed shop producer board. We're talking about highly processed finished product.

To the Asian nations of traders this monopoly situation is particularly difficult to understand. Why can't he supply his retail chain in Hong Kong with his NZ grown product?

One client is purchasing a boutique vineyard to market his wine under his own label. With this industry he can do this. Another, as mentioned, his premium specially processed beef.

But any dairy-based product is prohibited unless he works through a Dairy Board agent. To the Asian trader the mandatory middleman is an anathema. I strongly recommend a greater degree of lfexibility on the part of our producer boards.

A serious impediment to offshore investment in our rural sector would have to be our taxation regime.

It would be fair to say, New Zealand is not regarded as a competitive economy by international comparisons. We are regarded as lacking economic and financial dynamism, industrial efficiency, an international orientation to our marketing and a degree of political consistency.

I have no doubt industrial efficiency and productivity will improve with new labour laws and that in turn will bring a much needed dynamism to the domestic economy. That will not, however, address the international market perception regarding our competitiveness in the short term.

A serious impediment to offshore investment in our rural sector would have to be our taxation regime.

Undoubtedly Roger Douglas introduced his tax regime with an overall tax rate of 22% to 23% in mind. On that basis anybody paying tax in NZ would pay on the whole of their income worldwide whether the funds were repatriated or not. We all know the 22% rate did not eventuate but the new tax regime remains in place. Apart from Australia, who followed the NZ model, nowhere else in the world does this tax law apply.

So as an offshore investor planning to live in NZ, I am liable to pay NZ tax on my worldwide income. This is a major negative factor to the investor. The NZ tax regime urgently needs to be made sympathetic and comparable with other countries overseas.

Taxation should apply at the point at which the funds are repatriated to New Zealand.

I am repeatedly told that this law is impossible to police and recovery depends solely on the honesty of the individual therefore the advantages to NZ are negligible but as a disincentive to the potential investor it ranks very highly.

Finally - on my negative list - I must highlight the general lack of professionalism the overseas investor encounters when, having weighed up the impediments, he decides to buy.

We urgently need new and higher standards of precision with budgets 0 and cashflows. We must be scrupulously thorough with detail. A couple of pages of forward projections will not do.

These are long-term investors. They do not want a quick return. They think in 10 and 15 year cycles. They want to know in advance if facial eczema is a likelihood over that period, for example. That must bebuiltinto thebudget. Similarly drought, lfood or whatever other projections. They want detail - thorough and honest assessment and *all* cards on the table from the outset. We are seen as friendly, lovely folk who are quite simply slack.

There is a huge business cultural gap between our country and those offshore. We need to demonstrate patience and skill and professionalism. We need to be observant enough to understand the makeup of the Asian or European mind.

We need to present our information to them in a form they understand. Our traditional way of presenting information is not always understood. We have to tailor the information to their needs and present it in a fair and positive way.

In short, we need to know how to market ourselves to the customer. It's called understanding the customer. It's basic.

I repeat, these are discretionary investors. We are not god's gift as a destination or investment prospect and we should quick smart wake up to this fact.

Maybe we should even remove the ministerial override to these rural investment decisions and simply lay down the criteria and let the Overseas Investment Commission get on with its job.

Again, the ministerial influence smacks of "godzone mentality" and does little for overseas reputation when we have a thoroughly professional and efficient Overseas Investment Commission in place to protect our national interests.

In short, we have a lot to learn. We are giving outconfusing signals. Quitefrankly, they wonder if they're welcome - if foreign investment is what NZ wants.

And finally, when they wait months and months and months for the NZ Immigration Service to process their applications for residency and junior immigration officials interview from a position of mistrust and suspicion, I have to say their concerns are confirmed.

For those of you convinced by my case that offshore investment is a critical component in getting growth back into NZ's rural sector, you will no doubt be sharing our frustrations at the impediments we as a country place in its way.

You will probably be asking yourselves why, in the face of these difficulties, we attract any investors at all.

My response should give you heart.

To the European farmer seeking to relocate, New Zealand's competitive advantage can be summed up in two words - clean and green.

It's the Chernobyl syndrome that they are fleeing. It's difficult for us to appreciate just how devastating the potential for radioactive fallout can be for the European - let alone for the European farm product.

Imagine testing your milk or your stock or your crops for radioactivity.

GENUINE
NUCLEAR FREE
NZ COW

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Imagine a country where products are clean and free from chemical pollution or free of the dreaded growth stimulants so prevalent in the Northern Hemisphere.

Imagine a coastline free from the horrendous oil spillages destroying European coastlines.

While the European farmer is exercising his imagination, we must be aggressively marketing just these advantages NZ offers. This is our most valued and valuable marketing tool our isolation. It is the primary reason why the European looks to invest in our rural sector.

Unquestionably to the Japanese rural investor New Zealand falls somewhere between paradise and nirvana on their scale of countries they want to reside in. The sheer physical beauty; the accessibility to mountains, lakes and forests, the crisp clean air; and the blinding clarity of the light and absence of industrial noise are the reasons.

Few New Zealanders realise that Japan, with a population of 124 million still preserves 75% of that land mass in farm and forest. Such is the priority that Japanese place on their environment. Such is the extent of the congestion for the population residing on 25% of the available land.

To the Japanese one's natural environment and the balance of man with nature is the very embodiment of the Japanese soul and spirit.

We offer it in bountiful abundance. The only difficulty, I have to say, is the NZ property must be no more than an hour from an airport. And in addition, as one client said to me recently, "and I don't want those windmill planes either." He means no Friendships, only jets please. The return from this investment will be very much a part of a long-term strategy.

The investment will probably link into other investments elsewhere. He will not be budgeting for a quick high return he will be thinking at least 10 years out. He will expect the very highest standards of management and professional support. The Taiwanese, Singaporean or Hong Kong Chinese investor will be less mesmerised by the beauty of the countryside and more focussed on the sort of return he can expect off the investment short and medium term.

He will be looking for quality of performance. But again he will expect high standards of servicing.

He will also want permanent residency. Thepolitical instability facing HongKong and to a lesser extent Taiwan will be a real factor in his decision.

The European investor is frequently relocating from one farming property to another. He will bring with him skills and technology and a work ethic we should be wholeheartedly embracing. He too as I have said will be influenced significantly by environmental factors.

But it will not be sufficient for NZ to rest on her natural resources and expect the funds to flow in.

I believe we need to develop a foreign investment strategy for our country and I believe we need to do it now.

We must market our investments skillfully and professionally, we must introduce greater flexibility into our producer boards as a priority, we must demonstrate the increasingly competitive nature of the NZ economy, we must reform our draconian tax regime and we must stop assuming we know what the offshore investors wants from us and become market and customer responsive. We must have a strategy with targets and a regime that rewards and doesn't turn away.

The more I travel, marketing the investment opportunities here, the more I am reminded how fortunate we are to live here.

But like you, I know the NZ that provided us with so many opportunities in the past will not be the NZ providing our children with those same chances, unless we get smart and truly open our doors to the capital and innovation the foreign investor can bring. We can all share in the benefits - including your sector of the rural economy. A

Shopping Centres Development

by A Sewell

Developers What Is Their Role

A property developer is essentially an entrepreneur who uses knowledge of property investment, the property market, business requirements, local body bylaws and town planning ordinances to put together property solutions to the accommodation needs of tenants and owners. Developer = Deal Maker.

The developer operates more in the tenant market than the owner-occupier market for it is here that the greatest opportunity to create an investment exists.

It is by creating an investment in property whose cost is lower than the perceived market value that the developer makes his money.

An astute developer works from a well planned strategy brought about by a thorough knowledge of cost and value of property. Many would argue that this leads to an emphasis on cost driven low quality developments which enhance the developers profit but leave problems for tenants and investors. This was probably the case in the mid eighties at the height of the property boom but the surviving developers have learned the lessons and know that to survive what is required is quality at a reasonable cost.

Developers of successful shopping centres are usually specialists in that field with a thorough knowledge of retailing from both the operator, customer and property investor viewpoint.

Developers: Where Are They In 1991

The pre-1987 boom in the New Zealand property market saw a massive influx of "developers" into the New Zealand Property market. The majority of them were drawn into thebusiness by the lure of "overnight" profits, and the opportunities to produce property investments in a market with an apparent never ending supply of tenants and investors.

The results of the 1987 crash and the subsequent 1988, 1989, 1990, 1991 downturns are well known to all of us. The winners at the end of all this madness are the company receivers, the losers are the developers, financiers, and the property industry which now has a reputation lower than that of the secondhand car industry.

If we cast aside the pages of ill informed comment which we find in the property pages of our newspapers, sometimes written by reporters normally reporting on the racing page or the children's page who move into the property section when there is nothing else to do, and take a more educated look at the market. There are several points that have never changed.

1. Strength of tenant essential
2. Quality of legal documentation the lease
3. Quality of building appropriate to its use
4. Location
5. Market rentals/market price

Shopping Centre Development In New Zealand

Shopping centres were first developed in New Zealand in the early 1960s. They copied American centres and were based around food and department store anchors with a range of-other retailers. The developers were normally institutions or centre managers or a combination of both. This period saw centres open mainly in Auckland and Christchurch.

Development continued slowly through the 70s and 80s but many of the older centres were becoming run down as investors saw no advantage in investing further funds in centres which in the main were controlled by head lease arrangements which provided no real incentive to the investor.

Retailing in New Zealand at this time was strictly controlled by import tariffs. There was little choice of product and retailing was very ho hum.

The late 80s saw things change. Tariffs were removed, new retailers established, people travelled and saw what was available overseas and began to demand better products, service and in the end better shopping centres.

Approximately 10% to 15% of retail sales in New Zealand are made in shopping centres. In Australia the figure is approximately 46% and in USA 68%. This is a fairly clear indication of where things will go in New Zealand. Retailers have recognised this and are now actively seeking shopping centre retail opportunities.

It is this change in retailers' attitudes,

Tony Sewell is Business Development;; Executive for Downer Group Limitec' based in Christchurch. He has worker in various roles in the property deveh. opmentfield including carpentry, niirysurveying, project managernen ontracts managemer,

and customer perception that is driving the current moves in shopping centre development.

Recent research has shown that a K Mart with a supermarket and approximately 20 specialty shops can survive on a catchment of 40,000 people.

Our research has shown that there are currently 40 retail projects in New Zealand that could be developed in the next three to five years. That represents approximately $800 million in property investments available in New Zealand. Our biggest problem will be investor funding for these projects.

Shopping centre development remains a field for experts and there is a wide range of issues which must be fully understood for a developer to be successful.

We will now look at what a developer does to put together a shopping centre development, using South City Centre, Christchurch as an example.

Shopping centre development takes time and money in large doses. The average centre is two years in the development phase before a site is purchased so a long term view is essential.

The first step is:

1. Research:

   If you start any further ahead than the research stage you are wasting your time. I

This paper was presented at the NZIV Seminar held in Christchurch town hall on 23 April 1991

If you haven't researched you will have to do it all again.

1.1 Citywide Research

To establish clearly:

- Existing centres, their size, their catchment, improvements planned, turnover levels, customer counts
- Town planning issues
- New developments in residential
- Population movements

This research will show any gaps that are occurring in the catchments of existing centres and it is from here the opportunities arise.

In the case of South City it was clear that there was an opportunity in the Southern Zone. Customers in an arc from Lincoln Road to Linwood had inadequate shopping facilities. Barrington was becoming tired and redevelopment was delayed by town planning.

Sydenham was also becoming tired, St Martins was too small and Linwood provided the eastern boundary being a relatively new centre.

Our decision. Look at the Southern Zone.

1.2 Demographic Research

We employed consultants to carry out a demographic study of the Southern Zone to establish the following information:

- Population
- Household number
- Age spread of population and family make up
- Household income level and expenditure levels
- Individual income level and expenditure levels
- Traffic pattern
- Existing shopping patterns

This information was analysed to provide the following information:

- Potential centre size
- Potential turnover
- The pitch of the centre
- An indication of retailer types
- Special features looked for in centres

Further research was carried out to identify secondary catchments, eg the rural sector, other parts of the city.

From this research we confirmed there was a need for a centre to service southern Christchurch. It had to be approximately 15,000m2, with adequate car parking and it had to have a middle lower pitch aimed at good value family shopping. There was a growing emphasis on shopping ceasing to be a chore and some entertainment value was required. With a large family based population and an above average spread of younger children some form of playground was seen as an advantage.

Research Into Retail Investment

Very little is known about retail investment in New Zealand. Most of the centres were owned by large institutions who keep their investment information confidential.

When assessing South City the major criteria was size of investment. From our research and market knowledge we considered the largest investment that would attract interest in Christchurch would be $30 to $35 million. This decision limited the size of centre we would develop and effectively ruled out the potential for including a K Mart within the development.

Guessing on cap rates was crystal ball gazing but we made assumptions based on other investments available at that time and our projections on how the centre would perform.

Tenancy Demand And Rental Levels Research

To establish that there were retailers in New Zealand that were thinking the way we were who would lease space in acentre to serve the south of Christchurch, we visited them with our demographic research and asked questions. The response was excellent.

To establish therental levels welooked at rental levels in other shopping centres in Christchurch and from this information we established our average rental level.

Site Research

Potential sites for a centre were sought out. The parameters were:

Location	within the Southern Zone, preferably central
Size	approximately 3 hectares (7 acres)
Zoning	commercial or capable of justifying a zone change
Topography	flat
Access	major road frontage
Tenure	freehold
Ownership	as few owners as possible to enhance chances of total purchase.

From this research the following sites were identified.

1. Barrington Mall-existing centre plus additional land
2. Beckenham - adjacent to existing shops
3. Sydenharn Mall-existing centre plus adjacent land
4. Sydenham industrial zoned land
5. Railway Station land
6. Andrews and Bevan, Newmans site
7. Sucklings, Smith City Limited
8. Whitcoulls Printpac site

Feasibility Analysis-Stage One

The feasibility analysis is the basis for all budgetary and financial control on the project.

The first stage was a reversionary assessment to establish what price could be paid for land and what budget figures could be used for the construction of a centre. It became obvious from these studies that there was an optimum price for the land which if increased meant less money for the centre and if decreased either more money for the centre or more margin.

From this initial study we could see a centre was feasible enough to proceed with site selection and preliminary design.

The Project Team

The next stage was to assemble a project team. Our experience has proven beyond doubt that there is no substitute for expertise. The thought of saving on fees paid to advisers is often tempting when you think you can do it yourself but it is a very short term view which could cost you dearly in bad decisions and repeat effort when things go wrong.

Developing a shopping centre is a major undertaking over a reasonabl y long period of time. To succeed you must have teamwork.

Our team was made up of the following:

1. Architect
2. Engineers - structural, civil, mechanical, electrical, acoustics, fire protection, traffic
3. Legal advisers
4. Surveyors
5. Quantity surveyors
6. Retail consultants
7. Centre managers
8. Valuers
9. Project management
10. Construction/Buildability
11. Research/demographics
12. Foodcourt consultants

I make the following commentary on our consultants.

Architects:

With the greatestrespectforNew Zealand architects, there are very few with adepth of experience or understanding of retail design. Several have recently formed alliances with Australian, American or Canadian firms but we must remember a borrowed company name is no substitute for having experienced the work yourself. No doubt several firms are now on a very fast learning curve which will produce genuine expertise in time. But a few centres developed will be the true test.

We opted to look at Australian architects and we chose Hames Sharley International.

There were three major reasons for the choice:

- We felt they understood retail business and had a good understanding of the basic issues of layout and interior design.
- They had established an office in Auckland.
- The personal chemistry seemed to work and we thought they would fit well into a team.

They were employed on a lump sum basis to carry out the architectural design and supervise the works from a quality point of view as well as being the architect to the contract in terms of the Conditions of Contract between ourselves and our contractor.

Engineers:

Structural/Civil: We had worked with Alan Reay Consultants Limited on a number of projects and from discussions with our architects on the fundamentals of the design we thought his knowledge of tilt panel construction would be of benefit to the project. He was also employed to design the car park and drainage requirements for the centre. Employed on a lump sum basis to design and supervise the structural and civil works he was another consultant who worked well on our team.

