VALUERS' JOURNAL

DECEMBER
1992

IN THIS ISSUE

NEW ZEALAND INSTITUTE OF VALUERS

Incorporated by Act of Parliament

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Valuers Registration Board

of New Zealand

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ADDRESS CORRESPONDENCE TO THE REGISTRAR, P 0 BOX 5098, WELLINGTON

16 November 1992

To All Registered Valuers

1993 VALUERS REGISTRATION BOARD FEES

Background

In 1991 Government amended the Valuers Act 1948 to enable the full cost of servicing the Act to be met from within the valuation profession. This amendment enabled the Board to broaden its income base by providing for an annual registration fee to be levied on all registered valuers.

In the Board's view registration as a valuer is a valuable privilege earned by those who have worked hard and met the statutory criteria. In a nutshell if registered status is worth having, it is worth paying for and the Board has resolved to move towards a more equitable fee structure. It is nevertheless recognised there will continue to be scope for exemption from fees in appropriate circumstances.

Fee Collection by the Board

As in 1992, the Board's 1993 fees will not be collected as part of the Institute's subscription system. The Board will be directly invoicing registered valuers, and these fees are payable in addition to any subscriptions owing to the Institute. Those valuers resident in New Zealand can pay their invoices simply by taking them into their closest trading bank and using the attached deposit slip. Valuers overseas must send a cheque in NZ dollars direct to the Board.

1993 Fees

The Valuers Registration Board has resolved to meet the commitment made to the Institute last year, that in 1993 it would not increase the overall amount of fees levied on valuers in 1992. The following fees will be levied by the Board for the 1993 calendar year:

Annual Registration Fee	-	\$100 plus \$12.50 GST
Annual Practising Certificate Fee	-	\$100 plus \$12.50 GST
Retired Valuers	-	Exempt liability for fee

Practising registered valuers will therefore pay \$225.00 including GST for 1993. Those valuers who do not pay the annual registration fee by 31 March 1993 (unless exempt) may be removed by the Board fromtheRegister ofValuers.

Annual Practising Certificates

If you currently hold an annual practising certificate., an appropriate invoice will be sent to you. This is for payment by 1 January 1993, as it is desirable that every valuer hold an annual practising certificate as soon as they commence practice each year. Until this fee is paid you will not be practising legally in 1993. If you have changed your practising status please advise the Board in writing immediately.

Annual Registration Fee

If you do not intend practising (holding yourself out as willing to make valuations of land for members of the public) at any time during the 1993 calendar year, you need only pay the annual registration fee of \$112.50 including GST. If you are not currently holding an annual practising certificate and are not on our records as being retired an appropriate invoice will be sent to you. This should be paid by 1 January 1993, if not paid by 31 March the Board may remove you from the Register. If you come within the retired category as outlined below please write to the Board with a full explanation of your circumstances. The Board will consider each case on its merits.

Retired Valuers

The Board has agreed that retired valuers be exempt from liability for its annual fees. A retired valuer is one who has retired from active practice as a valuer and is not otherwise in paid employment. This is only applicable if a valuer will be retired for the full calendar year. If you are currently on our records as a retired valuer no invoice will be sent. If you should re-enter the workforce or practise as a valuer please advise the Board in writing immediately and forward the appropriate fee(s).

VALUERS' JOURNAL

DECEMBER 1992

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The New Zealand Valuers' Journal is the official publication of the New Zealand Institute of Valuers. The focus of the Journal is to publish researched articles on valuation, property investment and related matters, and to encourage the investigation and expansion of the frontiers of knowledge that cover such fields. It seeks to publish reports of decisions of hearings of tribunals, courts, and arbitrations of special relevance to the profession.

The New Zealand Institute of Valuers has a special interest in scholarly research that can be useful in property valuation and development, finance, investment, property management and market analysis, real estate and the valuation of plant. The Editorial Board is willing to work with any potential author who is developing new and exciting ideas.

Articles and correspondence for the New Zealand Valuers' Journal should be submitted to the Editor at the following address:

The Editor, New Zealand Valuers' Journal ,
P o Box 27146, Wellington, New Zealand.

All contributions should be typewritten and accompanied by a biographical note of the author. The Editor 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. Each manuscript submitted will be reviewed by the Editor to evaluate its appropriateness for the Journal and assigned anonymously for review by two or more referees. Complete editorial policy review process and style instructions are available from the editor. 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 (1992) N.Z.V.J. December page.

Contents

Articles

Editorial Comment

The judicial influence on rental review valuations and arbitration procedures

Decisions from arbitrators, High Court judges and the Court of Appeal in recent years have had considerable influence on the manner in which comparable rental data and lease terms should be interpreted by valuers so that sustainable rent review valuations are produced.

The valuation profession has, in this writer's view, benefitted considerably through the direction and guidance provided by those decisions commencing with theHighCourtjudgementofJefferies J in *Government Life Insurance Corporation v Wellington Hospital Board.* The decision was in respect of the appointmentby the Courtof a suitable person as umpire to an arbitration when the parties had been unable to agree whether the appointee would be a qualified valuer or a qualified lawyer. The decision was not only notable for the guidance it gave in respect of the circumstances when certain qualifications and experience may be advantageous or appropriate, but it also pointed up the necessity for valuers to be aware of the precise terms of a lease providing for reviews of rent, appointment of valuers and procedures to be adopted in the event of disagreement between the parties. The Courtof Appeal made it clear that it was not acceptable for valuers to proceed with rent reviews in ignorance of the specific termsof alease. Asubsequent High Court decision of Holland J in *BurnettTransportLimited vLJDavidson (and G R Fail & JA Walker)* set aside an award and required that the rent review be arbitrated again on the grounds of a misconduct of the original proceedings arising mainly from the informality of those proceedings. The umpire had considered only the written submission of each arbitrator and neither of the arbitrators had been given the opportunity to cross-examine the other.

A good measureof controversy broke out amongst members of the valuing profession on the release of the judgement of Tipping J in the High Court case between United Sharebrokers Limited and Landsborough Estates Limited (JNB Wall). This decision was widely misinterpreted by valuers as demonstrating a bias by the court for the preference of rentals agreed on review. However the judgement was simply illustrating that the umpire was perfectly entitled to prefer one method of assessment to another, supported by the evidence in submissions, and that the Award could not be overturned on the basis that a certain aspect of the evidence may or may not have been considered to a greater or lesser degree. The legal system support to Umpire's Awards was further demonstrated in the Court of Appeal judgement in *Manukau City Council v Fencible Court Howick Limited* which reversed a High Court decision and reinstated the Award. This case had revolved around the effect on the Award of an error in interpretation of a clause in the leaseby theumpire. Itwas held that the error of interpretation was not a significant factor in the determination by the umpire. However, the power of the Court to set aside an award where an error of interpretation by an umpire had had material affect on the umpire's decision was demonstrated in the *Melanesian Mission Trust Board v R M McGough (John Henry Centre Ltd)* case heard in the High Court.