Mechanical: This was our biggest worry. Has anyone heard of or seen an air conditioning system that really works? Following advice from our project managers we employed Tony Thompson from Auckland. To his credit we have a system that not only works but it is also cost effective to operate. He was employed on a lump sum basis to design, supervise and commission the air conditioning system including tenancy works.

Electrical: I thought all you needed was a wire to a switchboard, a few switches, power points and lights and you were in business.

No one told me about substations; power correction factors; soft start motors; bulk buy electricity. Now I know thanks to Pedersen and Partners. After a few hot sessions at the start we now have an excellent electrical system using bulk electricity.

Acoustics:

What do you need acoustics for? When your mechanical fan room was to be above specialty shops adjacent to the mall it was cheaper to get good sound advice than have to issue our customers with loud halers. Marshall Day did this work for us on a lump sum basis.

Fire Protection:

We opted for a design build on fire services. Initially Wormald worked with us on a punt basis to look at our options and prepare a brief. This brief was checked by Beca Carter who also vetted the tenders and negotiated the changes we required to bring it up to our standards. Wormald were the successful Design Build tenderer and performed creditably on this project. Beca Carter were paid a lump sum for their services. Once again the comfort gained by having experienced independent advice had its advantages.

Traffic:

When you have a projected customer count of 30-40,000 persons per week and a 600-car capacity car park which enters and exists off the main central city street, you need advice on layout, entry and exit locations, traffic flow, taxi stands, bus stops and last but not least local authority negotiations. We employed Traffic Design Group. They did an excellent job.

Legal Advisers:

There is only one way to go. Get the best available. They will costa fortune but will save you thousands by keeping you out of trouble.

You must get experts in the shopping centre field. They must be experienced in the following areas:

- Land purchase, subdivision/amalgamation of titles
- Contracts of employment for consultants
- Retail leases and their negotiation the Anchors and Specialty
- Building contracts
- Centre management agreements
- Company law and taxation

We used Kensington Swan from Wellington. We received excellent advice and timely service.

We now have good leases, a completed building on a site with suitably amalgamated titles, owned by a single asset company.

Surveyors:

Our surveyors were required for the following:

- Boundary definition
- Checking of contractor layout of the buildings
- Title amalgamation
- Nett lettable area survey

Our surveyors were Davis Oglive and Partners who were employed on a lump sum basis.

Quantity Surveyors

Someone had to give us an estimate of cost and then be responsible for ensuring that the design was carried out within the budget, to prepare the schedules of quantities, negotiate with the contractor, check the progress payments, agree the variations and final account, and prepare the taxation depreciation schedules. This was the quantity surveyor's job, Malcom Timms and the Rider Hunt Team did a fantastic job, and to their credit the job was brought in on budget.

Retail Consultants/Centre Managers:

I have bracketed these two consultants together. Their job was, in association with the architect, to establish the retail mix and tenant positions and in conjunction with the developers to establish base and percentage rentals, to lease the specialty shops, set up the centre management and take the centre over at completion to manage on behalf of the owners. Their two roles were joined together on the basis that by being responsible for leasing they would manage their own mistakes.

H G Livingstones were employed on a lump sum basis as retail consultants and on a percentage basis as centre managers. The retail consultancy was carried out with excellent results. The management is in place and to date we are very satisfied with the results.

Valuers:

We needed advice on land values as we accessed our prospective sites. The most objective advice must come from valuers. They have access to sales data, and can comment on market trends.

Fright Aubrey were our valuation advisers for the development of the project. They were employed on a lump sum fee basis.

Project Management:

A term used for anyone from computer operators to foremen. What we wanted was someone to co-ordinate this team, referee the fights, reward the effort and be responsible for bringing the project in on time, on budget, fully leased to the best tenants with the right tenant mix and when they had done all that put up with our constant harassment and appease ourconcerns. We employed Keys Preston Maskell who did all of these things, as well as bringing their own expertise in retail and centre management to the project.

You will note I left programming

out of the above. Overall development programming was one of the project manager's essential tasks as they couldn't achieve the goal without it. But when it comes to programming the building works, I firmly believe this is the contractor's job. He has to know how to manage his own resources and isn't this part of what he's paid for.

C onstruction/B uild ab it ity:

There is no point in designing something that's difficult to build especially when you are in a hurry. I believe in getting the builder on the team early. We did this with maximum effect. Downer Construction were members of the project team from day one. Commenting on aspects of the design and suggesting alternatives where appropriate. When it came time to build the centre there were very few surprises on the drawings. They provided this service free of charge, no doubt because they were to be negotiating the contract.

Research/Demographics:

There is a wide range of consultants in this field, but check their track records before employing. Axis Consulting did this work for us. They were employed on a lump sum basis for the task. Their report was very comprehensive and provided the basis for our initial decisions on this project.

Foodcourt Consultants:

We had decided to put a foodcourt into the centre. Our architect had some experience but we needed more expertise on equipment, menus and operation. Having sought submissions from consultants in New Zealand as well as Australia, we employed Retail Planning Associates of Melbourne. Andrew Chambers, Rod Stefan and Francis Loughan carried out research into food likes and eating habits in Christchurch. They established a design, an equipment schedule, a menu and an operating manual for the foodcourt. As well as this service, Andrew Chambers' expertise in retailing was used to good effect to recheck our thinking on retail mix. To our team's credit he confirmed our proposals.

They were paid a lump sum fee for their services. Without doubt, this was some of the best spent money on the project.

PR Consultants:

For the centre to be successful we needed our tenants and customers to know all about it. We employed Collins Communications and Aspex Consultants to promote the centre. Both consultants had some marvellous ideas and it is to their credit that the centre opened a roaring success.

One of the reasons for the success of this project was teamwork. The other was the clause in the consultants employment contract which was put in on the insistence of our project manager, David Keys of Keys Preston Maskell. This clause stated that all consultants were employed COB. I can explain that OB meant On Block. I will leave the rest to your imagination. If it was found you were responsible for a mistake the solution would be the removal of part of your anatomy. Needless to say the meat cleaver was not required.

Site Selection And Purchase

With our architect and engineer employed and our research completed we began the task of site selection. Each site was evaluated in depth to establish our best option.

The process involved a basic design and feasibility study to establish if the site had the potential. It became clear in the very early stages that the Whitcoulls Printpac site had its advantages.

Barrington Mall
- town planning problems, ownership and lease problems

Beckenham
- too many owners, town planning problems

Sydenham Mall
- not enough land, adjacent land too expensive, town planning hassles

Sydenham Industrial Land
- too many owners, land developed as industrial, too expensive to purchase

Railway Station land
- difficulty in achieving control, town planning problems

Andrews and Bevan/Newmans
- not enough land, too many owners of adjoining sites, access problems off Madras Street; potential problem of separation from South Zone by railway

Sucklings Smith City land
- not enough land, poor access off Moorhouse Avenue; total site area not available; some owners difficult to deal with; potential problem with separation from South Zone by railway

Whitcoulls site
- potential problem with separation from South Zone by railway

The Whitcoulls site was chosen because it offered everything we wanted, town planning approval, main road frontage, potential purchase of additional land.

Some of you may think the purchase was brought about through our relationship with Whitcoulls through our ownership by Brierley Investments. This was not the case. We had ruled this site out 12 months earlier during preliminary assessments. But the persistence of a local real estate agent who drove home the virtues of the Colombo Street frontage convinced us to assess the site again.

We secured the site with a conditional contract. In essence the contract was conditional on the centre being viable and our board of directors approving the scheme. In all it took nine months to confirm the contract following extensive reviews of design and in-depth financial analysis.

Our initial studies showed the project to be very cash flow sensitive in relation to finance costs. We opted to make our offer to purchase based on settlement two months after the planned completion date. We had researched our vendor well and reached some assumptions as to his bottom line price and what deferred settlement would mean to them. We agreed upon a price and timing which appealed to both parties.

We had previously optioned a small site in Bath Street owned by the Crown. We exercised our option and purchased the site and settled at the start of the project.

We had secured our total land holding with only two purchases - a great advantage.

The Design Phase

Preliminary Design: The preliminary design went through several schemes but all were based on a simple philosophy.

1. All the activity in a shopping centre is inside and the number of entry and exist points need to be controlled to give the retailers every chance to secure the customers.
2. The overall design has to allow for constant change on a 5-year cycle over the life of the centre.
3. Decoration was an important factor. In essence you can buy a lot of flags, banners and other decoration for $10,000. You don't get much timber framing and gibboard finishes for that price.
4. The centre had to be a low maintenance structure with outgoings capable of control.

At this stage we had had discussions

with the potential major tenants who included Foodstuffs, (Pak 'n' Save) - Magnum, (Countdown) - Mace, (Woolworths Big Fresh) Deka, Dress for Less.

Two preliminary schemes were developed.

One a Big Fresh, Deka, Dress for Less, with foodcourt and specialty shops, the second a Countdown, Dress for Less, with foodcourt and specialty shops.

The result was the centre very much as it is today.

The preliminary design was established as a team effort between architects, engineers and the developer. In hindsight we should have had the total team together earlier to take part in the initial decisions.

An estimate of costs was prepared by the quantity surveyor and the contractor. They were within a few percentage points of each other.

Feasibility & Financial Analysis:

The next stage was an in-depth feasibility study and financial analysis, to establish the viability of the proposals.

Accurate feasibility studies were carried out to establish a clear budget for the project. These were then transferred into cash flows. I cannot overstress the importance of cash flow forecasting in establishing the viability of a project. Its affect on finance costs can make or break a project.

The next stage of the analysis included a discounted cash flow analysis to establish an internal rate of return. Our project was to be internally funded. To obtain funds it had to prove itself to be a good use of funds.

The next stage of the analysis was a performance analysis over a 10-year holding period. We needed to know how the project would perform as, investment, whether we retained ownership or sold the project. This understanding of the investment we believed was critical.

All these studies were taken through several layers of sensitivity analysis to check and recheck the figures and to establish clearly which factors had the greatest effect on the project.

These semitrades included:

- Rental growth, interest rate, refurbishment costs at 5-year periods
- Changes in tax rates, increases in construction costs, lower rental levels, yields on sale.

All of these analyses gave us greater knowledge of this project and a clearer understanding of the factors that would make it succeed or fail.

Approval To Proceed

We had negotiated lease agreements with the anchor tenants and our research had shown that there were no buyers in the market for shopping centres who would purchase off the plans.

We now had to convince the directors that the project should proceed on the following basis:

1. Anchors leased
2. No specialty leasing
3. No buyer commitment with the potential for ownership of the centre for up to 10 years.

A full report presenting in detail most of the information discussed so far was presented to the directors for approval in principle.

Agreement was reached in November 1989 but a significant change had occurred.

It was obvious that a war was beginning among the major grocery operators. All of them fighting for market share. Two of the major players were relatively cash rich. Magnum with Countdown, Mace with Big Fresh.

One of the most important aspects for any developer is to minimise risk. We decided a sensible way to divert part of the risk was to insist that one of the grocery majors provided 50% of the equity in the development.

We proposed a joint venture agreement to both Mace and Magnum. They both responded positively.

In the end a joint venture was established with Magnum on the basis of a 50/50 joint venture company. South City Retail Limited was formed to develop and own the centre.

The proposals were reanalysed and a report forwarded to the directors of both companies. Approval to proceed was finally granted on 23 December 1989.

The consultants were appointed and a programme established. We were to open for business in the second week in November 1990 with the 15th being set as a tentative date. To achieve this we had to commence construction work by 22 February 1990.

Tenders were called for the demolition of the buildings which covered 80% of the site. A demolition contract was let on 23 December and demolition commenced that day.

The project team agreed to the design programme which required permit documentation to be available by 22 January 1990. With some grumbling we agreed to forget Christmas holidays and work through, meeting at weekly intervals to review the design. At each stage of the design the drawings were agreed and signed off to avoid the potential for constant unnecessary change.

A schedule of quantities was to be drawn up and a contract negotiated with Downer and Company Limited by 20 February to allow them to start on site on 22 February.

I believe it is an opportune time to talk about negotiated contracts. We chose this method because it gave us the following advantages we could get the builder on board early and get early commitment to the programme, as well as the advantage of his advice on construction methods and buildability.

We negotiated a margin to cover profit and off site overheads at day one. All sub trades were put to tender, the only components to be negotiated were concrete, carpentry and preliminary and general costs. This represented about 30% of the total costs of the works. The rates for this work were well known by the quantity surveyor so the negotiations proceeded without too much hassle. We had the advantage of working with a contractor and project team we knew and trusted. The result is now history. Project built on time within budget. The final account agreed within three months of completion. If we had gone to tender we may have saved 1 % or 2% but at what cost, through claims for extensions of time and increased costs. The potential for conflict between builder, consultants and developer would have been introduced. We definitely would not have been the winner. By negotiation we had a fixed price contract with performance time and cost under control. We had eliminated another risk.

Finance

As a part of a major company, Downer Development did not seek finance for its projects from thebanks. Our projects were funded through an in-house treasury. Each application for funding was judged objectively against any number of proposals seeking funding. In the end it was the value of money over time or the IRR that was the determining factor.

In more recent times we have moved towards the use of external funding. We are becoming more and more involved in joint venture arrangements with other developers or investors or in a consultancy role in assisting other developers or investors with these projects. Our expertise has become a marketable commodity.

In the majority of these cases bank funding is a requirement. I must say I 0 am dismayed at the attitude of our financial institutions. Most of them are still shell shocked and reeling from the effects of the 1987-91 crash and the constant line up of ghosts which jump out of any cupboard and filing cabinet to haunt them.

I have very little sympathy for the banks, having seen the calibre of their lending criteria in the boom where financial analysis and risk assessment was practically non existent. It is no wonder many of them were so badly hurt.

But do all developers have to be tarred with the same brush? Recently I have seen well thought out projects with excellent risk assessments and financial analysis either turned down by banks or offered finance on conditions that can only be described as draconian.

When will the banks start to employ either personnel or consultants that have a thorough understanding of the property market? This problem is even greater when we come to retail development.

To be fair, I cannot strike a blow at all financial institutions. I have had excellent dealings with some but sadly they are in the minority. To have bankers complain to me about the bad risks in development based on their experiences of projects, that the majority of the astute property people knew were suicidal at the time is nothing but an insult to the survivors of the property crash.

If you have a project which returns 17% to 22% why would anyone want to put in their own capital? Provided the cash lfows are secured by leases to substantial parties, where is the risk. Inmost cases the banks insist on a capital injection by the developer who when the project is completed and operating for say 12 months, refinances the project based on a valuation in many cases for an amount greater than the cost of the project. Where then is the logic in turning the project down for 100% debt funding in the first place?

As I quoted earlier in my paper there is approximately $800 million worth of retail developments available in the New Zealand market.

They all need development finance with the majority also requiring investor funding. If the banks concentrated more on sound property investments and less on high interest rate credit card type lending, the outlook for all of us would improve.

On the positive side my best advice when seeking finance is to make sure your presentation and analysis is accurate and well set out. Cash flows must be accurate, agreements to lease must be binding and not open to interpretation. A wide range of sensitivities need to be carried out to establish the areas of true risk. Perhaps with more of this information on hand the banks will better understand our business.

To finish this section a short comment on merchant bankers.

If you don't understand finance, don't get into development. Merchant bankers hauling your scheme around the institutions seeking funding will produce pages of computer printouts and a dictionary full of financial jargon. If your project is good enough to put your resources into why do you need someone to hold your hand when you go to see the bank.

Construction

The success of the construction phases of any project is dependent on the following:

- The contractor
- The consultants
- The developer

There is no truer expression than the saying: "You only get what you pay for."

Shopping centres are major undertakings. To be successfully completed you need a contractor who can effectively manage resources. The majority of centres will have construction costs of between $10 and $50 million. To manage projects of this size with the complexity of design and sophistication of plant and equipment will require the contractor to have a competent on-site team including project manager, quantity surveyor, quantity control personnel, subcontract and supply management and programming staff. Successful completion includes the finalising of the account and the presentation of quantities and as build drawings.

There is a tendency today towards project management or subcontracting all the works. As long as someone has ultimate responsibility and liability when things go wrong, OK, but beware. When the roof leaks because the air conditioning guy left a hole who's responsible? If the toilets block on opening day because the concrete truck cleaned out over the sewer manhole, who do you get at to fix it? I like the comfort of suing one party the bloke you had the contract wi th the builder.

Leasing

The Majors:

Lease terms and conditions for majors in shopping centres are well established. They are all based on a nett lease with base rent and turnover rent provision. Some concessions on operating expenses are given dependent on the anchor's perceived ability to pull customers to the centre. Most concessions on operating expenses are met by some form of additional charge on specialty retailers.

There are some new moves afoot currently and I suspect they have come from across the Tasman where anchors are seeking turnover only rentals, complete fitout by the lessor, rent free periods, and no operating expenses.

I would suggest that agreeing to their terms is taking on board unnecessary risks. Remember it is the developer or investor's capital. If the operators want these conditions they may have to put up the investment capital themselves.

The Specialties

Leases:

Once again stick with the industry standard lease check the credentials of the tenant. Guarantees are very important in the 90s following the collapses of the 80s.

Stick with your retail mix plan. The retailers will all disagree but it is your centre and if it is well thought out you will attract the tenants you need.

Put a copy of your lease with your agreement to lease. Agree to all the terms and conditions at that stage. Leaving item s open to negotiation later will cause problems.

Stick with one rule. No signed lease no shop on opening day.

Tenants Work Guide:

Prepare a comprehensive tenants work guide. This will explain clearly the respective obligations on fit out and centre operations leading up to opening. For the centre to be properly integrated you must approve all fit out designs.

Items to be particular about include: air conditioning, electrical, shop frontallowance, floor loadings, water supply and waste outlets, security arrangements.

Foodcourts

Foodcourts are new to New Zealand. There are very few experienced operators. Expert consultants should be employed to design the foodcourt. The majority of operators cannot afford to fit out to the required standard. To overcome this at South City the developer fully fitted out the foodcourt.

We offered the operators an 18 month licence to occupy with a base rent and a percentage rent which reflected the level of return we required on our equipment.

We insisted on control of the menu, recipe, and pricing structure. We set standards of dress including a uniform and standards of cleanliness.

We can dismiss the operators with one week's notice.

At the end of the 18-month period, we can grant the operator a lease, we will not charge key money and will. sell him the plant and equipment at book value.

This is the only way to keep control of

Residential Subdivision Development

by C Wilson

What makes a land development successful? Simply this - like most pursuits in this world, to become successful requires hard work. And development is no exception with most of that work being done before the bulldozer starts. The intending developer has to find correct answers to the following:

- Is the location correct?
- Will the market support this land cost?
- Where is the opposition, is the area over supplied?
- Is there an unknown opposition subdivision in the pipeline?
- What are the development costs?
- Does the subsoil structure hold any "unknowns"?
- What are the council's requirements?
- Will the council require service upgrade charges?
- Will the council require cash or land for Reserve Contribution?
- Is the section layout design correct for the targeted market segment?
- Should there be any sections allocated for units? If so, what ratio?
- What building covenants should be imposed?
- Is the right market segment for the area being targeted?
- Has a realistic construction critical path analysis been formulated and accepted?
- Is the marketing strategy right for the present market?
- What time span is required for the sections to sell?

Once it has been ascertained that all the above and many other factors are within the acceptable parameters in the feasibility study, the intending developer can be quite confident in buying the land and starting the subdivision. While the development is in progress, the management analysis work continues.

- Do the contractors work specifications reflect exactly the design requirements?
- Are the contractors getting enough supervision by the engineers?
- Are the contractors *keeping up* with the critical path analysis?
- Have services reticulation power, telephone, sewer, etc been connected to the mains supply? (often overlooked)

Chris Wilson is the proprietor of Suburban Estates Limited. He has been involved in land development in Christchurch for more than 15 years.

Valuation Aspects

That brings me to aspects of residential subdivision that vitally concern valuers and developers alike.

1. Section values (the most crucial area)
2. Development costs
3. Profit and risk percentage

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This paper was presented at the NZIV Seminar held in Christchurch town hall on 22 April 1991

this new feature of our shopping mall. Finding the right operators is difficult once again there is no substitute for expertise.

Publicity And Promotion

For a centre to succeed from opening day the potential tenants and customers must know what is going on. For this to happen you need a good PR campaign.

The campaign mustbetargeted at your potential tenants in the first instance and your customers secondly.

We went through a range of publicity stunts from contract signings, mid winter on-site barbeques, celebrity row hand prints, mayoral visits, topping off ceremonies, to a grand opening including a champagne breakfast. The centre name and logo was the toughest assignment. All this PR was good fun with the result that the centre was well known by opening day and has traded well since. One small note of caution you can never allow enough in the budget for PR.

Opening

There is nothing like the panic build up to a centre opening. Most of the retailers start their fitout about two days before opening with the whole show in a state of panic right up to opening.

It is said that someone always thumps someone the night before opening, but in our case everyone was too busy to worry about that. The last shop fitter left at 4.30 in the morning. The champagne breakfast started at 6.30. The centre opened at 9 o'clock and has roared its head off since.

The opening must be appropriate to the centre and should be a spectacular event. Shopping centres are supposed to be fun places; this should be the theme.

Ongoing Management

Shopping centre management is a specialist field. From a development point of view we needed experts who would get the best out of our centre to enhance its trading performance.

We sought submissions from three well known and respected shopping centre management companies. H G Livingstones were appointed based on their local knowledge, experience and track record.

Sale

It would be very difficult to write a paper on successful shopping centre sales in New Zealand. There is very little evidence of sale.

To successfully sell a centre it must be marketed effectively. To do this there needs to be a well designed brochure which will introduce New Zealand, the city the centre is in, and the centre itself to the prospective purchasers. This must be backed by a thorough dossier of information on the centre.

The agents appointed to sell the property should know and understand retail investment. As the most likely buyers are offshore buyers, your agents must have international connections and clear ability to deal at that level. You must establish a fairaskingprice-don'tgive the project away but don't ask too much. This decision is very difficult when there is little sales evidence. Your advisers must have a thorough knowledge of offshore investor requirements when they offer advice on these matters.

Shopping centres are specialist projects that must be sold by experts. A

Section Values

Please interpret the value, don't set it.

So many times valuers have interpreted a momentary upward trend as a long term one. However in many cases the trend has started to dip and by the time the sections are on the market, the prices bear no relation whatsoever to the original hypothetical section values. What that means is artificial inflation and disservice to the client. And if your clients are mortgagees they soon lose their sense of humour not to mention, possibly, their mortgage. Records show that over a period of 30 years in Christchurch section sales have shown remarkably regular upward and downward swings. Of course, back in the days of high inflation, we were relatively safe: rampant inflation covered the sins of valuers' and developers' misinterpretation. Nowadays inflation won't take care of large margins of error.

You may say, "So what if we set the value of the sections slightly higher than the market? The market is sure to catch up with the hypothetical value; it will give the block a higher value and the clients will be happier." Unfortunately, no!

Let's see what actually happens. Recently my company finished a project that had set some good prices in that area, but there were reasons for that: the design, size, tree studded sections and the market was peaking when they were sold. However when a very ordinary neighbouring block was valued, the valuer set a value around $15,000 higher per section than the best in the area had produced. Well of course his client thought Christmas had come early! He was overjoyed at the newly perceived value of the block.

But what happened then? As *so often happens!* The upward trend had peaked, section sales were slowing with an accompanying softening of prices. Our company was approached to buy, we submitted our prices which of course bore no resemblance to the new perceived high value. The owner then approached other developers who offered prices in the same region as ourselves. By the time the client realised he had been misled, the market had dropped even further, *and so had the block's true value.*

So who lost out there?

- The client lost. His chance of getting the original market value came and went.
- The developer lost we lost a possible project and had to suffer the client's opinion that as developers we were trying to rob them blind.
- And the valuer lost. He is now thought - by both client and developer to be incompetent.

How as a valuer can you keep abreast of trends? Simple. Three words

Research, Ask, Listen.

Get the opinions that will enable you to *interpret* the facts you work with. Now that may sound like teaching grandma, but in my experience, valuers - of all people don't do it nearly enough.

And talking about getting the facts. Let's go back to a previous example. Our sales had set new prices in an area. And a very reputable, supposedly reliable firm was asked to value a block in close proximity. Of course, because of the recent sales, they used our project as an example of how they arrived at the value but they did this without contacting our company at all. When I saw this valuation I could hardly believe it: the sale price was incorrect, development costs way out and sales time span a complete fantasy. The whole valuation could only have been more divorced from reality if it had been written by Hans Christian Anderson. *And a simple phone call could have got it right.* I wonder how their client would feel if they knew.

Communication with developers, real estate companies, even lawyers, in some form is essential. The coal face is the only place to find out about the supply and cost of, and demand for, the coal. As a development company, market or trend analysis is the absolute cornerstone of our business. To this end to guarantee that we are keeping abreast of the trends, we do the majority of our selling ourselves. Sure, we may save on some commission, but it's the only method by which we can be positive that we're getting accurate feedback from our clients ie the market (to calculate the demand or lack of it).

As valuers you are often under pressure to have the highest possible value. You do have to be positive, but I urge you to take into account that these days for every surge in demand there's going to be an almost equal drop. So I say again, please interpret values, don't set them.

Development Costs

The majority of development block valuations I have seen have been only adequate concerning development costs. However, with the margins being squeezed, with inflation down to 2% or 3%, with the tightening of the market, and if for no other reason than for the sake of accuracy, *the valuer must be more precise with his or her development costs.*

Reserve Contribution

It was straightforward when the reserve contribution was 7.5% cash or land, no "ifs" or "buts". However we now have the black cloud of the *Land Management Resource Bill* looming on the horizon.

The Bill was first introduced just 16 months ago, and the National Government has confirmed its intention to pass it by the first of July 1991, although it has appointed a review group to report on the *workability* of the Bill.

I believe, and I know there are a lot out there who agree with me, that it is possibly anti-development, lacking any strategic focus for forward planning and having the potential to cause unnecessary delays and costs in the implementation of projects. To be fair, some see the Bill as a "necessary response to the recent, rapid social and economic change, which has resulted in a greater concern for the environment with greater accountability being required".

But no. In some respects the first draft of the Bill is a bit like the *Titanic.* The second draft is the rearrangement of the deck chairs. But whichever way you view this Bill, the facts are, *at present:*

1. There are no *proposed quantitative limits* on the amount of land for reserves or reserve contribution. (Councils will set their own standard under their District Plans.)
2. Compensation will only be paid for esplanade reserves where they are in excess of 20 metres wide and the councils will not now pay for the related survey costs.
3. The current position whereby a more general financial contribution may be asked for, other than merely for reserves, still remains.
4. The current position whereby a contribution may also berequired towards infrastructure costs such as services upgrades, still remains.
5. Resources consent may be necessary for many subdivisions, with an associated increase in costs.
6. Cross lease developments will be treated as subdivisions with an associated increase in costs.
7. There are no proposed limits for financial contributions that a council can require a developer to pay, other than they have to be in accordance with their district plans.

In our experience, most councils are usually rather enthusiastic when it comes to asking land developers for financial contributions, therefore one would assume that this will continue.

As far as valuers are concerned, I believe it most important that you keep abreast of the passing of the Bill and the associated ramifications concerning Council related development costs.

Soil and Foundation Test

The soil and foundation test is often overlooked. A slight oversight? Don't you believe it. It can be catastrophic.

I know disclaimers concerning engineering, etc are usually written in a valuation report, but it doesn't alter the fact that overlooking the soil and foundation test can cause you to drastically underestimate the development costs.

Recently my company was negotiating to purchase quite a large block on which a valuation had been completed with as usual no soil test. The block was purchased, development commenced, and then we discovered a stream. Now was this a delightful little brook meandering its way through the buttercups and adding delightfully to the value of the land? It was not. It was an underground stream. It cost us $150,000 extra in earthworks.

You can imagine what that did to the valuer-client relationship. And what would have happened if we had been using all borrowed monies with small margins? Well, to say that the mortgagee would have been *disappointed* with the valuer would in my view be something of an understatement.

Fortunately, in this case, the possible damage was minimised because we had done our homework.

Soil and foundation testing should be mandatory. Quite simply, it could be the difference between profit and loss.

Marketing and Presentation

Marketing and presentation are often the most underestimated direct development of land development..

I don't believe that global pressures have fundamentally changed the market. But *they* have changed our marketing and the level of sophistication of the marketingprogrammes-andtheamount of money allocated by developers to their marketing budgets. Why? Not so long ago, you sold developed lots by knocking up a signboard and throwing a few ads at the local rag. If you were a high flier, you produced a cheap, one sheet diagramatic layout with a catchy phrase or two on the bottom.

Today, even the planning and design stage is influenced by the marketing strategy. One must have the socio-economic group segment targeted and then plan and design accordingly. The market has to be identified before the section value is finalised and block value deduced.

Now we formulate the concept proposal, basically to illustrate the marketing/promotional effort necessary to attract prospects.

From there we identify the relevant location marketing factors often divided into both advantages and disadvantages. Forexample, primary, secondary and tertiary educational facilities, and if relevant highlight accordingly. Next, a logical sequence - promotional elements, creative strategy, media strategy.

And finally, when all of the above has become a lean and compact formulation, marketing strategy can be implemented.

The days of allowing a couple of dollars per section for advertising have long gone. In medium to tough times I would allow approximately $750 or 1% to 1.5% of the selling price per section. It may seem high - it is not, especially when you compare it with other industries that also sell to the public where a figure of between 5% to 7% is the norm.

Profit and Risk

That brings us to profit and risk. You could call "profit and risk" the challenge, the spice, the agony or the ecstacy or simply what it's all about. It's a single allowance made for the elements of profit and risk. It's the percentage of the outlay thattakes into account how *difficultor easy* it may be to develop a subdivision and sell the sections.

I must say at this point that, in my opinion, the ease or difficulty of subdividing should not be a factor in deciding the profit-risk percentage. If you have investigated the block correctly the ease or difficulty will be known, *reflected in development costs, and therefore no risk.* It should be a known component.

What percentage to use? Well, 25% has a nice ring to it. The courts think so too, having often judged it as acceptable. So it is used in probably three out of four block valuations. Twenty-five per cent may be correct for the *average* market.

There is a problem with that of course. Reality is the problem with that! Have a look at a market graph and you will see that the average market is applicable only about 10% to 20% of the time. So our 25%-most-of-the-time theory becomes very questionable.

Years ago there must never have been any unusual risk. In 1959 Judge Archer in *Cook v Queen* says, "Nor do we agree that any such figure as 40% or even 30% is usual or recognised to be the proper figure (of profit and risk) in New Zealand." With all due respect to that Judge, it appears he was implying that a lesser amount was the proper figure.

But six years later, thankfully, some developments must have developed more risk elements. That same Judge commented in *Minister of Works v Green and McCahill,* "It would be wrong to regard 25% as the `usual' or'normal' allowances for profit and risk, though it would appear that this figure has been frequently adopted by valuers when assessing subdivisional values. *The appropriate allowance in any case must be assessed to its own particular facts."* End of quote. In other words, *decide every case on its own merits.* Ironic, isn't it? How often we need a judge to state what should be common sense.

In good to boom times, if we allowed 25% we would never be able to secure a block. Competition and demand soon sorts out the acceptable percentage. It could be anything from 14% to 20%. Of course, because of the good times, the sales will be buoyant, so your risk is considerably diminished. So, in theory and in practice, you are still on a level playing field. In a recession the oppositeis true-atpresent, depending on the block, we could be allowing anything between 30% and 75%.

Every block is different and the profit-risk percentage allowance should be investigated on that basis. Don't get caught in the 25% blinker syndrome. It's useful to remember "the allowance for profit-risk is finally determined by the equilibrium of supply and demand".