The controversy involving "subjective" and "objective" clauses in leases determining rent reviews was raised in the JeferiesvR CDimockLtdcasebut largely dispelled in the Court of Appeal decision *ModickR C Limited (formerly RC Dirnock Ltd) v P J Mahoney (and Giltrap Group Holdings limited).* The appeal was dismissed but the decisions contained important opinions on matters relating to contemporaryrentreviews suchastheextent to which the profitability of the lessee's business could be considered in determining the rent, and the greater consideration that should be given by valuers to freely negotiated market rents rather than reviews of rental between existing parties. The decision stated:

"It is only a freely negotiated rent on a new letting that can confidently be taken to be truly comparable, provided of course that there are also sufficient similarities in site and otherwise." And stated further: *"In particular it shows that historical data is inadequate. Without modification from contemporary material, traditional material such as existing rents can lead only to artificially high rentsfailed businesses and emptypremises."*

The judiciary had now clearly signalled the methodology that should be adopted by valuers when assessing review rentals and had exposed the "two or three tiered rental market" as being a myth. Assistance to determine true market rents was afforded by the Court of Appeal decision involving AMP Society and Watpat Nominees Limited in the Trust Bank Centre building in Wellington. The appeals against subpoenas for full disclosure of incentives involved in tenancy agreements butcoveredbyconfidentialityclauseswe e dismissedand the way was openedforthe arbitrators to obtain access to full details of the incentive agreements and thereby calculate true market rent levels. The umpire's decision in the Trust BankCentre building rent review following the Court ofAppealdecisionappears tobeagraphic illustration that the valuing profession is benefitting from the directions that have been issued by the various judicial decisions and are being applied in practice.

Umpire P J Mahoney defined market rental in the context of his "Trust Bank" Award as:

- It is a current market rent reflecting market conditions applicable at the relevant date
- It must be a true rent and not a fictitious rental figure effected by any ancillary or side agreements
- The rental so determined must assume both parties willing to trade, neitherbeing forced, but both having full knowledge of the options available in the market.
- The rental must have regard to all the terms and conditions of the lease as well as the location and quality of the accommodation provided
- In determining the true market rent, therewilllikely beoccasions where it may be necessary for the valuer or arbitrator in addressing specific issues to apply appropriate adjustments for those factors not capable of evidential proof, provided or course that the market indicates that such adjustments are required
- Market driven evidence must be given greater weight than valuer driven evidence. This does not however preclude the admissability ofrentreview evidence, provided it can be substantiated under any responsible test that such review evidence compares with new open market lettings."

Trevor J Croot.

Damned if you do and damned if you don't

I have recently read the paper presented by Mr Bruce Bon holds, Barrister at a recent seminar in Wellington. In that paper Mr Bornholdt was critical of valuers and their approaches to rent reviews. His main criticisms can be summarised in his own words as follows:

"My belief is, that if valuers (and some do) took time off to re-examine their valuation approach to arent review or the methodology used (call itwhat you like) then we might get some sense out of the valuer. For too long the valuation profession in general terms has remained somewhat blinkered, suffering from tunnel vision, not being prepared to attack the problems in a logical and common sensemannerwiththeapplicationof sane lateral thinking to the problem at hand".

Ratherthanblinkeredandsufferingfrom tunnel vision I believe valuers are hampered by the conflict between proof as in "last sale" and projection as in "economic forecast" which has lead to the criticism levelledby MrBornholdt. Since 1987 when the market changed drastically, what was needed in establishing rentals, and, in my view still is needed, is grater emphasis on economic forecasting.

Those valuers and indeed economists who have dared to venture into the arena of economic forecasting will know of the pitfalls and the uncertainties involved and how on the face of it these uncertainties, which often result from the fact that the property market is far from perfect, may not appear to rate wellwith the evidence of past transactions. Yet reliance on that "better" past evidence can and has lead to less equity andf messthaneconomicprojectionwould have.

The law and the approach of lawyers in my view very definitely favours past precedent over economic projection and in that respect lawyers can be accused of perpetuating a blinkered and tunnel vision approach. Perhaps it is the training of lawyers which persuades them always to look back and seldom to question or depart from the decision of a higher authority on their own initiative even though they may not agree with thathigherauthority. The task andcost of upsetting precedent is inevitably at the expense of the client.

There are many examples where the law has been wrong and in my view is still wrong relating to rent reviews and in particular ground rent reviews. Instances include the recent reversal of decisions as to the awarding of interest on rental determinations. Hopefully at some stage in the future we may see a re-definition of the term "disregard the *value* of improvements" (emphasis added) as distinct from "disregard improvements". To the valuer this distinction seems quite clear but the law at present does not so distinguish.

While it cannot be denied that valuers have been slow to react to a changed market in the matter of rent reviews, let us not forget that it was the lawyers who wrote the leases and it is lawyers that who tellus what we are or are not to take into account. In reading a multitude of leases over the years one cannot help but feel that individual lawyers are forever trying to outsmart their colleagues in the interpretation of otherwise straight forward matters. Both the lessee and lessor expect the rental which shall change hands in the future should be based on the then current market level excluding a rental component attributable to improvements affected by the lessee. If valuers and lawyers were to concentrateon this principle of rent reviews then I'm sure valuers will be very capable of interpreting that position. Simplifying this aspect of leases may allow the reinstatement of the original intent of the arbitration clause as an expedient and relatively inexpensive method of resolving simple and non legal disputes. In my view this is certainly not happening at the present time.

Perhaps it is time to put away the lances and restore the integrity of the rent review provisionsofleases,fagetaboutwinningand losing and concentrate on serving the client.

A G Stewart,
Darroch & Co Ltd.

World Congress for Auckland

The fifth World ValuatianCongmsswillbeheldin Auckland from January 31 to February 4 1993.

The University of Auckland and the New Zealand Institute of Valuers together with the ISVA in London are organising the programme. Other sponsoring universities are. Amsterdam, British Columbia, City (London), Royal Melbourne Institute of Technology, Singapore and Texas.

Under the theme of International Valuation Problems in National Settings, subjects will i ncludeva uationwhenmarketevide=isscarceor aprivatepropertymarketisnonexistent; sitevalue taxation; major reforms in planning legislation; statutory licensing of valuers; thevaluer as expert witness and the coordination of international valuations. As international property investment assumes greater importancethis congress offers an opportunity to discuss some of the major issues.

A maximum of 140 delegates are expected from more than 20 countries. The fees for the congress range from NZ$1005 to NZ$1380 according to the standard of accommodation selected. Early registration is encouraged.

Further information and a registration form may be obtained from
Professor Gerald R Brown (NZ): fax 64(09) 373 7410.

Appraising Residential Property

American Institute of Real Estate Appraisers

ISBN 091178095-51988 Punted In USA. Price US$30

Reviewed by Rod Jeff eries

The aim of the publishers was to fill a need for a textbook thatcovered the fundamental concepts and procedures of residential real estate appraising. Itwas designed to instruct students and practitioners in a direct, practical manner. It is deliberately broad in scope, though providing astep-by-step guide through the valuation process. It represents the collective effort of a team of expert appraisal consultants.

This text of 443 pages consists of eight parts, with 22 chapters plus three appendices, bibliography and index.

The main parts cover: foundations of appraisal; data collection and preliminary analysis; highest and best use; the cost approach; the sales comparison approach; the income capitalisation approach; concluding the appraisal; and special problems.