The Future

Predicting the future is nothing new to us of course, that's partof your job and mine. And in our case the crystal ball demands a careful look at present trends.

I have never had so many qualityblocks of land coming across my desk for sale as there are at the present time. And for the first time in many years the vendors are showing realism in the opening asking price. This *does not* in my opinion reflect a residential development market where everybody wants out. It does however, reflect two underlying maladies.

First, the degree of "banking backlash". You see it in the lending criteria mortgage lenders are now demanding for any type of development or entrepreneurial venture. And many developers would rather sell the undeveloped block than subject themselves to the "rigid" controls that the banks are setting (of course, time and common sense will correct this problem).

Second, the siege mentality adopted by financial and legal circles. They lack confidence. They're suggesting that everybody cash up at all costs. And surprise, surprise, there's a detrimental rippleeffect throughout the market. This absurd level ofpessimism ispuzzling. Afterall, around the late 70s and 80s it took 10 years for productivity growth to double. But it has doubled again in the last four years. And deregulation and competition have brought big improvements.

New Zealand already has the least distorting tax system of any OECD country, the most liberalised financial markets and probably the most independent central bank. Soon it could also have one 0

Compiled by Leonie Freeman

Shopping for Accounting Software?

by R Turner

his question begs a few more questions, the issues and answers to which, are the subject of this article.

Business organisations are currently experiencing the rough and tumble of changing economic times. Fluctuating activity, sharper competition, changing cost structures are causing business managers to put key areas of their organisation under the spotlight. In particular, accounting information systems are now being looked at to provide a faster and more timely response to performance issues arising out of the performance of the business in terms of marketing and selling of products and services, productive capability, service quality and profitability.

Planning For The Future

Valuation practices, like other professional services practices, are partof this business scene, even though they market and sell time rather than products. Most professional practices have computerised accounting systems in place which do a competent job at"bean counting". In other words, they provide a platform for time recording and billing, managing debtors and collections, and calculating profit.

...continued from previous page

of the most deregulated labour markets and one of the most efficient welfare systems- a free marketeconomist'sparadise.

I believe that, provided the world and New Zealand economies do not suffer any more shocks in succession so as to further erode confidence, the New Zealand residential development market should remain on the present level (albeit subject to local cyclical trends) which is still, considering the other property, equity and bond markets, *relatively* healthy.

However, I must stress that all developers and valuers should take care to ensure that they retain objectivity in what may become an over supplied environment, due to lack of demand which is the logical spin-off from lack of confidence in our overall economy. A

Most of these systems have been sourced from standard software packages geared for a commercial environment but "tweaked" to cope with the particular need to manage time rather than product.

The requirement by business managers forbetter information is now outpacing most of these accounting systems solutions and many practices are already giving some thought to the sort of systems that might be required for managing a practice through the nineties. There is undoubtedly a temptation to immediately go out and shop around for more up to date accounting software but this should be resisted until a number of other factors have been considered.

Increasing emphasis has been placed on businesses being strategically placed for the nineties and many large organisations, including professional services practices, have invested considerable time and effort in developing strategic plans. These plans are developed from the answers to three issues - where is the business now, where does it want to be in the future and how will it get there? The business goals and objectives are analysed and defined, critical success factors are determined, and plans are developed taking into account market positioning, competitive advantages, organisation and management structures and information systems needs. Information systems are used in this context as a collective description for all business related systems including those with an accounting emphasis.

Relating the information systems needs to the business goals and strategic plan has therefore become a fundamental requirement for all businesses to ensure that the competitive advantages that they seek will be achieved. One hears and reads a lot these days about the use of information technology for competitive advantage. This has been interpreted by many to mean that investing in up to date computing facilities will automatically bring forth a competitive advantage. True, one may achieve a smarter or faster way of getting

Robin Turner is the information systems partner of Ernst & Young chartered accountants at Wellington.

a result but there is no guarantee it will support the organisation's objectives. So the message is Plan first.

Planning for your next information systems upgrade or replacement does not have to be an expensive and time-consuming exercise even for smaller organisations. However, the plan should be prepared in a formal structured way to ensure that the investment required to upgrade the systems meets current and future anticipated information needs. The main ingredients to this process which have been mentioned above (ie business strategies and plans, critical success factors, organisation structure and activities, etc) are analysed to define the information requirements of the business. In addition the information systems principles are defined, current systems are evaluated, and short-term improvements identified. The results of these activities contribute to the development of alternative solutions along with an appropriate cost benefit analysis of the options. A migration and implementation plan would also be produced to indicate timings and resources needed to put the desired option in place.

Such a plan would provide management with a sound basis for deciding on the appropriate option and making the necessary recommendation for funding of the information system upgrade or replacement. Following approval, a request for information and/or proposal can be prepared seeking input from suppliers on the various options available in the marketplace.

More detailed analysis mayberequired of the information needs in order to clearly communicate the requirements to suppliers. The remainder of the process involves selecting an appropriate software fit to the requirements, remembering that package solutions may only provide a 65% to 80% "fit". Depending on the criticality of the system to meet certain business objectives, consideration may be given to developing a bespoke software solution.

This is not a decision to be taken lightly as it can prove time-consuming and expensive.

Accounting Information System Requirements

Having established a logical approach to the problem of addressing an organisation's information systems needs, it is appropriate to turn to the issue of what valuation practices could, or perhaps should, be looking for from their information systems in the future. Given some key assumptions on the management and operation of a practice (eg, maximise profitability, provide a high quality and responsive service, look after employees) the systems will need to focus on the management of:

- employee information (staff, partners)
- client information (organisation, activities, contacts)
- marketing information (prospects, contacts)
- assignment information (time and cost, billing)
- financial information (debtors, creditors, general ledger, budgetary control)

Employee Information. Employees include all partners and staff whether directly engaged on client servicing or on administration activities. Details required range from the obvious name, address, remuneration and benefits, leave entitlements through to career development details, curriculum vitae details (qualifications, work history, industry experience) and other personal data such as marital status, contact details, date of birth, etc. Information from performance reviews and evaluations can be appended to this store of data.

Client Information. The data required for this area comprises organisation name, location, activities, structure and brief history, relationship to other organisations, communication points (mail, fax, telephone), individual contacts and position.

Marketing Information. Similar details about prospective clients (organisations and individuals) and Industries/ Markets are required to support a practice's marketing activities. These activities often result in the production of mailing and contact lists for the targeting of service and product information by way of brochure, newsletters, seminars, client briefings, client and prospect entertainment. The key issue here is the one of targeting, and the ability of the system to be "searched" for particular groups or types of clients/non-clients is important. Analysis of industry/market data assists in this targeting process.

Clearly the above repositories of information will not be static. There will need to be some way of handling the dynamic relationships between the information categories, eg employees know or work on clients, prospects become clients, client contacts move between organisations, organisations become part of other organisations and so on. The relationship can be complex and the system must be structured to ensure that the information can be updated easily and also provide straightforward access to extract the required information in summary or detail form. Database technology provides the key to managing these issues but care is still required over the design to ensure the desired relationships can be achieved.

Assignment Information. For organisations that "sell" time, a good time and cost system is critical to staying in business. Timely recording of client servicing activities followed by timely billing and collection will ensure that bank managers are kept happy and partners/ proprietors content. Thereare a number of "musts" in terms of features of a good time and cost system which are too numerous for inclusion here. Just as important though are the system rules or guidelines. One issue still debated is whether it is necessary to record non productive time or time spent by administrative staff on their specific tasks. Apart from salaries, non productive time is the other significant "cost" of operating a professional services practice. This cost therefore needs to be managed and this can only be achieved by recording all time for all employees.

Measuring performance on assignment is just as important as time recording. This can be achieved by including assignment budget data for comparison against actual performance. Depending on the size and complexity of the assignment further analysis could be obtained to determine how effective individual employees were at performing assignment related tasks. Normal statistical performance data about employees would be obtained as part of this system indicating overall productivity and contribution levels for comparison to b udget by staff member or staff category.

The definition of "productive" time should be linked to the practice's business objectives. Productive time is usually defined as time spent on billable work but in some practices it can be taken to include specific practice development which results in billable work. The business rules should spell this out. Whichever definition is adopted, careful time recording is importantto ensure employee performance is measured against clearly understood criteria.

The mechanics of the system should be flexible enough to cope with the recording of disbursements against assignments, allow the use of optional charge or scale rates, include cost rates by employee, and have built in prompts for initiating the billing activity. Billing activity can be reported and measured in a variety of ways, eg billing by partner/staff against budget, timeliness of billing measured by months of time input tied up in work in progress (unbilled time). Many office activities (photocopying, telephone, fax) can now be automatically monitored to produce disbursement information which can be interfaced to the time and cost system. Output to the general ledger for work in progress and billing data will be necessary.

Financial Information. As a minimum, practices will need the core financial subsystems of debtors, creditors, general ledger and fixed assets. Depending on size, payroll may be important although it is typically handled manually in small practices or through a bureau in larger ones. The debtors system should be linked to the billing process enabling timely reporting of amounts due for payment. The incorporation of a collection or credit control system, certainly in larger practices, should be considered. Collection performance can be monitored through the usual ageing analysis as well as other key performance measures, eg months of time input tied up in outstandings. In extreme cases these measures can be used to develop incentives for good behaviours by imposing an interest charge upon partners/practice areas when billing/collection falls below the required minimum. Alternatively a credit can be applied to those performing above standard.

The creditors system would be linked in part to the time and cost system for disbursement charging to assignments and to the general ledger for practice costs. The size of the practice will determine whether computerised cheque production is required and the extent of supplier reporting desired.

Reporting from the general ledger generally requires some flexibility particularly if the practice is made up of several operating units for profit reporting purposes. The apportionment of administrative costs using a variety of bases may be required in order to report down to a net profit level. Comparing actual performance against budget is an absolute minimum requirement and should include value and time (where relevant) variables. Standard monthly reports, ad hoc reports, and annual reports should all be produced automatically from the reporting system.

The Next Step

The requirements outlined above cover the key business issues involved in determining an accounting information system appropriate for a valuation practice. The issues are the same regardless of the size and scope of the practice, as is the process of planning, selecting and implementing a system. The important point to take away from this article is that an accounting system should not be selected or developed in isolation from the rest of the practice activities. Instead, it is an integral part of the practice which should reflect the partners/proprietors own aims and philosophies. Other information system areas (office automation, storage and retrieval systems, external databases, valuation specific productivity tools) should be planned for, developed and implemented in a similar coordinated way. Recent software developments incorporate smarter and more easy to use functions than systems of yesteryear, some of which almost required a degree in computer engineering to operate them. However, it is still easy to be hooked on the gimmicks and quickly lose sight of the need to ensure the system overall meets business objectives.

The subject of hardware has been deliberately left out of this discussion for a very good reason. Practices which now have a need to upgrade their accounting systems will be only too aware of the costs incurred in the last computerisation exercise. A significant component of that cost, particularly in terms of distributable income, resides in the hardware even though a larger "cost" was incurred in the form of time when the system was implemented. There will be some sensitivity over the potential replacement of the computer hardware but unfortunately the obsolescence factor must be faced. Most computing equipment is now trending away from proprietary lineages towards an "open" systems architecture incorporating more powerful processing capability. The issue of hardware is (or should be) a consequence of the software chosen to meet the practices information needs.

The above process may appear overwhelming, but it does represent a challenge to any practice to ensure that it approaches the nineties with business objectives which are comprehensively supported by a responsive, accurate and timely information system. A

Is Anyone in Your Office still using a quill pen?

by T Proctor

This is the second ina series of articles provided by Financial Systems, an Auckland based dealer which specialises in computer based solutions for the corporate market. The author, Tooki Proctor, is the Training Manager for Financial Systems Ltd.

n these days of office automation, the word processor has meant huge improvements in productivity. We have moved from electric typewriters to those with a memory facility, and on to dedicated word-processing computers.

Now most managers have discovered that the versatility offered by a personal computer provides the most flexible solution to a number of business requirements, including word processing.

But once you have decided to purchase a PC, the next question is "What software?" There is so much available today, and everyone will have a good word for their favourite, leaving you more confused than ever.

You will doubtless have many questions:

- *What is the Graphical User Interface (GUI) and do I really need one?*
- *What is the difference between desktop publishing packages and word processors?*
- *What about fonts and printers and all those areas what do I need to consider?*

If you are thinking of buying a word processor, the first thing you should ask yourself is what you are expecting it to do. What is the bulk of your office output letters, memos and standard reports? Are you wanting to produce a newsletter in columns with numbers imported from a spreadsheet and simple graphics such as your logo, and smart marketing brochures with fancy layouts? Or are you looking for a simple tool that all your managers can use to keep on top of correspondence and reports?

The basic functions we want from a word processor are the ability to type text in, manipulate blocks of text such as inserting, deleting, moving and copying, and apply formatting such as bold, italic or different typefaces.

Most companies do not need a huge range of typefaces, but the limited use of fonts in your correspondence can aid the professional impression you create for your customers.

We want to be able to print (and we will have many different printers that we want supported) and we would like some features such as a spelling checker, the ability to change tab settings and some page size or margin control.

Most word processors today do this and more. For the specialist, there are even separate programs that check your grammar, and at least one word processor includes a grammar checker as an option. So how do we choose?

CUI or GUI

There is a huge range of word processing programs available today that meet a variety of needs. Some are character-based which means you are not working on a true representation of the document as it will print, but you have the advantage of speed over the graphical-use-interface (GUI) which requires more powerful (and therefore expensive) machines to support the What You See Is What You Get (WYSIWYG) view.

The graphical interface also has icons, or graphical representations of the editing and formatting tools on the screen and is designed for use with a "mouse" a device that allows the user to select an item on the screen by "pointing". It certainly makes many tasks easier, but is not of such value to the speedy copy typist who is used to performing functions from keyboard commands.

For the average office typist whose work consists mostly of letters, memos and faxes, there may be no advantage in taking the step to a graphical environ ment that will involve an expensive outlay on hardware.

However, GUI is certainly the environment of the future, so if the move into Information Technology is new to you, you should take account of future trends before investing in a system with a very limited life.

Also, many companies are now finding that they use a combination of IBM-compatible and Macintosh machines.

The GUI environment is closer to the Macintosh world, and the similarity of programs such as Microsoft Word for Windows on the IBM PC and Word for Mac (or PageMaker for the IBM and for the Mac) makes transporting files from one machine to the other much easier.

The major GUI advantage is WYSIWYG, which has most value to the user of complex formatting and layout commands. So we come back to the question of the nature of your typing and the need for desk-top publishing tools. There is no one program that will provide a total solution for all tasks, but sophisticated word processing packages do meet the "publishing" needs of many offices, whereas a dedicated desk-top publishing package is a specialised tool that requires particular design skills that cannot necessarily be taught.

What Is Publishing?

Let's look for a moment at what we mean by "publishing". It has three basic components content editing, copy editing and copy fitting.

Content editing is concerned with the text itself - the meaning - and only involves formatting where bold or italic text is used for emphasis. Copy editing includes a check on grammar, spelling and the formatting of headers, by-lines and other visually distinct text elements.

Copy fitting refers to the layout of text and graphics on a page and any manipulations required to make the information fit the available space.

This is what distinguishes a true desk-top publishing package from a word processor. It includes facilities such as kerning and tracking the typographer's tools which enable complex layouts to be manipulated on screen with ease. Most desk-top publishing packages assume that the basic editing functions such as spelling and grammar checking are performed in a word processor so you would never buy a desk-top publishing package in order to type letters, memos and reports.

However, if you want to produce a marketing brochure in columns with the company logo in the corner, or proposals and reports that use a range of fonts but consistently reflect your company's style and image, the high-end word processors are more than equal to the task.

Hardware

Hardware also forms a part of your software purchase decision. For the computers on which you are going to run the programs, you need to consider two things - memory and processing power. If we pretend that the computer is like a desk, you can compare memory to the size of your office desk-top.