It is largely devoid of practical examples, except in some of the latter chapterson the application of the sales comparison approach.

Almost slavish dependenceon the "three approaches" and liberal use ofjargon (albeit mostly defined) such asFannie Mae, Freddie Mac, and Ginnie Mae requirements (Federal and Government loan agencies), make the book rather remote and of casual interest for readers outside the United States.

I found the text interesting in its insight into the general residential property market characteristics and apprais al methodologies in the USA, but found the presentation very hard going. The "textbook" solutions in the market data grids, which show no variation in the "final adjusted sale prices", project that a 100% degree of accuracy is possible, which is quite misleading. Thebookisthick on theory and generalities, being constrained also by the requirements of the AIREA Code of Professional Ethics and Standards of Professional Practice.

The book deals in depth with some topics, such as analysing depreciation, but the outcome is rather confusing. I am still wondering what is the point, when valuing a house, of breaking down depreciation into "incurable physical deterioration-short-lived items", "incurable physical deterioration - long-lived items", "curable functional obsolescence-deficiency requiring additions", "curable functional obsolescence- deficiency requiring substitution or modernization","curable functional obsolescence - superadequacy", "incurable functional obsolescence - deficiency", "incurable functionalobsolescence-superadequacy", "external obsolescence estimated with paired set analysis", "external obsolescence estimated by capitalization of rent loss" and other gobbledegook!

On balance the subject coverage is excellent, with each chapter well presented by being broken up logically into sections including a concise summary with review questions at the end. It includes a copy of the uniform residential appraisal report forms (URAR) used by all major USA real-estate orientated government agencies, and in the appendices the AIREA Uniform Standards of Professional Appraisal Practice, as well as other recognised standard appraisal report forms.

Unfortunately, in New Zealand, this text's destiny is most likely to be a library bookshelf. It will be useful for student reference on international comparative valuation methodology, but of little practical assistance in our teaching programmes or for use by practitioners in this country. A

NZ Market definition wins global support

New Zealand has won international support for a change to the definition of market value at The International Assets Valuation Standards Committee (TIAVSC) meeting in Canada.

New Zealand Institute of Valuers President Alex Laing reports that the insistence by New Zealand of the inclusion of the willing buyer as well as the willing seller in the wording of the definition of market value was supported by the 36-member international committee at the recent Toronto meeting.

"The importance of the amended definition extends beyond just the accounting use and particularly in developing and newly industrialised countries, will be adopted as a basis for determining market prices for purchase, sale, rating, taxing and security purposes," Mr Laing said.

"As the former Eastern Bloc countries join the international business community of the free market, the need for an acceptable reporting base will be crucial and in this regard the accepted membership of Czechoslovakia is of note," he said.

Mr Laing said market value internationally was now defined:

Market value is the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction, afterpropermarketing, wherein the parties had each acted knowledgeably, prudently and without compulsion.

In deciding on a new definition, the meeting placed particular emphasis on the need for consistency, Mr Laing said.

"Considerable emphasis was placed on the new Exposure Draft 43 issued by the International Accounting Standards Committee and the views of theEuropean Group of Valuers of Fixed Assets and the Appraisal Foundation, Washington D.C.," Mr Laing said.

TIAVSC had direct contact with the International Accounting Standards Committee (IASC) through its Chairman, New Zealander Mr Graeme Horsley, a past President of the NZIV who attends IASC consultative group meetings.

MrLaing said the North American experience was well detailed with a strong swing from a complex reporting process to a bussnessdemand, particularly in theUnited States, for the uncomplicated market value test

TIAVSC's key objective is to develop international standards in the valuation and reporting of fixed assets, including land and buildings.

The Toronto meeting accepted membership applications from Iceland, Czechoslovakia, Indonesia and Mexico.

"A feature of today's fast-changing world is the increase of investment on a truly global scale, bringing with it a growing demand for internationally accepted standards to ensure the security and enhancement of those investments. Of necessity, those standards might well be changing and need to evolve. However, it is fundamental that a common approach be agreed for adoption," Mr Laing said.

The new definition will be promulgated in New Zealand by the NZIV and amended Guidance Notes will be published once background papers have been reviewed by TIAVSC.

The NZIV will also present submissions to New Zealand regulatory bodies, ensuring their awareness of the amended international standard. A

October Council Meeting 1992

Report by the Editor

The October Meeting of the Council of the New Zealand Institute of Valuers was held at Quality Inn, Oriental Bay, Wellington on 4-5 October 1992 commencing at 9.30am.

President Alex Laing welcomed councillors, invited guests and representatives of the Executive Committee. Apologies were received from Roger Stone and Graeme Horsley who were both overseas. Tony Fraser was welcomed as deputising Councillor for Hawkes Bay in the absence of Roger Stone. Minutes of the previous Council meeting were confirmed as a true and correct record of those proceedings.

President Alex Laing introduced Mr Errol Miller who was invited to attend the planning session as facilitator. Mr Miller outlined procedures for the planning session which was to covergroup discussions and recommendations on the role of the institute in research, services, education, standards, membership and international relations. The planning session commenced at 9.45am and concluded at 3.30pm with a short break for lunch.

Reports from Nominees to External Organisations

COUNCIL OF LAND RELATED PROFESSIONS

David Henshaw reported that CLRP had been disbanded but a draft constitution has been produced for a replacement organisation proposed as the Federation of Property Institutes. Council agreed that the draft constitution for a proposed federation be considered.

MASSEY FOUNDATION

Bill Cleghom, Vice President reported on the activities of the Massey Foundation in funding overseas travel for university personnel and for research projects. He advised that Mr N Darroch and Dr S Locke of Auckland had recently been appointed to the foundation.

REAL ESTATE, VALUATION & PROPERTY MANAGEMENT EDUCATION FOUNDATION

President Alex Laing advised that over recent years the NZ Institute of Valuers had contributed significantly to the establishment of chairs and departments in property studies at Auckland, Massey and Lincoln Universities but that it was now time that separate foundations were established at Auckland University and Lincoln University as had been done atMassey University.

INSTITUTE OF PLANT AND MACHINERY VALUERS

Earl Gordon reported on recent activities of the IPMV and advised that there are now 65 members.

Merger Proposal

President Alex Laing reported that he had visited all institute branches except one this year and has discussed the merger proposal with members. He advised that a generally positive reaction has been received.

John Larmer, Vice President, reported on meetings that had been held with representatives of the Property Management Institute and the NZ Society of Farm Management and advised that the target date of 30 June 1993 has been set fora poll of members of each institute to determine the merger proposal. A green paper is to be prepared on the proposal, explaining it in detail, for distribution to all members. A lfow chart was presented to Council setting out the steps to be taken in preparing for a referendum of members.

Valuers Act

President Alex Laing advised that a draft of the revision of the Valuers Act 1948 had been received by the institute and it is tobereviewedby himselfandJohn Gibson, Chief executive officer and comments and amendments noted.

International affairs

Pan Pacific Congress 1992. President Alex Laing reported on NZ Institute of Valuers continuing participation in the Pan Pacific Congress and outlined strategies for a bid to host the year 2000 congress in Auckland.

Council agreed that a brief history of Pan Pacific Congresses since 1963, cataloguing all the papers, should be prepared at a cost of up to $8000.

TIAVSC

John Larmer, Vice President, reported in the absence of Graeme Horsley that TIAVSC had now agreed on a redefinition of Open Market Value which includes the willing buyer concept. He advised that the NZIV Residential Standard has been amended to the effect that all residential valuations are to be completed on a Goods and Services Tax inclusive basis. Members of the institute are to be provided with a copy of the revised standard.

Standing Committee Reports

EXECUTIVE COMMITTEE

Council considered and confirmed the Mission statement and Aims and Objectives of the Executive Committee. Ian Gribblereportedon inconsistent standards that are being applied by branches to the qualifying experiencerequired forANZTV status. A report with a recommendation on amended procedures is to be prepared by Ian Gribble for presentation to Council.

President Alex Laing reported that Coopers & Lybrand have been commissioned to review the institute computer system and to make recommendations on upgrading the system. Council approved expenditure of up to $40,000 over the next three years to implement the recommendations of the consultants.

PROFESSIONAL PRACTICES COMMITTEE

John Wall, chairman advised of two complaint investigations that have been successfully carried out by appointees of the Committee and that in one of those cases the complaint was not prosecuted before the Valuers Registration Board. He reminded Councillors that branches mustbe careful in handling complaints to ensure that an investigation is not commenced into any matter involved in the complaint through actions of the branch.

Planning Session Report

Erroll Miller presented his report as facilitator to the Council on the Critical Success Factors in the Institute highlighting significant issues which need to be considered by the council for the future.

LPMS

Lindsay McAlister NZIV nominee to the Land Professionals Mutual Society reported on recent activities of the Society. He advised that there are now a total of 253 firms involved in the insurance scheme, of which 150 are valuation practices. Loss Prevention Seminars promoted by the Society had recently been held in most North Island centres with only adequate attendances by Institute members on most occasions. Seminars are to be held throughout the South Island in the near future.

Mr McAlister advised that 26 claims or alerts against valuers are currently before the Society. He noted that professional indemnity insurance cover on the world insurance market is cur: ently "hard" with premium rates rising. He advised that the LPMS had incurred a substantial loss again this year.

PROMOTIONS CONIlMTTEE

The Council, considered and confirmed the Mission Statement and Aims and Objectives for the Promotions Committee and confirmed the proposed budget.

Alan Stewart, chairman, reported on the NZTV Young Professional of the Year Award proposal and the Council agreed to the terms of the Award. It is to be offered from 1 January 1993 and nominations are to be for institute members or affiliates who are 30 yeas of age or less and who have a significant professional participation with NZIV or who have completed original research of outstanding significance and/or authorship of outstanding significance coupled with outstanding technical and/or professional excellence, or have made a significant contribution to the community that has brought credit to the valuing profession.

Alan Stewart advised that new brochures promoting the services of registered valuers for residential, commercial and rural valuations are being prepared. He reported that the new thrust of the Promotions Committee is to include visits to branches by the Marketing Manager of the Institute with the costs to be included in the Committee budget.

EDUCATION BOARD

Bill Cleghorn, Vice President and chairman of the Education Board, advised that the Mission Statement and goals and objectives had been reviewed and confirmed by the Board. Council approved a budget for the Education Board after BillCleghom had outlined the need for budgetary resources to be provided so that the Board could conduct the Continuing Professional Development programme and to further other research and education matters. He advised that further discussions had been held with the Valuers Registration Board in respect of the Continuing Professional Development Programme and the proposal that fulfilling CPD requirements for Institute members should be a requirment for the issuing of annual practising certificates by the Valuers Registration Board.

Council agreed that a memorial for R J Maclachlan should be recognised either through the nam ing of the Institute Library or by introducing anannual R J Maclachlan memorial lecture to the Institute calendar.

SERVICES COMMITTEE

Tony Gowans, chairman of the Services Committee, advised that the Mission Statement and goals and objectives had been reviewed and confirmed by the committee.

Bob Hargreaves reported thattheNZIV Services Limited company is to bewound up. He outlined a proposal fora task force to be established by the committee to further develop, on a commercial basis, computer based valuation data and programmes. Council approved the allocation of $7500 from reserves as an advance to the proposed establishment board (as a taskforce) to be set up. The Council approved the Services Committee budget.

John Gibson, Chief Executive Officer, reported that new Modal Building Costs have now been completed for approximately two thirds of the country and have been published in the current issue of Statscom. He advised that there has been difficulty in completing nationwide coverage for the Modal Costs due to budgetary constraints and the high level of expenses demanded by some building firms to provide costings.

STANDARDS COMMITTEE

JohnLarmer,vicepresident, intheabsence of the chairman, Graeme Horsley, reported that the committee had confirmed its Mission Statement and goals and objectives. He explained the composition of the committee and the status of its various members.

Council approved with some amendment the standards for The Valuation of Residential Properties and for The Valuation of Rural Properties. The amendments are to be included in a reprint of the standards for distribution to members.

EDITORIAL BOARD

Bill Burgess, chairman of the Editorial Board, advised that the Mission Statementandgoals and objectives oftheBoard had been reviewed and confirmed. He responded to questions from Councillors regarding the New Zealand Valuers' Journal as a refereed publication and advised that there had been some conflicting advice received as to the requirments for acceptablerefereed status. He advised that the matter was being further considered by the Board and was on the agenda for further discussion at the forthcoming meeting.,

Council agreed that up to four pages of suitable commercial advertising should be included in each issue of the New Zealand Valuers' Journal.

EDITOR'S REPORT

Trevor Croot, reported that a satisfactory flow of suitable articles was being received for the Journal and that these were largely being contributed from university oracademic sources. He advised thatgood quality and cost effective production editing is continuing to be provided by Vicki JayneofWordsmithPartnershipandgood printing services at competitive cost are being produced by Devon Colour Printers. Minor publication changes in style and format are continuing to be made to improve the Journal.

WESTBROOK HOUSE - BODY CORPORATE 66017

John Gibson, Chief Executive Officer, presented a report on Westbrook House advising of recent work carried outon the building and a future maintenance programme.

Financial

Council approved a budget for 1993 showing a surplus of $13,025 and with working capital and reserves standing at $274,500.