The more memory, the more files you can have open at once. That is particularly important in the Windows environment where you are often wanting to open multiple files and cut or copy information from one file to another or even from one program to another. For example, if you frequently want to create links between information in a spreadsheet and that in your word processor, you will need enough memory to run both programs at once.

The second question relates to your need for processing power and speed. Financial Systems Limited recommend 386-level SX-chip-based workstations for any Windows programs that is to say, machines with a hefty amount of processing power.

Otherwise the graphical environment slows down your work to a ridiculous extent. If you have older XT or AT machines that you do not want to upgrade, you will be restricted to the character-based word processors.

The next question to consider is your output device there is no point in having a sophisticated word processor that produces a newsletter in columns sprinkled with your logo, charts and other graphics, borders, boxes and shading if you cannot print it on a machine that will do it justice. For anything other than basic office correspondence, we recommend aLaserPrinter.

In the next issue we will take a detailed look at the questions you can ask yourself in preparation for choosing word processing software. A

Business Telephone Services

by C Raines

rior to April 1989 telecommunications services were a total monopoly run by the New Zealand Post Office and later by Telecom. It was illegal to offer competing network services, to cable buildings or supply telephone equipment.

Deregulation has changed this bringing competition, choice and improved service but many businesses are still unaware of the options open to them.

Previously the telephone account was treated like the power and the rates, a necessary evil with no options. Now there are many ways this overhead can be reduced. 0

Clive Raines is Managing Director of KeyBusiness CommunicationsLimited (Keycom) which is an independent telephone system company providing a total service, including consultancy, planning, building cabling installation, training and maintenance.

Telephone System Rental

The PABX system found in most businesses today is an older model which is still being rented from Telecom.

These are generally outdated, discontinued systems which lack many of the features and flexibility found on modern systems.

The rental is an ongoing cost based on a high equipment value.

They can now be replaced with a new system offering considerable savings. Some companies purchase the new system outright but most opt for a three to five year lease term. The lease has no deposit or residual value, provides a depreciable asset and a limited payment term.

The monthly lease cost compared to the old rental often produces a saving of up to 60%.

A few of the newer features are:

- Ability to instantly retrieve calls after they have been transferred
- Call detail information output (for printer or call costing)
- Music on Hold (real music, not "Home on the Range"!)
- Busy extension identification
- Intercom
- Automated after hours operator
- Direct Dialling In

Mjjssun Dorms...

Real Music!!

There are numbers of models available from several major manufacturers ranging in capacity from 6 extensions to over 600. An independent supplier or a consultant can recommend the best options for each business.

The way the new system is engineered and programmed can make a big difference to the overall efficiency of a business and the service being provided to customers.

Many companies cannot justify a full time operator and require calls to be answered by more than one extension.

It is also possible to divide calls into groups. For example, a sales hotline number can be promoted which connects directly to the first free extension in the sales office.

Network Operators

Deregulation has also brought competition to the telephone network giving consumers the choice of how the call is routed from AtoB.

The major competitor is Clear Communications who provide an alternative network. At present direct connection to customer premises is not available so the Telecom network is used as a gateway. A local call is made to the Clear interconnection point where the call is then routed to the destination through Clear's network.

At the destination the call is routed back into the local Telecom exchange and to the required number.

This sounds complex butonly requires '050' to be inserted in front of the STD number being dialled. Using Clear will generally result in a minimum saving of 12% on STD and ISD calls.

Other network operators such as Netway offer point to point services between the main centres. These services should also be considered, particularly where communication between branch offices takes place.

Many of the newer telephone systems offer Least Cost Routing. This facility looks at the telephone number being dialled, selects the cheapest available service to route the call at the time and automatically inserts any required access codes or digits required to complete the call.

This is transparent to the caller who simply dials the usual STD number. Many companies have three or more network services and use surplus capacity on leased data circuits for voice also. The total savings in these cases can be quite substantial.

Data Circuits

Due to past restrictions many companies still lease a number of point to point services for remote computer terminals. These are generally expensive and inefficient.

In many cases bureau services can be used to reduce this cost. These are either network operators or other users who sell off surplus capacity.

As ISDN (Integrated Services Digital Network) services become available it will be possible to combine voice, data, video and fax transmissions over a single circuit. Generally digital services are not cost effective for smaller businesses at present but this is likely to change. If you presently use data circuits it would pay to discuss your present uses and future requirements with a consultant or other vendors.

New Buildings/Premises

The cabling of new buildings, both riser and floors is also open to competition. Network operators now provide a demarcation point at the entry point to the building.

There is a large range of cable trunking systems, jackpoint styles and combined voice/data cabling available. This also applies to the prewiring and installation of residential dwellings.

It pays to think of likely future requirements at the planning stage. Always get more than one proposal.

In summary there are many companies competing for your communications dollar. Look critically at your present communication systems and suppliers. You should be rewarded with better service and an overhead reduction of at least 15%. A

Legal Decisions

IN THE COURT OF APPEAL OF NEW ZEALAND
C.A. 192/89

BETWEEN MANUKAU CITY COUNCIL a body corporate constituted under the Local Government Act 1974
Appellant

AND FENCIBLE COURT HOWICK LIMITED a duly incorporated company having its registered office atAuckland
Respondent

Coram: Cooke P.
Hardie Boys J.
Gault J.

Hearing: 18 March 1991

Counsel: D M Carden and E J M Rawnsley for Appellant.
R J. Beech for Respondent

Judgment: 18 April 1991

JUDGMENT OF COOKE P

Having had the advantage of reading in draft the judgment to be delivered by Gault J in this case, I agree with it in toto and wish to add only the following.

In the judgment under appeal Fisher J exercised the common law jurisdiction of the High Court to set aside an award (fixing a rental under a lease) for error of law on the face. It is a jurisdiction still existing in New Zealand, though in the common law world quite widely regarded as anomalous. The modem tendency is to replace it by restricted statutory provisions for curial review, for instance appeal to the Court on questions of law but only by leave. The subject and the policy considerations have been canvassed in judgments in this Court in *Manukau City Council v Fletcher Mainline Ltd* (1982) 2 NZLR 143; *Attorney-General v Offshore Mining Co Ltd* (1983) NZLR 418; and *CBI NZ Ltd v Badger Chiyoda* (1989) 2 NZLR 669 and by the New Zealand Law Commission in their discussion paper on Arbitration (1988), paragraphs 23-39,163-170.

As mentioned in the *CBI* case at 678, there are various ways in which the parties can by agreement exclude this common law jurisdiction. The limits of that contractual ability do not call for further examination in the present case. In agreement with Gault J in this Court and Fisher J in the High Court, I think it clear that no intention to contract out of the jurisdiction should be imputed to the parties. On the contrary it seems highly unlikely that in advance of an arbitration which was to govern the rent of valuable commercial land for seven years, where neither the valuers nor the umpire were legally qualified, either party would have been content to leave the arbitral tribunal free to make a binding award, even if any award should turn out to be based manifestly on some seriously wrong understanding of the rights conferred by the lease. In such a case the existing powers of the Court to review for error of law, whether at common law or by statute (as under the Arbitration Amendment Act 1938, sll), would appear to be salutary if exercised with due restraint.

That qualification I venture to think equally important. Where parties have agreed to some form of arbitration rather than court proceedings, even when as here this element in their contract has been dictated by the statutory regime applying to such leases, the Court should not in my view allow the finality of the award to be destroyed except for truly compelling reasons. Certainly a statute such as the Public Bodies Leases Act 1969 limits quite severely the scope for treating party autonomy as a decisive concept in this area. But the Act and the lease under it contemplate a practical and relatively speedy and informal manner of fixing the rent by persons competent in valuation. Post arbitral litigation is not to be encouraged.

The learned Judge in the High Court devoted the greater part of his judgment to whether there was an error of law in the umpire's reasons. On concluding that there was, he dealt with the issue of materiality in one quite brief passage. It may well be that these proportions reflect the time spent before the Judge, on behalf of the Council, on the argument that there was no such error by the umpire. In this Court, however, from the outset Mr Carden wisely abandoned that argument. Materiality soon emerged as the essential issue.

All that the Judge said on materiality - and, if right, it was perfectly adequate - was this:

> *Because of those errors of construction it does not of course follow that the Award should necessarily be set aside. One should set aside the Award only if it appears that the Umpire would have come to a different result or may have come to a different result had he correctly interpreted the lease and applied the Plinth case principle.*
>
> *I am no expert on valuing. However I think it sufficient to say that having endeavoured to follow the quite detailed assessment of valuing considerations in the Award I am not prepared to assume that the result would have been the same had the Umpire correctly construed and applied the lease terms.*
>
> *It follows that I am not prepared to uphold the present Award.*

Gault J demonstrates how the conclusion can be reached affirmatively that the error of law did not affect the umpire's valuation. I add that the passage just quoted from the High Court judgment seems to me to suggest an approach to arbitral awards perhaps once congenial to the courts, but no longer so. At the present day there is a strong judicial respect for arbitration as a valuable mode of dispute resolution. When an expert arbitrator or umpire has acted impartially (and here the challenge to the umpire's conduct has not been renewed on appeal) the Court should be slow to be persuaded to strike down the decision. The mere possibility of a different result should not normally be enough to justify judicial "intervention". There should be no assumption that an error in expounding the meaning of the contract was or may have been material. The onus should be the other way. In my opinion, the Court should not set aside an arbitral award on the ground of error of law unless satisfied affirmatively that the error made a difference to the decision or at least probably did so.

Changes in the law as to arbitration are under consideration in New Zealand, as they have been in other countries. The result of the present case may serve to underline that the New Zealand Courts are alive to the need to encourage ar- �

bitration and respect arbitral awards. At the same time the view should not be overlooked that a party who can show that there has been a truly significant error of law has a justifiable grievance for which the law should provide a remedy, unless he or she has freely contracted out of that right.

The appeal should be allowed, the judgment in the High Court vacated and replaced by judgment for the defendant. In this Court the appellant should have $1500 for the costs of the appeal, together with disbursements including the reasonable travelling and (if necessary) accommodation expenses of counsel, to be fixed by the Registrar. The defendant in the High Court should also receive costs there, to be fixed by that Court if necessary.

Solicitors:
Wood Ruck & Co, Otahuhu, for Appellant
Chapman Tripp Sheffield Young, Auckland, for Respondent

IN THE COURT OF APPEAL OF NEW ZEALAND
C.A. 192/89

BETWEEN MANUKAU CITY COUNCIL a body corporate constituted under the Local Government Act 1974 Appellant

AND FENCIBLE COURT HOWICK LIMITED a duly incorporated company having its registered office atAuckland Respondent

or m• Cooke P.
Hardie Boys J.
Gault J.
Hearing; 18 March 1991
Counsel: D M Carden and E J M Rawnsley for Appellant.
R J. Beech for Respondent
Judgment: 18 April 1991

JUDGMENT OF HARDIE BOYS J

I have had an opportunity of reading in draft the judgments to be delivered by the President and by Gault J in this case. I entirely agree with the reasoning of Gault J and I also concur in the observations of the President.

Therefore I too consider that the appeal should be allowed with costs as proposed by the President.

Solicitors:
Wood Ruck & Co, Otahuhu, for Appellant
Chapman Tripp Sheffield Young, Auckland, for Respondent

IN THE COURT OF APPEAL OF NEW ZEALAND
C.A. 192/89

BETWEEN MANUKAU CITY COUNCIL a body corporate constituted under the Local Government Act 1974 ApellantpA

AND FENCIBLE COURT HOWICK LIMITED a duly incorporated company having its registered office atAuckland Respondent

Coram: Cooke P.
Hardie Boys J.
Gault J.
Hearing: 18 March 1991
Counsel: D M Carden and E J M Rawnsley for Appellant.
R J. Beech for Respondent
Judgment: 18 April 1991

JUDGMENT OF GAULT J

This is an appeal from a judgment of the High Court given on 9 June 1989 setting aside the award of an arbitrator fixing the fair annual rental of land located at Cook Street and Fencible Drive, Howick.

The appellant which was substituted for its predecessor The Howick Borough Council, granted to the respondent (then called Smith & Brown Maple Furnishing Ltd) a lease of the land pursuant to s7(1)(e) of the Public Bodies Leases Act 1969 for a term of twenty-one years commencing on 17 April 1979. The leases provided for perpetual rights of renewal and for rent reviews at intervals of seven years in accordance with s22 of the Act. It will be convenient to refer to the appellant and its predecessor as "the lessor" and to the respondent as "the lessee".

Clause 1 of the lease included the following covenants on the part of the lessee.

"(c) In a proper and workmanlike manner to construct on the land shop buildings and ancillary works in accordance with the site plan andoutline of development submitted with the lessee's application for lease such buildings and works to be completed in strict accordance with plans and specifications to be submitted to and approved by the lessor."

(a) To complete the buildings ready for occupation and to commence commercial operations on the land on or before the 31st day of March, 1980.

(g) Not during the term to assign underlet or in any way part with the possession of the land and the adjoining land owned by the lessee and referred to in the lessee's application to lease and used for the purposes of the commercial development on the above described land or any buildings on the land or the said adjoining land without the previous consent in writing of the lessor first had and obtained but this clause shall not prevent the lessee from entering into subleases of specialty stores or other shop premises not forming part of the lessee's commercial operations referred to in the lessee's application to lease.

The shopping centre development envisaged in these covenants was duly completed and the lessee commenced business in part of the premises.

The lessor duly gave to the lessee notice in writing of a valuation it had obtained to determine the fair annual rent of the land for the seven year period to commence from 17 April 1986. The lessee required the rental to be determined by arbitration in accordance with s22(2)(c) of the Act and each party appointed as its arbitrator a registered valuer of Auckland. They in turn appointed a further registered valuer Mr R L Jefferies as umpire.

The arbitrators appointed by the parties were unable to agree upon an award and referred the matter to the umpire for his award. The umpire held a hearing at which the arbitrators appointed by the parties made submissions. He subsequently required further submissions and inspected the land himself. On 9 February 1987 he delivered an award fixing the sum of $72,000 as the fair annual rental for the seven year period concerned.

The documents issued by the umpire consisted of a one page "Award" which refers in the heading to the lease and the submission, then recites the circumstances of the umpire's appointment, the manner in which he entered upon his task and concludes:

DO HEREBY AWARD
(i) the sum of SEVENTY-TWO THOUSANDDOLLARS ($72,000) as the fair annual rental for the review term of seven (7) years commencing from 17th April 1986 in accordance with the said Memorandum of Lease.
(ii) that the parties shall pay half each of my fee and costs of preparing this Award of a total amount of TWO THOUSAND SEVEN HUNDRED DOLLARS ($2,700) plus Goods and Services Tax.
WITNESS my hand this 9th day of February 1987.
R L Jefferies, Umpire

Attached to the "Award" by a staple were a further ten pages headed "Annexe to Award" the first paragraph of which reads:

For the benefit of the parties and Valuer/Arbitrators to this arbitration I briefly set out the matters which were at issue and my brief reasonsfor my accompanyingAward ofa ground rental of $72,000 per annum for the seven year review term of the ground lease from 18th April 1986.

There is then set out a concise description of the property in the following terms:

The property consists of a large and irregularly shaped commercial site at the south eastern end of the Howick Commercial area upon which the lessee erected shops in accordance with proposals accepted in response to an advertisement inviting an application to lease the land in 1979 and which the lessee developed in conjunction with an adjoining freehold site owned also by the lessees. It includes specialty shops, a large retail store occupied by Smith & Brown Limited and a supermarket operated by Three Guys, the latter straddling the boundaries of the leasehold and freehold land.
This ground rent relates only to the leasehold portion.

After referring to the lease and certain of its provisions the document then contains the heading "Basic Principles". Thereafter the umpire has summarised submissions made to him by the arbitrators for the respective parties including the following:

Mr Dean, arbitrator for the lessee, argued that the terms and conditions of the lease when read in conjunction with the application to lease required the value to be based upon the actual use of the site as *currently exists and that such alternative uses whi ch might be possible under the zoning of the land (ie offices) should be excluded from consideration.*

Mr Appleton, the lessor's Arbitrator, valued the land in accordance with the zoning and without any specific allowance for the effect (if any) of the actual use of the site in accordance with the lease...