Increases in subscriptions for 1993 approved by the Council are:

Registered Valuers (NZ)	$310 +GST
Non-registered	$170 + GST
Overseas	$140 + GST
Retired rule 14 (1)	$50 + GST
14(2)	
Free	
Affiliates (Non IPMV)	$170 + GST
IPMV levy	$60+ GST
Non-active	$170 + GST
Advancement/entry fees	$30
Life/Honorary	Free

Subscriptions and charges for theNew Zealand Valuers' Journal were approved at

Casual annual subscription	$50 + GST
Professional cards publication per insert	
to 2cm column depth	$45 + GST
to 3.5cm	$60 + GST
to 4.5cm	$72 + GST
over 4.5	$96 + GST
Advertising	
Full page	$750 + GST
Half page	450 + GST
Quarter page	$250 + GST
Loose Leaf Inserts	$1000 + GST

Services Committee subscription were approved at:

Microfiche sales data:	
Sole practitioners	$400+ GST
Multi-users	$600+ GST
Archival copy with	
Electronic data supply	$150+ GST
Statscom	$100+ GST

The Council confirmed Branch capitation remain unchanged for 1993. A

Valuation of Land Exclusive of Improvements

by R L Engelbrecht

Bob Engeibrecitt is a Fellow of the NZIV and;< principal of E gelbrecht oyds Co, farm man'; age nt consultants oral registered valuers fit Ashburton Bob graduated fromt Lincoln College !, with a;Diploma in Agriculture a id was the Gold tlXedc Tlst with distinction In X9 lie ct rrgtleted;I a Diploma in Valuatio and Farm Managemrent and was Gold Medallist with Honours in 1966

Bob atgelbrechtlsaFellowvfthcNZSocie of `arm Managemtent a cd was a founding meta ;; bet of the Society He is widely recognised far: expense to diverse mined fai ring en,erpnse andpartieularly intheuse of irr gation. l ath asa valuer and as afar nagement consultant

' n my view, the concept of LandExclusive of Improvements (LEI) is now obsolete. No-one knows or remembers what the land in many localities was like in its original condition, particularly rural land.

In an urban situation, the degree of development and the value of development of land is usually very small relative to the value of the land or site itself. For this reason, there is little problem with the LEI concept in these circumstances.

With rural land the situation is significantly different.

Rural valuation is an art rather than a precise science, but surely more factual data and less subjective judgement would not only result in a more accurate assessment of a particular property, but would reduce the chances of dispute and variationof opinionbetween valuers. This must lead to an improvement in the professional standing of valuers, in circumstances that can never be more than a matter of opinion. There can never be an objective or finite judgement.

What is "original" condition? Is itpre-European? Pre-Maori? At what date are we appraising the land? To a greater or lesser degree the land is constantly changing, being modified by nature, irrespective of man's influence.

Therearefew areas now of unimproved land (LEI) and, obviously, even less sales of such land. Even land that has been subject to no development at all, is influenced by what happens on the land adjacent to it, even if it is excluded from livestock grazing. The spreading of pasture and weed seeds by winds, insects or birds is but one example of the natural influence that will modify the land over time.

This is especially so on the plains area of Canterbury. The extremes in changes to the basic land resource is perhaps shown most clearly on the shallow Lismore soils in low rainfall areas of Canterbury, which havebeen developed forborder-dyke flood or sprinkler irrigation. Many of these areas could not now be recognised as the original soil types. Even the nature of the soil has changed after 20 years or more of intensive irrigation farming.

So, what alternatives do wehave to the LEI concept? To be honest, I have not given much thought to the possibilities. Perhaps a "Land Value" system would be more appropriate nowadays. With technology available now we can record in detail, in the form of photographs reports, etc, with a high degree of accuracy, the state of the land on farm by farm, or even paddock by paddock basis, at a particular point in time. This may then be updated from time to time, balancing the value of the individual assets owned by the lessor and lessee.

Fortunately, no more Crown Renewable Leases are now being created.

"LEI is determined by deduction from total current market value of the subject property"

In the meantime, however, we are stuck with the present system and need to work within the rules affecting the various components of farm land values. While some academics may deny the reality of the situation, the fact is that ultimately, LEI is determined by deduction from total current market value of the subject property. W hat a prudent purchaser would pay for an undeveloped property clearly linked to the real cost of putting the development improvements in place.

It is only in the case of a disputed valuation that most valuers will endeavour to estimate the likely fair sale value of unimproved land by one method or another.

I do not believe that we can generally rely on the sales of leasehold properties or free-holding sales as evidence of the value of LEI as there are usually a number of complicating factors.

Sales of Leasehold Properties

On one hand, one can argue that a lower capital requirement will increase the sale price of leasehold properties above the market level for the time being. On the other hand, the uncertainty of what is being purchased, the attitude of lenders and unknown future rentals can leave a purchaser very cautious and willing to pay a lower-than-market-price for the leasehold property.

Few valuers can agree on the value of the LEI. It is difficult to believe that farm purchasers and vendors are able to assess this value any more accurately.

Freeholding Sales

In most cases, the owner of the leasehold property is largely captive to the free-holdingofferputby theLessor. His choice is usually whether or not he accepts or rejects the offer. In some leasehold arrangements he has no automatic right to freehold.

In recent years there have been various incentives provided for free holding (such as discounts andconcessional interest rates on loans offered by the vendor) which makes the offer more attractive and must influence the lessees attitude to the assessed sale value.

The potential freeholder usually does not wish to face the costs of valuing, negotiating and/or arbitrating lower values. He is dealing with a set of circumstances with which he is usually quite unfamiliar. He simply considers the alternative of likely increases in future rentals and the independence that freeholding will achieve.

Factors Affecting the Value of Land Exclusive of Improvements and the Added Value of Improvements

The components of land value - the unimproved land for the lessor and the land improvements for the lessee are undeniably and intricately merged.

While"cost" is notnecessarily"value", it must finally be the major influence on value. Technology changes very rapidly nowadays. As land is improvedorallowed to deteriorate, we must continue to assess and review the effects that different factors have on the balance between unimproved land and the improvements to that land.

These factors may be divided broadly into two classes

1. *Art cial factors,* including changes in Government policy and legislation, etc - these factors are almost exclusively beyond the control of the individual lessee and,
2. *Technological factors,* such as improvements to the land by various means - factors which are directly within the control of the lessee.

Let me briefly review the factors involved. (My comments relate mainly to Canterbury in general, Mid-Canterbury or Ashburton Districts in particular, although many of the issues raised relate equally as well to other parts of New Zealand.)

1. Artificial Factors

1.1 Income Tax and Depreciation Rates

In November 1985 the Government introduced a phasing out of the tax deductibility of many aspects of farm development (See below)

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While new fencing, weed and pest control and some other management operations were changed from being tax deductible to non-tax deductible and recently, back to being tax deductible again, improvements such as new irrigation development has remained non-deductible, atleastin themeantime. These tax changes must have the effect of increasing the real costs of development and ultimately, the real added value of such development.

Equally, changes to the allowable depreciation rates on both non-deductible developmentand structural improvements such as buildings must alter the added value of such improvements to a particular property.

Note it must be recognised here that such changes can be made at the whim of changing Governments, so that the relativity between the value of LEI and the value of the improvements maybe altered quite significantly at any time.

Over the years farmers have tended to spend money on developmentoptions that were of doubtful profitability to avoid paying income tax Similarly they paid high prices for undeveloped land to acquire development opportunities.

Hopefully that attitude is now disappearing, although with the price paid for some undeveloped or poorly developed farms in recent months, one cannot be too sure.

1.2 Inflation Rates

In 1982, farm values reached a high point, following the inflationary trends at that time-even exceedingtherateofinflation.

In 1986 and 1987, as a consequence of sharply increasing farm costs and falling product prices, farm profitability and subsequently farm values fell sharply, to less than one third or even one quarter of what they were in 1982 in some cases. At the same time, inflation was still romping along. The cost of buildings and other farm improvements was still rising sharpl y.

In these circumstances, the LEI had to be diminishing to a very low value. One could argue that in some instances, the unimproved land had no value at all, save for that which a confident speculator may pay in anticipation of a reversal of the farm value decline. There were not too many of those speculators around, or farm land would not have fallen so low.

There was a period when, in parts of Canterbury, a farm could be bought for the depreciated value of the structural improvements; forget the value of the land development.

For a time, there was also an "anti-irrigation" attitude prevailing, following the large scale government-subsidised sprinkler irrigation development that occurred in the late 1970's and early 1980's, particularly those schemes f unded by what is now notoriously known as the "time bomb" loans.

There was almost a "negative" added value for sprinkler irrigation schemes on recently developed farms at that time. This would, of course, be a deduction from the added value of improvements.

Conversely, in times when farm values are increasing at a greater rate than inflation, and the cost of improvements is more or less stable (as has recently been the case), then the value of LEI must increase at a greater rate than the value of improvements.

> "Comparing the value on a "per stock unit" basis between the carrying capacity of the undeveloped land and the current land value can provide an accurate guide to the value of Land Exclusive of Improvements."

13 Interest Rates

In low rainfall, shallow soil areas, the development of soil fertility under dry land conditions, even with the benefit of modern technology, can take many many years to achieve.

For this reason, there is a long lead time to achieve soilfertilityimprovement, which must be credited to the land improvements rather than the unimproved land.

1.4 Farm Profitability

When farm profitability is low and farm values trend downwards, then normally most farm improvements will retain most of their value, while the LEI will decline.

In 1986/87 it would have been difficult to derive any net income from many areas of unimproved, low rainfall, shallow soil properties in coastal Canterbury. This even includes the option of using minimum inputs, and low cost high performance stock units such as fine wool production.

Soil Bureau Bulletin No. *14, Soils of theDownsandPlainsCanterburyandNorth Otago* , published 1967, states that these soils *`were usedasextensivegrazingareas carrying three-quarters of a ewe per acre. They are essentially droughty".*

Comparing the value on a "pea stock unit' basis between the carrying capacity of the undeveloped land and the current land value can provide an accurate guide to the value of Land Exclusive of Improvements. 0

1.5 Community Conferred Benefits

Wherenow lies the added value of owning an undeveloped farm within a community irrigation scheme boundary? Fann cooperatives have recently purchased these schemes from the Government. It could be argued that in times of low farm profitability, development was uneconomic and that the $12/ha water availability charge was actually a negative factor in assessing value.

What about the undeveloped dry land farm, within the Scheme boundary, where the right to take water has been relinquished and thefarm may only recoverthatrightfor irrigation water at the discretion of the local management committee?

What is the effect of these circumstances on the value on unimproved land?

Remaining in the Amuri Plains Irrigation Scheme in North Canterbury are Government-funded suspensory loans that are available to some farms for apredetermined time and may be transferable to anew farm owner.

What effect will these conditions have on anundeveloped or semi-developed farm within the Scheme area, particularly as the deadline for the availability of such loan draws closer?

1.6 Product Moratoriums

At present, no new dairy farmers are able to supply the Alpine Dairy Company. However, existing dairy farmers may expand their enterprises over additional land, providing that the existing dairy shed is used.

This moratorium may be changed next month, next season, or possibly in two or three years time. Given the premium that has been paid for land suitable for dairy conversion, what effects on LEI value do the above factors have, with all other influences remaining constant?

1.7 DDT Residue Levels

This is an ironic situation. The poorly developed and conservatively farmed properties of two or three decades ago (so long as they are included within the irrigation scheme boundaries) have now become the premium properties for dairy conversion.

Those farms thatwere "well managed", using DDT to control the serious grass grub pest have now become disadvantaged and devalued.

What are the effects on LEI of a property that

- has unacceptable levels of DDT residues?
- has marginal levels of DDT residues?
- has either of the above from random check samples only?
- has had all paddocks sampled as required by the Dairy Company?
- What about the farm that has had no DDT residue tests taken at all?

Overtime, the allowable levels of DDT residues havebeenprogressively decreased. There are some dairy farms that are operating under approval and successfully farming with soil residue levels that would not be acceptable for conversion today.

"No one remembers what the land in many localities was like in its original condition"

How do we accurately assess the LEI value on properties with the range of variations that are present?

(Note - I have no criticism of the dairying situation. Dairy farmers have to manage their livestock and farms very carefully to minimise the effects of DDT and avoid dairy company penalties for unacceptable residue levels in the milkfat. I simply use the variations to demonstrate the range of situations that are present and the considerations that individual valuers must make in assessing both current market value and the value of LEI.)

2.0 Technological Factors

2.1 Borderdyke Irrigation

With the purchase of the community irrigation schemes from the government, one has to consider whether or not the added value (if there is one) of being in an irrigation scheme belongs to the LEI: or the land improvements.

Does the value of irrigation development and/or LEI vary depending on the reliability of the water supply or its source?

For example, surface flood irrigation will normally use more water than overhead sprinkler irrigation. Where does one place the value then, on a borderdyke irrigation scheme that uses underground water from a shallow well, or perhaps a deep well? Both these types of properties exist

What effect do the increasing water restrictions on the communityschemes have on farm values and the components of value, particularly if theserestrictions were to remain or perhaps ever increase?

It is interesting to note that the cost of borderdyke irrigation development is, in many cases, lower now than it was in the headydaysofthelate 1970's/early 1980's.

This is a consequence of intense competition by contractors for the limited work available in recent years.

2.2 Sprinkler Irrigation Development

While acknowledging the discount that was placed by farm buyers on sprinkler irrigated farms in the 1986/87 period, the situation has now reversed to a degree where farmers are now recognising the potential of sprinkler irrigation on shallow soils close to the coast, with the versatility and flexibility of production options that such schemes provide.

There are, however, a number of factors that need to be considered. As mentioned above, on a number of farms at least, the soil changed significantly in nature and certainly in performance over the 20 odd years since first development.

It would be difficult for even the skilled eye to recognise the soil as the same basic soil type on the adjoining dryland farm, let alone the same soil undeveloped, if in fact it still existed anywhere in the locality

How then does a valuer identify the soil in its undeveloped state let alone attempt to place a correct value on it?

The value of the development on these soils must be appraised very closely, both for leasehold and freehold valuations, because the time factor, along with the standard of management, is very significant in determining the potential production and profitability.

I was fascinated recently to we in a valuation reporta global figure of $30,000 for added value of sprinkler irrigation development on 160 hectares of shallow Lismore soils.

While undoubtedly, some of the added value from irrigation must be included in the land value, I have no doubt that a prudent farm purchaser would have paid significantly less for the subject property without the irrigation scheme, (the deep well, electric motor, pump, control system and underground mainline network), in place.

Some of the factors that may affect LEI or improvements value are:

- the standard of farm management (which influences the degree of soil fertility development and productive potential),
- the length of time the farm has been irrigated,
- the amount of water available per unit area (which influences the scheme capability and productive potential),
- the percentage of the total farm area commanded by the irrigation scheme (which, while water may be limited, a high percentage commanded may allow an important strategic irrigation of, say, a winterfeed crop or new grass establishment),
- the depth of water in the bore- static water level (which influences pumping costs and consequently, farm profitability),
- the shape and dimensions of the farm (which significantly influence the efficiency of a sprinkler irrigation scheme. For example, ascheme which

"How many valuers ask the appropriate and necessary questions to determine the effects of efficiencies on farm value?"

provides optimum irrigation layout, avoiding overlapping or misses, is significantly more effective and efficient than a triangle shaped block of unsatisfactory dimensions),
- the existing irrigation scheme specifications compared with "optimum" scheme specifications.