The document then contains the following passage:

The only matter of basic principle to be dealt with *is whether or not Mr Dean was correct in limiting the value of the land to the actual use, all other matters being a matter of valuation opinion and interpretation.*
I agree with the lessee's arbitrator in that as the lease isdifferentfrom typical commercial ground leases in as much as the schedule to the lease containing the lessee's covenants makes specific reference to building requirements on the land in accordance with the lessee's submission, but I do not consider that this extends to putting out of consideration altogether the possibility that the lessee could alter, add to or redevelop part of the land during the term of the lease or any perpetual renewal thereof, as under Clause 1(e) the lessee may use the land for uses other than those stated with the previous consent in writing of the lessor. Such consent, would not in my opinion give the right to the lessor to demand any reassessment of the ground rental during any rental term of the lease to take into account any specific change in development provided that development was in accordance with the zoning for the land.
It is further my opinion after having viewed the documents submitted and the development on the land that at thispointin time the existing use would, in my opinion, still be the highest and best use of this site and that for the purposes of this seven year review of the rent a retail use is the appropriate type of use to be envisaged in assessing a land value and thus the fair annual rent to be based thereon. This does not exclude the possibility, in the future, that zoning and/or market conditions coupled with the aging of the existing structures, could result in a different basis of land value then being appropriate in terms of the le,-(se and any consents.

Then after reviewing the information provided as a basis for assessing the land value the document contains the following paragraph:

Having regard to the subject site, the persuasive evidence primarily from the Howick location but having also regard to the comparisons with other retail sites and making adjustment for their exposure, level of competition, the area of the site, the shape factor, the use constraint in the lease, the restrictions relative to the protection of trees and the protection of the historic well and other easements, I consider that a fair land value would be represented by a per square metre rate of $120/m giving a land value as follows:
7485m @ $120/m = $898,200.

The Arbitrator then settled upon an appropriate percentage rate for the purposes of determining the rental and fixed a rate of 8.0%. The document then concludes:

GROUND RENTAL ASSESSMENT;
I therefore assess the ground rental for the seven year review of this lease from April 1986 as follows:
Land Value: $900,000 @ 8.0% _ $72,000pa (SEVENTY-TWO THOUSAND DOLLARS PER ANNUM)
R L JEFFERIES

The duty of the umpire in the circumstances under consideration is set out in clause 10 to the First Schedule to the Act and reads as follows:

10. The duty of the umpire, on reference to him of any question, shall be to consider the respective valuations of the 2 arbitrators in the matters in which their valuations do not agree, and then to make an independent and substantive valuation, and the last mentioned valuation shall be the decision of the umpire; but in giving his decisions on any question so referred to him the umpire shall in every case be bound to make a valuation not exceeding the higher and not less than the lower of the valuations made by the arbitrators respectively.

It was not argued before us that the umpire failed procedurally to comply with this duty.

In the High Court the lessee sought an order setting aside the award on the grounds of first, error on the face of the award and secondly, misconduct of the umpire or of the proceedings.

The Judge rejected the ground of misconduct. That was not an issue in this court. On the first ground, however, the Judge set aside the award. He held that the "Annexe to Award" forms part of the t award and that, in addition to the eleven page document he was entitled to refer to the lease document itself and to any document incorporated by reference into the lease, as this was necessary to enable the reasoning of the umpire to be understood.

On the authorities of *Feltex International Ltd vJB L Consolidated Ltd* (1988) NZLR 668,672 and *Plinth Property Investments Ltd v Mott, Hay & Anderson* (1978) 38 P & CR 361 the Judge referred to the relevant principles for valuations in these circumstances. They require the valuer to have regard to such use restrictions as may be contained in the lease and not to assess value on the basis that the lessor will, or even might, relax or waive any restrictive user clause.

After referring to the manner in which the umpire dealt with the competing arguments, the Judge examined the terms of the lease and concluded that they do give rise to a use restriction to the effect that throughout the term of the lease the land will have on it the retail shopping complex building in the particular form in which it was constructed in accordance with the requirements of the lease. The Judge said:

> *What does seem reasonably plain is that the Umpire did not approach the matter on the assumption that the value should be based upon a use confined to land which had on it a retail shopping complex building.*

The Judge was not able to reach the view that if the Umpire had correctly construed the lease he would necessarily have reached the same conclusion and, accordingly, he was not prepared to uphold the award.

On appeal Mr Carden argued that because the Annexe did not form part of the award, an error apparent in the reasons contained in the Annexe was not error on the face of the award and could not provide a basis for the order to set aside.

With reference to somewhat similar circumstances, this court dealt with the relevant issues in determining what constituted the award when "reasons for arbitrator's award" were bound in with the formal award in *Manukau City Council v FletcherMainlineLtd* (1982) 2 NZLR 142. The Court reviewed the authorities which clearly indicate that it is the intention of the arbitrator ascertained on the evidence of the circumstances of the delivery of the award and from the terms of the documents that is determinative of what comprises the award. Sir Clifford Richmond Said (p 164):

> *The* Max Cooper *case is undoubtedly authorityfor the proposition that the intention of the arbitrator is the decisive factor in determining whether or not a statement of reasons has been incorporated in the award. There is no conflict here with* The General Valdes. *It is also authority, applicable I think, in all "incorporation" cases, that unless the intention to incorporate is clear the presumption should be against incorporation. No such principle was adverted to in* The General Valdes *but) detect nothing in the judgments suggesting any doubt as to the correct inference to be drawn from the facts.*

Somers J (p160) said:

> *There can be no doubt that the issue is one of intention. The recent cases such as* Giacomo Costa Fu Andrea v British Italian Trading Co Ltd *and* Max Cooper & Sons Pty Ltd v University of New South Wales *and the* Gold Coast *case can emphasise that the power of the Court to set aside for error of law on the face of the record is a form of relief which has survived (most would say regrettably) the right conferred by Parliament to require an award to be stated in the form of a special case and to have a question of law stated in the course of a reference; that it operates haphazardly being dependent on the way in which the award is formulated and in some cases as well on the acts of the arbitrators and the content of other papers delivered contemporaneously; and in general is probably contrary to the expectations of the parties one of whose reasons for submitting to arbitration is finality. For those reasons it is said that the Court should not be astute to incorporate so as to lay the foundation for a submission of error or law. All that may be readily accepted.*

Full citations for the cases referred to in these passages are *Max Cooper & Sons Pty Ltd v University of New South Wales* (1979) 2 NSWLR *257, Pearl Marin Shipping A/B v Pietro Cingolani SAS The General Valdes (1*982) 1 Lloyd's Rep 17, *Giacomo Costa FuAndrea vBritishItalian Trading Co Ltd* (1963) 1 QB 201; (1962) 2 All ER 53 and *Gold Coast City Council v Canterbury Pipe Lines (Aust) Pty Ltd* (1968) 118 CLR 58.

Mr Carden submitted that in the formal Award the Umpire used the words "Do hereby award" followed by his two directives and the attestation so as clearly to indicate the intention on his part that that would be the totality of the award. He submitted further that use of the word "Annexe" suggests that the document under that heading is subsidiary to, and independent from, the award and that the words in the first paragraph of the annexe "for the benefit of the parties and the valuer/arbitrators" indicate that the Annexe has purposes other than the provision of the award. He submitted further that the use of the word "accompanying" suggests that the two documents should be treated as independent.

For my part I find those matters are less than conclusive. I consider they can be taken as equally consistent with the delivery of a formal award with accompany reasons intended to be read together.

The Judge, after referring to the discussion of the relevant principles in the judgments in *Manukau City Council v Fletcher Mainline Ltd,* said:

> *Based upon those principlesI think it sufficient to say that in my view the whole IlpagesfonnpartoftheAward to which I may refer. The features upon which I rely are as follows:*
> *(a) The fact that the two documents were issued contemporaneously.*
> *(b) The fact that they were stapled together into one physical bundle.*
> *(c) The fact that the content of the annex is expressly described as "Reasons ...for my Award".*
> *(d) The fact that the annex itself concludes with wording in a formal manner as to the result arrived at by the Umpire.*
> *(e) The fact that there is no express disclaimer in the annex to exclude it as a relevant part of the Award this notwithstanding the reasonably well known and understood principles in this regard.*

I consider that these matters outweigh the points made by Mr Carden. Therefore the Annexe is to be read with the formal award for the purpose of investigating whether there is material error on the face of the award.

As before the Umpire, in the High Court the lessor appears to have argued that there is no use restriction in the lease other than that resulting from the zoning of the land. In this Court Mr Carden accepted the Judge's finding that the land was subject to the use restriction. He argued, however, that the Umpire did properly take account of the use constraint and that to the extent that he did not, his findings as to the restriction and its impact were made on questions of law specifically referred to him for decision and so cannot be examined for error. He sought to place this in the special class of cases referred to by this Court in *Attorney General v Offshore Mining Co Ltd* (1983) NZLR 418. Cooke J there said (p421):

> *Consequently it is also common ground that, if there were an error of law on its face, the decision could be set aside unless, as White J has held, the case should be classified as one in which a specific question of law has been submitted to the arbitrator. In that special class of cases it is settled that error on a question specifically submitted, such as a question of the interpretation ofa contract, even though apparent on the face of the award will not justify the Court's intervention; there must be some more fundamental illegality, ofa type which is not alleged to have occurred here: see* Kelantan Government v Duff Development Co (1923) AC 395, *408-411 per Viscount Cave L C. So whether or not the independent expert's decision does exhibit an error in interpretation has not been argued at this stage.*

After referring to the authorities Cooke J said:

> *The Court must surely look for the reality and substance of the reference agreed on by the parties. I do not think that the use of such words as "in express terms" and "as such" byLord Wright in his speech in* Absalom *at p615 can have been meant to suggest otherwise.* At *the same time, if at the outset the parties have referred a dispute covering a number of issues to an arbitrator in general terms, admissions of fact during the hearing should not normally, it seems to me, be treated as converting the reference to a specific reference of a question of law even although in the end the dispute may reduce to construction. One would still have to be satisfied that there was an agreement to alter the reference itself. Otherwise counsel making a sensible concession on fact might unwittingly deprive a client of ordinary remedies in law.*

In the present case the reference is to be found in s22 of the Public Bodies Leases Act read with clauses 10 and 11 in the First Schedule. That which is to be determined is the fair annual rent for the land for the next ensuing seven year period. The duty upon the Umpire is to consider the respective valuations of the two arbitrators in the matters in which their valuations do not agree and then to make an independent and substantive valuation.

Although the matters of the use of the land under the terms of the lease and its impact upon the valuation were matters upon which the arbitrators differed and made submissions to the Umpire, they were in my view no more than factors relevant to the decision referred. They were not matters specifically referred for the decision of the Umpire as matters of law, but matters which arose in the course of the dispute and became material.

I conclude that if there is error and it was material to the determination, the parties have not so referred the matter as to place it in that class of cases in which the finding is final as to a matter of law.

The error appearing in the award as found by the Judge is that clause 1(g) was misconstrued as containing a use limitation on the land when it is simply a restriction on assignment and sub-letting without the prior consent of the lessor. The Umpire appears to have interpreted this clause as envisaging consents by the lessor to changes in use of the land. It seems he misunderstood the language referring to the adjoining land. On the basis of that interpretation he then commented on the lessee's submission that the valuation of the land should be on the basis of its actual use by saying:

> *But! do not consider that this extends to putting out of consideration altogether the possiblity that the lessee could alter, add to or redevelop part of the land during the term of the lease or any perpetual renewal thereof, as under clause 1(e) the lessee may use the land for uses other than those stated with the previous consent in writing of the lessor.*

It is common ground that the reference to clause 1(e) is a clerical error and should read "1(g)".

Even if the lease had contained express provision for consents by the lessor to changes in use as the Umpire believed, this statement would be in conflict with *the Plinth* case as the Judge found.

Mr Carden rightly accepted that the Judge was correct in finding these errors, but he submitted that they were not material to the decision reached by the Umpire in his award because he did, in fact, take account of the use restriction in the lease in arriving at his valuation.

Mr Beech for the lessee submitted that such use restriction as the Umpire took into account arose from his misconstruction of clause 1(g) and not that which the Judge found is to apply to the lease.

I am of the view that when read as a whole the Annexe shows that the Umpire took into account the correct use restriction and that the error he made did not impact upon his valuation. The key to the correct understanding of the reasons is the paragraph immediately following that in which the Umpire said that the possibility of changes in use with consent should not be put out of consideration altogether. He stated:

> *It is further my opinion after having viewed the documents submitted and the development on the land that at this point in time the existing use would, in my opinion, still be the highest and best use of this site and that for the purposes of this seven year review of the rent a retail use is the appropriate type of use to be envisaged in assessing a land value and thus the fair annual rent to be based thereon. This does not exclude the possibility, in the future, that zoning and/or market conditions coupled with the aging of the existing structures, could result in a different basis of land value then being appropriate in terms of the lease and any consents.*

When the two passages are read together against what appears before them in the Annexe they indicate that the Umpire's views were:

1. That he accepted the lessee's submission that the lease restricts the lessee's use of the land.
2. That the existing retail use might be altered during the term of the lease with the consent of the lessor, subject to zoning restrictions.
3. That in principle he would not exclude from consideration in his valuation the possibility of changed use with consent.
4. That for the purposes of the seven year review under consideration no other use will justify any higher land value than retail use.
5. That in this case the possibility of other uses with consent need not be taken into account because they would not lead to any higher land value.
6. That there cannot be excluded the possibility that in the future (but not on this review) a different basis of value might be appropriate in light of changed circumstances in any consents then given.

The error previously identified by reference to the *Plinth* case carries into points 3 and 6. However, neither played any part in the valuation made by the Umpire. In effect he found it unnecessary to include in his consideration the factors he said he would in principle not exclude. Notwithstanding the errors, he embarked upon his valuation on the basis of no other use of the land than retail use which is what the Judge found the terms of the lease impose.

Mr Beech did not seek to draw any distinction between retail use generally and the actual retail use applicable to the demised land.

Mr Beech did, however, argue that by employing the concept of the "the highest and best use" of the land in the circumstances, the Umpire's decision is flawed. This point was made initially in support of his argument that the failure to take into account the correct use restriction justified the order to set aside because it could not be said with any confidence that the decision would have been the same if based upon the correct construction of the lease. I have held against him on his premise, but in the course of the argument, as I understood him, Mr Beech contended that even if the Umpire made his valuation on the basis of retail use of the land he still failed to give proper consideration to the full impact of the use restriction in the lease and was in error. So as to avoid any misstatement of his argument I set out the following passage from his written submissions:

> *In any event, a Lease without a restriction as to use is inherently more valuable to the Lessee than one containing a restriction. The value of the Lease to the Lessee is a function not only of the highest and best rent on the day but also of theflexibility of the terms of that Lease.*
>
> *The highest and best use of a building might well change during the course of a term, particularly so where that term is 21 years, as in this case. The ability to "change direction" and employ (or assign to another who may employ) the premisesfor the best use at a later stage within the term, is a factor which must add value to the Lease and therefore to the rental.*
>
> *See p142 para 740 of Whipple text. (Commercial Rent Reviews and Valuation Practice).*
>
> *It matters not, therefore, whether the existing use at the date of the review was the highest and best use. A restriction on use is a factor which in its own right affects the value of the Lease and so must be taken into account when assessing the rental.*

If this claimed failure to take a matter into account is an error, it is not an error apparent on the face of the record. The Annexe states at p4 simply that for the purposes of the seven year review under consideration a retail use is the appropriate type of use to be envisaged in assessing a land value, and at p9 that having regard (inter alia) to the use constraint in the lease the Umpire considered that a fair land value would be $898,200.

There is no statement of disregard for the effect of the use limitation on the value of the land.