Even the well location, whether at the top or bottom end of the farm (assuming the same static water level), will effect cost of irrigation operation, farm profitability and ultimately, farm value.

How many valuers ask the appropriate and necessary questions to determine the effects of efficiencies on farm value rather than just place a broad "added-value" figure for irrigation development?

While, as valuers, we must reflect the actions of buyers and sellers and their attitudes to purchase and sale of farm properties, we have, in my view, a clear responsibility to show a lead in many of these areas acknowledging the issues and adding or subtracting value fora wide range of factors.

What about a dryland farm in an area of known reliable deep wells?

What about a farm with an unsuccessful deep well?

What about a farm where a narrow gauge well is incapable of providing the volume of water required for the farm compared with a larger diameter bore that could have delivered this capability?

Note - aside from the farm managementcapability, all the factors noted above are fixed for the time being and will continue to influence the farm efficiency, profitability and, ultimately, farm values.

What are the effects of these factors on unimproved land, land improvements and structural improvements?

A recent farm sale in the Dorie area showed what I believe is a partial recognition for some of the above listed factors - the shape, paddock layout and dimensions, and irrigation scheme network were the ultimate in design for ongoing irrigation efficiency. New fencing, shelter planting and a central access lane enhanced the property presentation overall, along with a relatively consistent stone-free soil.

The farm sold for 48% above its 1 October 1991 Government V aluation. Only 56% of the farm was commanded by a near-optimum sprinkler irrigation layout, with water availability being the main limitation. The scheme had potential for extension into the dryland area of the farm.

Given that dryland farms in this locality have been selling at a narrow margin above the October 1991 government valuation, it is my assessment that a substantial premium was paid for the potential of the irrigated part of the property.

Since that auction on 30 April 1992, there have been further sprinkler irrigated properties commanding similar premiums.

Earlier mention had been made of the effect of rabbits and hieracium on the use of both unimproved land and developed land and the value of such land in the Mackenzie country.

We must also take into account the obsolescence of farm improvements, which may result from changes in technology and land use.

Summary

The important message is that we must continue to review and re-assess our methods of determining the various components of farm values.

We have an obligation, both to the public at large and the profession, to apply adequate research and make correct judgements as objectively as is possible.

The recent judgement by the Otago Land Valuation Tribunal on the value of Land Exclusive of Improvements on a farm in the Clinton area clearly demonstrates the issues, inadequacies and complications faced by valuers in respect of the relativity between the values of LEI and the added value of improvements.

This 56-page judgement should be studied by all valuers likely to involved in LEI valuations in future.(Published in this *issue. Ed)*

I trust my paper may provide the basis for debate and discussion of the various issues involved.

I have tried to be a little provocative, while at the same time identifying some of the issues which need to be addressed on a daily basis by valuers operating in the rural area. A

Rent Reviews in the Light of Wust Bank

by M R Hanna

Malcolm FFptttta is aFellow o theNZInstitute' of valuers a member of the American Socie y of ` Real Estate Counsellors, a Felloy of the Chartered Institute 4f Arbitrators and a Fellow oftreArbitratorsInstituteofNewZealand lie isa drrectorofRoberlsonYoung TelferLtdandi has» ore than 20 years' experience practising in ellington and `throe bout the <countr . specialising in Central Business District and"." ustria ..... tons; arbitr on ani property consultancy. Malcolm Hanna was for tnany years a member of ...,,,.:a luers Registration!..: Board and of the Land Valuation Tribunal '>

he subject of this paper is Rent Re-
T views in the light of Trust Bank a subject that is both stimulating as well as being cryptic and enigmatic.

Thecryptic part is, ofcourse, thephrase Trust Bank; the enigmatic is "in the light of"; and the stimulation is for any of my readers whose eyes light up when they hear the phrase "rent reviews". Each part of the title has its own sets and sub-sets.

Let me start with the cryptic.

A great many of you will know that the words "Trust Bank" in this context are a code or shorthand for the Award by Umpire P J Mahoney in the matters at arbitration between Australian Mutual Provident Society, as lessor, and Watpat Nominees Ltd, as lessee, in respect of a review of rental for a three year term from 1 June 1991 for certain demised premises described as Levels 9-20 inclusive, forming partof the Trust Bank Centre,No 125 The Terrace, Wellington.

But for those of you who are not familiar with the circumstances of that Award, it may be that I should give you some background to the matters which were then in dispute.

Trust Bank Centre is an office tower standing upon a seven floorpodium which includes two levels of retail accommodation fronting to Lambton Qu ay and forming a part of the "Capital on the Quay" complex. The remaining five levels are of carparking with access from The Terrace via the neighbouring UDC Tower. Above that podium rises a 13-storey office tower generally known as Trust Bank Centre. This building was completed in 1990 and is of superior quality by local standards. It is fully air conditioned and is finished, serviced and fitted out to levels well above the average.

It is also of a handsome architectural style and its location allows the benefit of access from both The Terrace and Lambton Quay, together with a good outlook including fine views across the CBD to Lambton Harbour and the surrounding hills.

In short Trust Bank Centre would generally be regarded as one of the four or five best office buildings in the city.

As I understand it, development of the site was first considered by the owner, AMP, early in 1987 and they entered into negotiations with the prominent legal firm, Rudd Watts & Stone, with the view that the solicitors should become one of the anchor tenants. As a result of subsequent negotiations, Rudd Watts & Stones' nominee company, WatpatNomineesLtd., finally became the head lessee of the whole of the office tower with the exception of that small area of office space which is located on Level 8.

As to rental, the parties agreed that the initial rent under the lease should be set at a rate which was consistent with the then ruling market rate for similar space in the city, with the proviso that such amount should be increased by a pre-determined annual percentage compounded monthly until the date of occupation.

> "The Trust Bank Arbitration... became an event which illuminated the procedures whereby reviewed rentals have come to be determined"

In protection of the interests of both the parties it was further agreed that this compounded rent should stand only for the first year of the tenancy, and that it would then be reviewed without ratchet for the first full period of the triennial review sequence which was to continue to the end of the term some 14 years later.

We now know that, in the event, market conditions changed radically between the time of agreement and the date of occupation of the building by the lessee on 1 June 1990, and they were indeed contended by Watpatto have changed still further by the date of that first unratcheted review one year later.

The dollar amounts which were at issue and which were finally awarded need not concern us, but it is of interest that the Hearing, at which the parties were both represented by leading legal counsel, was strenuously contested and extended over a period of some 13 sitting days, producing several large volumes of the transcript of evidence from 20 witnesses, and ranged widely across the principles as well as the details which were before Umpire Mahoney.

In turn his Award, when published, ran to 59 pages of close-typed script and I believe that that document has b een widely, if unofficially, read and it has certainly been widely discussed around the city.

That then is a decoding of those cryptic words Trust Bank and they lead me neatly through to the enigmatic phrase "in the light of".