Further, it appears that this is a point not previously advanced on behalf of the lessee. I have carefully reviewed the submissions made on its behalf to the Umpire and they contend for just the approach I have found the Umpire followed. Mr Dean in his submissions of 22 April 1986 after referring to the terms of the lease said (p6):

> *In terms of this property we are of the view that the rental that a prudent lessee would pay for the landfalls to be determined upon the use to which the lessee was permitted to put the land in tems (sic) of the lease.*

On the next page he said:

> *As a first step in determining the fair annual rental of the land, it is necessary to derive a freehold value for the leasehold parcel. In the subject case, and because of the specific building provisions made within the lease, we consider that thefreehold market value of the land must be determined by reference to the permitted level of development approved by the Howick Borough Council.*

I find no difference in this approach from that of the Umpire. Further, I have examined the three alternative methods of arriving at the freehold value relied upon by Mr Dean and his submissions in relation to the percentage of the freehold value to be taken for the purpose of fixing a rental and I find no reference to any adjustment for this additional factor of potential reduction in value through flexibility of future use.

In my view it is a factor which, if required to be separately identified and taken into account, would render almost useless the comparison of values undertaken as an essential part of land valuations because of the differences in use provisions in leases. Also assessment of its influence in rental assessments in perpetual leases could be little more than speculation. I am not prepared to treat omission of this somewhat nebulous factor, if omission it is, as an error of such significance as justifies setting aside the award. Accordingly, while I agree with the Judge that the Umpire made errors in his construction of the Lease and in principle, I differ from the Judge in concluding that in his valuation the Umpire was not materially influenced by those errors because he confined his consideration to the existing use of the land.

I would allow the appeal and reinstate the award.

Solicitors:
Wood Ruck & Co, Otahuhu, for Appellant
Chapman Tripp Sheffield Young, Auckland, for Respondent

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY
M.NO 230/91

UNDER Section 11 of the Arbitration Act 1908 and its Amendments

IN THE MATTER of an application to set aside or remit an Award

BETWEEN THE MELANESIAN IMSSION TRUST BOARD a body corporate under the provisions of the Charitable Trusts Act 1957 Plaintiff

AND ROBERT M MCGOUGH of Auckland, Registered Valuer First Defendant

AND JOHN HENRY CENTRE LTD a duly incorporated company having its registered office at Auckland and carrying on business as Shopping Centre proprietors Second Defendant

Hearing: 22 April 1991
Counsel: P M Salmon QC for Plaintiff
G K Atmore for Second Defendant
Judgment: 2 May 1991

JUDGMENT OF ROBERTSON J

This is an application to set aside an Award made by the first defendant on 8 November 1990 and for an order that the first defendant be required to reassess his Award having regard to the proper construction of the lease between the plaintiff and the second defendant. The first defendant took no part in the proceeding before me.

The plaintiff is the owner of commercial land situated in Henderson which pursuant to a registered lease number 329508.3 was leased to the second defendant for a term of 21 years commencing on 1 April 1975.

It was a term of the lease that the yearly ground rental payable would be reviewed at seven yearly intervals. Such review was to be undertaken on a basis set out therein.

In March 1990, the plaintiff and second defendant appointed arbitrators to represent their interests and the arbitrators duly appointed the first defendant as umpire to determine and fix the yearly ground rental payable for the seven year period commencing from 1 April 1989. Pursuant to such appointment, on 8 November 1990 the first defendant fixed the ground rental at $109,500 per annum plus goods and services tax if applicable.

The substantial challenge made to the Award is that there is apparent on the face of the Award an error of law in that the umpire erred in determining the proper construction of clause (8) of the lease which improper construction materially affected his conclusion as to the annual rental value.

Although there was some semantic debate, there was no substantial difference between counsel as to the function of the Court in an application such as this. Counsel referred to a similar situation in *Auckland Regional Authority v Codelfa ConstructionLimited* (1981) 2 NZLR 300, where Thorp J at 305 noted:

> *Any question of law being a question of interpretation, the Court is not free to set the Award aside simply because it would have come to a different conclusion to that reached by the arbitrators. On the contrary, the Court should not set the Award aside unless satisfied that the conclusion reached by the arbitrators was not one which they could legitimately have reached.*
> And at 306:
> *...the Court must be satisfied that the construction of the contract which the arbitrators adopted, when one was considering a question of construction, was plainly wrong.*

And further on the same page the learned Judge adopted the passage from 2 Halsbury's Laws of England (4th Ed) para 623:

> *In order to be a ground for setting aside the Award, an error in law on the face of the Award must be such that there can be found in the award, or in a document actually incorporated with it, some legal proposition which is the basis of the Award and which is erroneous ....but if it appears on the fact of the Award that the arbitrator has proceeded illegally as, for instance, by deciding on evidence which was not admissible, or on principles of construction which the law does not countenance, there is error in law which may be ground for setting aside the Award.*

I was also referred to the judgment of North P in *Wellington City vNationalBank of NZ Properties Ltd* (1970) NZLR 660 at 668:

> *Before I proceed to consider the argument we heard from counsel, it may be helpful ifI define the principles which, in my opinion, require to be applied when the Court is asked either to set aside an Award or remit it to the arbitrators or umpire, as the case may be, on the ground that an error of law appears on the face of the Award. These principles were considered by the Judicial Committee of the Privy Council in* Champsey Bhara & Company v Jivraj Balloo Spinning & Weaving Company Ltd *(1923) AC 480; (1923)A11 ER 235, ina judgment of the Board delivered by Lord Dunedin. He said:*
> *The law on the subject has never been more clearly stated than byWilliams J in the case of* Hodkingson v Femie*:*
> *"The law has for many years been settled, and remains so at this day, that, where a cause or matters in difference are referred to an arbitrator, whether a lawyer or a layman, he is constituted the sole and final Judge of all questions both of law and of fact... The only exceptions to that rule, are cases where the Award is the result of corruption or fraud, and one other, which though it is to be regretted, is now, I think, firmly established, viz, where the question of law necessarily arises on the face of the Award, or upon some paper accompanying and forming part of the Award. Though the propriety of this latter may very well be doubted, I think it may be considered as established."*
> *This view has been adhered to in many subsequent cases, and in particular in the House of Lords in* British Westinghouse Co v Underground Electric Railways Company *...Now the regret expressed by Williams J in* Hodkingson v Fernie *has been repeated by more than one learned Judge, and it is certainly not to be desired that the exception should be in any way extended. An error in law on the face of the Award means, in their Lordships' views, that you can find in the Award or a document actually incorporated thereto, as for instance a note appended by the arbitrator stating the reasons for hisjudgment, some legal proposition which is the basis of the Award and which you can then say is erroneous. It does not mean that if in a narrative a reference is made to a contention of one party that opens the door to seeing first what that contention is, and then going to the contract on which the parties' rights depend to see if that contention is sound. (The italics are mine) (ibid, 486;237).*

My own researches have revealed that recently the metes and bounds of the Court's functions in this area have been considered by the Court of Appeal in *Manukau City Council v Fencible Court Howick Ltd* (CA 192/89, 18.4.9 1) a case to which I will refer later.

The first issue to be determined is whether there is an error on the face of the record and if that is established, whether the Court should in the exercise of discretion refer the matter back.

Clause 8 of the lease provides:

> *8. THE Lessee will not carry on or permit to be carried on upon the demised premises or any part thereof any business of a nature notpermitted under The Town Planning By-Laws & Regulations for the time being of the Henderson Borough Council applicable to the demised premises (or of any appropriate local authority which may have authority over the demised premises from time to time) or do or suffer to be done any act or omission which may become or prove a nuisance or annoyance to any adjoining owner or occupier or to the neighbourhood.*

There can be no question in my view but the Award of the umpire makes substantial reference to this provision. He notes:

> *While the first portion of Clause 8 relates to use and is thusnotan unusual provision, I noted the extension which prevents any act or omission which may become or prove a nuisance or an annoyance to any adjoining owner or occupier. Following my consideration of the configuration of the land in question, together with the*

development prospects put forward, I concluded that the latter part of Clause 8 had relevance.

In fixing a fair annual rental for the subject land, I must ignore the value of any buildings on the said land, I must ifx a rental on the basis of that permitted under the Town Planning By-Laws but, at the same time, Clause 8 of the Lease stipulates that the Lessee shall not do or suffer any act or omission which may become orprove a nuisance or annoyance to any adjoining owner. No evidence was directly addressed to this point although it was adverted to in Mr Barratt-Boyes' assessment. It would appear to me that any attempt to place buildings along the Edsel Street frontage blocking off portion of the Smiths City exposure, could constitute a nuisance or annoyance to them thus being in breach of Clause 8 of the Lease. While no evidence was submitted as to the adjoining Smiths City's rights, evidence in the form of an extract from a valuation report to the Lessor prior to its acquisition, did show *that both the subject site and the Smith City site were developed under "conditional use" consent, jointly.*

In fixing the fair annual rent for the subject land, I must therefore take into account the potential for an objection, or even refusal, to any development that would give rise to becoming a nuisance or an annoyance to the Smiths City owner or occupier. I have no hesitation in finding that a redevelopment in front of Smiths City would be both a nuisance and an annoyance.

4. Mr Gamby made no adjustment for that portion of the Edsel Street frontage projecting across the Smiths City Building and I am unable to agree with that, having regard to Clause 8 of the Lease ....

Ifound the evidence ofMrJulian to be of intense interest, necessitating full coverage. However, the weight to be given to it was severely diminished by the fact that it was not aimed at the relevant date and did not take into account Clause 8 of the Lease .....

Accordingly, were! to be satisfied that my adopted land value of $1,460,000 was beyond doubt, I would uphold Mr Barratt-Boyes' 8% as at 1 April 1989. I was not so satisfied for two reasons:

1. After consideration of the comparable sales combined with the evidence of Mr Julian, I believe the adopted land value to be a maximum. The appropriate rental rate cannot be regarded in isolation to the level of land value, particularly in an uncertain market.

2. I was not convinced that the implications of Clause 8 of the Lease did not have wider ramifications than those put before me in evidence.

I have quoted the passages because they demonstrate the extent to which the umpire was influenced by the construction which he placed on Clause 8. It is that construction which the plaintiff now contends is clearly wrong.

The existing building erected on the leased site covers only a part of the total available area. It was common ground that the most important street commercially was Edsell Street which is the northern frontage. There is no building within 35 metres of that either on this section or on the adjoining land from which Smiths City operate a retail store.

The umpire correctly held that in as much as he was required to determine yearly ground rental, the potential of the land for further development had to be taken into account. In this regard the valuer concluded that he had to take into account:

> *The potential for an objection or even refusal to any development which would give rise to becoming a nuisance or annoyance to the Smiths City owner or occupier.*
>
> And later noted:
>
> *I have no hesitation in finding that a re-development in front of Smiths City would be both a nuisance and an annoyance.*

In my judgment, clause 8 enabled the lessor to ensure first, that the lessee complied with all planning requirements pertaining to the leased premises; and secondly, that the lessee refrained from acts or omissions which may be a nuisance or annoyance to neighbours. In my view clause 8 deals with two separate matters. The first is the planning regime which must be complied with. The second necessarily means, acts which are nuisance or annoyance other than in a planning sense.

It was common ground that the land in question was subject to "controlled" planning designation the effect of which was that the Local Authority could maintain a degree of supervision over improvements, but there was no right of objection from adjacent occupiers of land.

In my judgment the valuer was mistaken when he concluded that clause 8 was a fetter on the lessee undertaking redevelopment on the site which was permitted within the appropriate planning regime.

Counsel referred to a number of decisions as to what could constitute a nuisance or annoyance. Reading the clause as a whole, I conclude that as a matter of common sense and principle, the words cannot prohibit a construction which the adjoining land owner might subjectively think was a nuisance or annoyance, but only an activity which objectively fell within that categorisation. It is still open to the occupier of land to exploit fully the potential of a resource providing it does so lawfully. For a lessor to inhibit a lessee, for the advantage of neighbours but to its own detriment, does not make commercial sense.

The construction adoptedby the valuer in essence held that if the occupier of the leased premise has a partial development on the site, thereafter it is circumscribed from any further development which a neighbour does not like. That cannot be what the provision in the lease means. "Neighbours" have clearly defined rights under planning ordinances by-laws and regulations and under the general rule, which in some circumstances provide a degree of control or input. It was a patent error to suggest that this provision in the contractual arrangement between lessor and lessee restricted the enjoyment and use of premises out of a sensitivity to the position of adjoining occupiers of land. The lessee is constrained from carrying on an activity which might in law constitute objectively a nuisance or annoyance to neighbours, but to include within that category development in accordance with the appropriate by-laws, cannot be correct.

Mr Atmore argued that there may have been an obligation on the lessor to the adjoining occupier of land which required such approach. There is no evidence thereof but in that regard the lessor has powers under clause 4 of the Memorandum of Lease in respect of siting and the like which would cover the position.

I consequently find that there is an error of law on the face of the record. It is not a case where there are competing constructions which were reasonably available which would make it inappropriate to intervene.

Having reached that conclusion I have no doubt that the incorrect interpretation (which was adopted by the valuer without having heard argument on the point) permeated and affected the entire valuation exercise.

At page 4 of his judgment in *Manukau City Council v Fencible Court Howick Limited,* Cooke P noted:

> *When an expert arbitrator or umpire has acted impartially (and here the challenge to the umpire's conduct has not been renewed on appeal) the Court should be slow to be persuaded to strike down the decision. The mere possibility of a different result should not normally be enough to justify judicial "intervention". There should be no assumption that an error in expounding the meaning of the contract was or may have been material. The onus should be the other way. In my opinion, the court should not set aside an arbitral Award on the ground of error of law unless satisfied affirmatively that the error made a difference to the decision or at least probably did so.*

I have also had regard to the careful analysis of the facts in that case by Gault J and the importance of considering whether it has been established that the error has had a material effect upon the umpire's decision. In this case I accept Mr Salmon's submission that it did. I am persuaded that it not only influenced his assessment of the appropriate land value, but that he again gave weight to it in determining the rental rate which should apply. Although I have considered whether it is possible to sever either of those matters and remit only part, I have concluded on the evidence and a reading of the words in the Award itself, such an exercise would be artificial.

Accordingly there will be an order pursuant to slI of the Arbitration Act setting aside the Award dated 8 November 1990, and a further order that the Award be remitted to the first defendant for re-determination in light of the proper construction of clause 8 of the Deed of Lease.

The normal position is that costs should follow the event. I was told that this matter had an effect beyond the immediate confines of this case which should mitigate against an award. However, the plaintiff had invited the second defendant to agree to the matter being re-submitted to the umpire forre-consideration and that course was not accepted. Costs should never be a punitive aspect of litigation, but in all the circumstances the plaintiff is entitled to a contribution towards its costs which I set in a total sum of $1500 together with disbursements as fixed by the Registrar. Solicitors Hesketh Henry, Auckland for Plaintiff: Buddle Findlay, Auckland for Second Defendant

IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY
CP.NO 108/90

IN THE MATTER of the Arbitration Act 1908

BETWEEN IRVINE OSWALD SIBBALD of Auckland, company director, trading as Sibbald Investment Holdings
Plaintiff

AND BP OIL NZ LTD a duly incorporated company having its registered office at Wellington
Defendant

Hearing: 20 March 1991

Counsel: T W H Kennedy-Grant for Plaintiff
C Anstasiou with Alison Brown for Defendant

RESERVED DECISION OF McGECHANJ

Proceeding

The plaintiff (effectively lessor) claims against the defendant (effectively lessee) that an umpire in determining arbitral rent review for the premises concerned erred in law or alternatively misconducted himself; and seeks orders remitting the matters concerned for reconsideration under s11 or a setting aside of the award under s12(2) Arbitration Act 1908. The two primary questions are:

1. whether a so-called "Memorandum to the arbitrator" which contains the impugned reasoning is to be regarded as part of the award and thus open to attack.
2. whether, if so, the impugned reasoning is erroneous in law.

There is no significant factual dispute. I will record the factual background, as it emerges from the pleadings and was accepted in argument, to assist understanding of the issues involved.

Factual Background

There is a large service station standing on the comer of Jervois Quay and Willeston Street, Wellington, popularly known as the "Big E". It has frontage to both streets. It is not a stand alone structure. It is part of a larger building used as a carpark. That larger building extends around its north and west sides, and over its top. The ground floor area of the service station is accepted as 785m2. The leased area extends vertically upwards from the ground for 6.6m, creating a so-called leased "envelope". An area at the northern extremity of the envelope is utilised to full height by ground floor shop premises, and first floor office or similar accommodation. The area at the western extremity is utilised as a truck bay. Also on its western aspect is an area servient to a right of way to the parking building. There appears to be no dispute the area so subject to rights of way comprises 11 8m2 out of the gross 785m2. There is also an appurtenant right of way over the land, the location of which is not clear to me, which appears to comprise a gross area of 27m2.

The bulk of the service station gross area comprises ground floor space, sealed and available for motor vehicle access to pumps and ancillary facilities. Apart from the office or similar accommodation over the shop at the northern extremity, there is no physical utilisation of any first floor space which may be available over such ground floor area. I have no evidence whether, as a matter of engineering practicability,some additional structural use could indeed be made of that upper segment of the 6.6m envelope, apart from the existing office or similar accommodation mentioned.

Permitted uses under the lease are restricted to service station and motor repair garage and commonly and properly associated businesses, including refreshments to customers. Under the lease, no alterations, additions, or partitioning or equipment installation may be made without prior consent from the lessor. There is no express provision such consent should not be unreasonably or arbitrarily withheld.

The chain of title as between the parties to this case, in dispute on the pleadings to some extent, no longer is in issue. Freehold for the whole building, including within it the service station, is held by the Wellington City Council. There is a head lease to Victoria Street Parking Centre Limited. Shares held in Victoria Street Parking Centre Limited entitle the holder to a sub-lease of a defined area.

The sub-lease of the service station area originally was held by Bigee HoldingsLimitedby sub-lease dated 24 August 198 (sic) (presumably meaning 1984); which in turn sub-let further to Central Service Station Limited from 1 De- 0 cember 1983 to 29 April 2000 at an initial rental of $55,000 per annum, with further rights of renewal for 3 and 21 years.

There is also provision for contribution to expenses. Central Service Station Limited assigned this sub-sub-lease to the defendant BP Oil NZ Limited, with all necessary consents. Bigee Holdings Limited assigned its sub-lease to the plaintiff Sibbald, subject to the sub-sub-lease concerned.

The definition of the premises applicable to this sub-sub-lease as it now stands, following a supplementary deed of variation dated 10 March 1989 (with "lessor" read as referring to the plaintiff Sibbald as sub-sub-lessor) reads:

> *The ground area at the corner of Jervois Quay and Willeston Streets Wellington for which (sic) the Lessor is entitled to occupy by virtue of its shares in the Capital of the Company of Victoria Street Parking Centre Limited No 9072 to 9231 (inclusive) being Group 470 and by virtue of a certain lease dated August 1984 (the Victoria StreetParking Centre Lease) between Victoria Street Parking Centre Limited and the Lessor or in the event of a subsequent transfer or transfers of the said shares such lease issued by Victoria Street Parking Centre Limited in terms of the Articles of association of Victoria Street Parking Centre Limited to any person who is the owner of the above mentioned shares to a vertical height of 6.6 metres above the ground floor level and more particularly shown on the plan attached to a certain Deed of Sublease dated 14April 1983 between Riddiford Holdings Limited and the Lessee.*

The last mentioned plan is not in evidence. I was informed in argument it was not material.

Rent reviews are due three yearly from 1 December 1982. That in dispute in the currently relevant arbitration fell due 1 December 1988. Under the review clause, rent is to be fixed by agreement, or failing agreement by two arbitrators, and failing their agreement by an Umpire. Arbitration provisions are standard for a Wellington commercial lease. In particular, there is no express requirement for the statement of reasons in any award. Renewal rental is to be determined under clause 7.4(b)(ii):

> *the Full Market Rental of the Premises (On the basis of the Premises being valued firstly as the land being regarded as an unimproved service station site having regard to the then current market rental of service station sites in the central city of Wellington PLUS the then current market rental of all improvements carried out by or for the Lessor being foundations, service station structure including works, upper floor and verandah, plumbing and drainage, electrical connection to board, concrete ground slab (piles included with canopy) reinforced concrete blockwork wall and spandrels, proprietaryflooring, reinforced concrete beams, blockwork spandrels to be treated with a proprietary texturedfinish of selected colour aluminium shopfront windows with glass clear weight for size, timber framed walls unpainted gibraltar board, stain, 2 w.c.'s, 2 wash hand basins, 1 shower, connection to main board only, but such rental not to include any allowance for improvements carried out by orfor the Lessee* (such *combined assessment being referred to as "the Full Market Rental".)"*

Award documentation

The arbitrators appointed by the lessor and lessee failed to agree. As commonly occurs, both then took advocacy roles before the umpire. The umpire in due course delivered two documents, each dated 14 November 1989. The first, drawn up in legalistic fashion, comprises two pages. The first is headed as in the matter of the Act, Deed of Sub Lease, and Valuation, and has the sub heading "Award of Umpire".

After reciting the reference, and asserting consideration of evidence and submissions, the Umpire proceeds to "make this award" fixing (a) "full market rental" at $219,578 (excluding GST) and (b) his fee as Umpire.

No findings or reasoning are set out in this two page document. It is signed over the designation "Umpire". The second document, drawn up more in narrative fashion, comprises 9 pages, does not have a formal heading, but has a mid page description "Memorandum to the Arbitrators". Importantly, it commences in these words:

> *"I issue this memorandum as an Annex to* and as a part of, *the attached Award in order to inform the arbitrators of the opinions I formed from consideration of their submissions. Since copies of the written submissions are in the hands of both partiesI do not propose to review the evidence which I heard in detail but rather to set out those points which have been significant* in *my task of setting a fair and reasonable rent consistent with the terms of the lease". (Emphasis added).*

The narrative then notes the question at issue, respective contentions, definition of rent, and sets out with accompanying explanatory material calculations of the $219,578 figure appearing earlier in the two-page "Award of Umpire". I describe this reasoning in more detail subsequently. As an incidental matter, the respective two-page and nine -page documents, each separately signed and dated, are attached and page numbered in a single consecutive series, pages 1 through 11.

Award: "Award of Umpire" only, or "Award of Umpire" plus "Memorandum to the Arbitrators"?

The plaintiff lessor contends for a construction which brings both documents in as the award. The defendant lessee seeks to restrict the award to the formal two-page document.

The question, of course, is the intention of the Umpire as objectively ascertained. I was referred to the leading authorities, notably Manakau City Council v Fletcher Mainline Limited (1982) 2 NZLR 142, and also helpful recent illustrations in J Rattray & Son Limited v Telfer (unreported) High Court Christchurch, 23 October 1987, CP 417/86, Williamson J and United Shares Brokers Limited v Landsborough Estates Limited (unreported) High Court Christchurch, 18 May 1990, CP 298/89, Tipping J. I also had the benefit of detailed submissions.

I bear in mind the public interest in finality in the arbitration process, and the arguably stand alone character and formality of the two-page "Award of Umpire".

I note also that the Umpire was not obliged by either terms of reference or any proven local practice to state reasons for his award. Any action in doing so was voluntary.

However, treating the matter as one of intention, given express statement in the "Memorandum of Arbitrators" that such Memorandum is issued "as an annex to and as part of the attached award", the matter is very clear. Plainly the Umpire intended the memorandum to be read as part of the overall award. There is nothing in contrary indicators, singularly or in total, which outweighs that clear signal. I find, without difficulty, that the "Award" which the Court must consider for error of law, and otherwise, comprises both documents, and the entirety of pages 1 through 11.

Award: Reasoning

The memorandum forming part of the award is a detailed document. The Umpire starts, realistically enough, by pinpointing the "matter at issue" as being rent to be set; and interpreting Cl 7.4(b) (ii) ("Full Market Rental") as requiring:

a. a return on the "value of the subject land subject to certain specific qualifications as stated", and

b. a return on the lessor's investment in development improvements, given condition at review date.

Allowance was to be made for operating expenses (common ground), and affordability or comparability with total rent paid for other service stations was contractually irrelevant. The Umpire then took area as "now agreed to be 785m2". However, notwithstanding agreement, inspection revealed the site to be subject to, and to have the benefit of rights of way. Utility was reduced and enhanced accordingly. The Umpire recalculated as "Effective Land Area" the following:

Gross area	785m2
L= Area Subject ROW	118mZ
	667m2
EJi 50% usage of Area subject ROW	59m2
33.33% usage of Area Appurtenant ROW	1n2
Therefore Effective land area	735m2

While the pleadings are somewhat opaque, this is the first point at which the plaintiff lessor alleges error. The plaintiff presses for entitlement in accordance with the full basic gross area of 785m2.

The Umpire then turned to the "Utility which is available to the tenant in terms of his lease".

Each side contended for "different levels of Plot Ratio in order to establish the worth" of the envelope of space.

The Umpire concluded in favour of 1:75. He then ruled:

`I believe that the calculation of the worth of the envelope on the basis of its Plot Ratio relativity must be confined to the actual usage provided by the improvement constructed by the Landlord. These comprise:

At ground level the effective area stated	*735m2*
Above ground level the area of the 1st floor accommodation (Stokes Figure)	*195m*
	930m

This is the second point at which the plaintiff lessor alleges error. The plaintiff contends for entitlement not on the basis of actual usage provided by landlords improvements, ie ground floor 735m2 and first floor 195m2, but on the basis of two potential floors which comprise the full 785m2.

On the plaintiff's approach, the sub lease is said to:

"Require the value of the land to be fixed on the basis that the site was an *unimproved service station site, whereas the Umpire calculated it on the basis of the improvements (error in law); or alternatively, the Umpire was required to determine the value of the site as an unimproved service station site. He did not determine this question, but another question, namely the value of the site on the basis of its actual improvements" (misconduct).*

The Umpire proceeded onward to assess the "share of value" of the service station site so pinpointed. He ruled:

"The share of value will be a function of the value attributable to the full site area on the basis of fully allowable Plot Ratio as follows:

Full Plot Ratio

785m2 x 7.50 = 5887m2

Plot Ratio utilised in envelope 930m2

Therefore Percentage of Value 15.80%

Thus far the land value calculation may be stated as follows:

Full Site Value:

785m2 x ($8,000p.s.m. + 15% CJ.)

S7,222,000

Proportionate basic value of Plot Ratio Envelope at 15.80%

$1,141,076

The Umpire then noted need for a margin to recognise ground floor location. He applied a margin of 25% "to the 735m2 of effective ground floor area including benefit of corner influence".

The Umpire noted also that ground lfoor space "can command only 1:7.5 of Plot ratio (or 13.33% of total available rights)". He then proceeded:

"This part of the calculation may now be stated as:

735m2 x ($8,000 p.s.m. + 15%) x 13.33% x 25% *$225.343*

The total value of the land comprising the Service Station is therefore $1,141,076

Plus Ground Level Benefit $225.343

$1,366,419

say $1,366,000"

The Umpire then assessed value of landlord's improvements at

"current depreciated replacement cost as $646,000, deriving a capital value of the demised premises"

as $1,366,000 plus $646,000 ie. $2,012,000. After allowing for an appropriate percentage return on that figure, and a sum for operating expenses, the Umpire derived the $219,578 per annum specified.

Plaintiff Lessor's Submissions

As noted, the lessor submitted error in law existed in making "an adjustment to reflect the existence of certain rights of way", and in confining the worth of the building on Plot ratio aspects to improvements constructed by the lessor. On the latter point the lessor submitted

"that the sub lease required the review rental for the premises to be fixed on the basisfirstly of the land as an unimproved service station site and secondly on the lessor's improvements".

The lessor relied primarily upon the wording of the paragraph 7.4(b)(ii) in the context of adjacent 7.4(a) and 7.4(b)(iii). The lessor further submitted

"the Umpire calculated the value of the land (ie the first factor in the equation) not as an unimproved service station site but on the basis of improvements."

The lessors submission reliedparticularly upon the Umpire's reference to a belief that calculation of the worth of the envelope

"must be confined to the actual usage provided by the improvements constructed by the landlord",

and the calculation deriving 930m2 quoted above. In the lessor's submission the calculation should have used the full 785m2 without deduction for right of way, applying a multiplier of two, and in effect so allowing a full first floor potential.

Defendant Lessee's Submissions

The lessee emphasised the allotted task was to value an unimproved service station site. Potential for other commercial uses was irrelevant. More importantly, the question of limitation of potential by actual present improvements, as opposed to the alternative use of a multiplier of two, was not a matter of lease interpretation, and therefore not a reviewable question of law, but was a matter of valuation principle or method which was neither error of law nor misconduct.

Decision

The central direction in the lease was for valuation of an *unimproved service station* site.

The valuer was to disregard improvements. The valuer was to value as a service station site, allowing for ancillary uses such as refreshments for customers, and related office needs, but was not to allow for potential use for unrelated offices, shops or the like.

The valuer was required to deal with a somewhat unusual ground floor and vertical 6.6m envelop. It was subject to physical constraints on two sides, and overhead, imposed by the related building, and of course Town Planning and similar stipulations.

It was subject also to engineering and commercial realities, including in particular the practicability or otherwise from those standpoints of a service station use extending by way of a first floor structure out over the ground floor pump area.

The Umpire's approach was to take the site in the first place as unimproved land. He then made deliberate allowance for its being subject in part to a right of way.

I see no difficulty in that regard. His doing so was not a question of construction, but appraisal of utility. Part of the land was subject to user rights given to others.

That could be allowed for in a monetary sense, or it could be allowed for by notional reduction in area. The latter method chosen was a matter of valuation technique, and nothing more. Clearly, he treated that (notionally reduced) site as bare land, ie unimproved. He did not take in any of the lessor's improvements.

With equal clarity, he treated that area as a service station site. There is no hint of allowance made for potential for unrelated shops, offices, parking facilities, or otherwise. to this point, there are few problems.

The Umpire next needed, as a matter of valuation principle, to consider the utility of the notionally reduced site. It did not comprise bare land surface along, (the so-called "footprint"). It included the development potential of space above to an envelop height of 6.6m, within surrounding physical constraints.

The Umpire chose to treat that above-ground development potential as limited to the area already so developed by the lessor; in other words, the space occupied by the small first floor already installed above the ground floor shop. His reasons are not stated.

The lessor submits this limitation means the Umpire did not value an unimproved site, but through regard to the extent of lessor's improvements, valued (at least to that extent) on the basis of *improvements*. I am unable to accept that submission.

The Umpire was not bringing lessor's improvements into account, and valuing on the basis of such improvements. Those improvements would fall for appraisal at the second stageasadifferentitem. Rather, the Umpire was looking for the development potential of the unimproved site. He decided, as a limitation upon such development potential, that it would not be possible, or at least appropriate, to develop at first floor level beyond space occupied by existing structures. He may be correct in that conclusion as a matter of engineering or economics. It may be impracticable, given those considerations, to extend the first floor area out over the full 935m2 below. I have no evidence either way on that point, although commonsense raises some questions. He may be incorrect in that conclusion.

Whichever, the conclusion is not one based on some misconstruction of the lease direction. It is based on valuation methodology, applied to the actual unimproved site as seen: a matter not of interpretation, but of valuation technique. Simply because the Umpire, in the final stages of valuation has regarded the true first floor potential as in fact limited to the area the lessor already has developed, does not mean he has misconstrued the lease. I find against error of law or misconduct.

Costs

With all respect, I believe some rather clearer expression on the part of the Umpire might have foreclosed this challenge. I may be regarded as something of a mutual misfortune. I reserve costs, and will receive exchanged memoranda if desired. There may be something to be said in the circumstances for costs lying where they fall.

R A McGechan J

Solicitors:
Keegan Alexander Tedcastle & Friedlander, Auckland for Plaintiff
Simpson Grierson Butler White, Wellington for Defendant.

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