I have heard the Trust Bank Arbitration described as both "a benchmark" and as a "mile stone", but it is convenient here to see its effectby using another metaphor, that of "a beacon" for, whether because of a chance of timing or because of the size of the stakes, it became an event which illuminated the procedures whereby reviewed rentals have come to be deter-

This paper was presented at the seminar promoted by Simpson Grierson Butler White, solicitors, in association with the Arbitrator's Institute of New Zealand , held in Wellington 1 July 1992

mined, and so enables us to distinguish more clearly the obstacles of principle which may yet be before us.

In the light of Trust Bank we can now look back across the past three or four disputatious years and appreciate the achievements of that period in clarifying the principles by which most commercial rent reviews shall be determined. In saying that, I do not mean that the relevant legal principles were not well established before the flush of commercial office rental arbitrations which have occurred in this city from late 1988 on.

Far from it; but I do mean that the practitioners involved, and in particular the valuers, have come to better understand the objectives of the process.

For example I was particularly struck during the Trust Bank Hearing that there was no effort by any of the parties to resuscitate that now discredited monster, "the two-tier market".

It was accepted, I believe by all participants, that since the lease required that we should set the "current market rental" then this meant that our objective must be to establish what rental would have been paid in the open market at the review date to lease the premises with the assumption of vacant possession for a period equivalent to the balance of the available term and otherwise under the general provisions and conditions of the existing Deed.

Over earlier years some valuers had been of the persuasion that where a rental was the subject of review, the best evidence was from other reviewed rentals. I am happy to report it is now generally accepted that, while such evidence may be of some weight, its precedence is well below that of freely negotiated rentals in the open market place where neither party is bound by contract and where each has the opportunity to walk away until the time at which he makes a contractual commitment.

> "...gradually with the assistance of right minded Umpires, the proper interpretation had been achieved"

During those earlier years, both English and Australian case-law had been used to argue for and against that proposition, but gradually with the assistance of right minded Umpires, including in particular my friend Mr Bruce Bornholdt, the proper interpretation had been achieved.

Notwithstanding those advances, relevant New Zealand case-law had been lacking.

It was not until the decision by the Court of Appeal in *Modick RC Limited v. P.J. Mahoney* (1991) CA 12/90 that substantial local authority became available. It is true that this case related to a rental review under what are sometimes described as "subjective" criteria but the Court seemed to state clearly its view of the general principles which should be applied.

In his Judgment when referring generally to the rental issue Cooke P. stated that:

> "*A clause of the kind found in the present case, under* which *the enquiryis as to the rent that would be agreed between reasonable parties embodies the same idea and indeed is a manifestation of the familiar willing vendor - willing purchaser test. The question is what figure would notionally be agreed upon by the parties,* acting *freely and adequately informed? Figures fixed by arbitration or rent reviews as between captive parties are not necessarily a reliable guide, since they do not represent the unfettered playof marketforces, but rather the Arbitrator's assessment (assuming that he has applied himself to the task correctly) of what market forces should produce.* It is only a freely negotiated rent on anew letting that can confidently be taken to be truly comparable, *provided of course that there are also sufficient similarities in site and otherwise". (My emphasis)*

This is, I submit, a powerful authority and its effect and that of the determinations of other learned judges and umpires was summarised by Umpire Mahoney in his Trust Bank Award as follows:

"A market rental so determined must therefore ensure that:

- It is a *current market rent* reflecting market conditions applicable at the relevant date.
- It must be a "true" rent and not a ifctitious rental figure affected by any ancillary or side agreements.
- The rental so determined must assume both parties willing to trade, neither being forced, but both having full knowledge of the options available in the market.
- The rental must have regard to all the terms and conditions of the lease as well as the location and quality of the accommodation provided.
- In determining the true market rent, there will likely be occasions where it may be necessary for the valuer or arbitrator in addressing specific issues to apply appropriate adjustments for those factors not capable of evidential proof, provided of course that the market indicates that such adjustments are required.

Market driven evidence mustbe given greater weight than valuer driven evidence. This does not however preclude the admissibility of rent review evidence, provided it can be substantiated under any reasonable test, that such review evidence compares with new open market lettings."

In this area, then, rent reviews are likely to be more sensibly and fairly contested in the light of, if not because of, Trust Bank.

But there are other matters which were also illuminated Perhaps the best reported of these relates to the constraints of Confidentiality.

As it happened, confidentiality agreements had been imposed by contract between other lessors and lessees whose rentals were thought to be relevant to the determination of the rent for the Trust Bank Centre.

In particular, leases existed between,the owners and tenants of the IBM Centre which were thought to be driectly comparable to and thus relevant to the Arbitration. But information concerning those leases was not available to the valuers other than by common gossip.

Since the parties to the confidentiality agreements declined to make available the details necessary for analysis by the valuers, counsel for the lessee subpoenaed representatives of the landlord and tenant with a view to obtaining the information from them before the umpire.

In turn, these parties applied to the High Court to have the subpoenas set aside and, after that application was declined by Greig J, the matter was taken to the Court of Appeal. The Court in its Judgment *re. Dickinson* (1991) CA268/91, clearly reinforced the thrust of its determination in *Modick*. For example Cooke P stated that:

> *(in Modick) this Court stressed the importance of the ability of valuers or umpires to be able to refer to genuine market rents: that is to say rents freely arrived at in negotiation between the parties, by contrast with those arrived at in the captive circumstances of rent fixations".*

Their Honours went on to decline 0

the appeal to set aside the subpoenas on the grounds that it was not in the public interest that they should do so, thus effectively removing the bar of confidentiality insofar as it limited the ability of the umpire in the Trust Bank Arbitration to arrive at a proper determination.

If you have not already read the Judgments of Cooke P and Gault and McKay JJ in *Dickinson*, then I strongly commend that you do so, for in my view they set out not only the Court's findings in this specific matter but seem also to indicate a general intent that:

- Rentals should be determined against criteria which are current and realistic rather than those which are artificial.
- There is an element of public interest in these matters. Witness the words of Sir-Robin Cooke that:

  "the overriding public interest is *in as fair a fixation of market rents as possible"*

  and statements by Mr Justice Gault htat

  "There is a public interest in an open market unless special circumstances exist. In my view it is important to get to the truth of comparable rentals where available so that proper rent levels are fixed" .

  and by Mr Justice McKay that

  "None of the reasons advanced carry any weight, to me, against the important consideration thatproceedingsof the kind envisaged in a rent review should be able to proceed with accurate information as to market levels".
- The general thrust of the Court's pronouncement in both *Modick* and *Dickinson* is toward an enlightened climate in which rent reviews can be settled fairly and equitably.

Valuers in their daily practice and in their not infrequent role as expert witnesses or arbitrators or umpires can only respectfully applaud the Court in its efforts.

I turn now to another area in which the Trust Bank Arbitration and Award cast light upon an immediate problem. That is in the treatment of Inducements.

You will all be aware that in the course of the past couple years or so, as the supply of available office stock has grossly exceeded demand not only in Wellington and other parts of New Zealand but also in similarly affected cities throughout the world, so has the practice of offering inducements to attract prospective tenants become almost a norm.

I think it is debatable whether this practice will continue to be as widespread in the future as it has been up until now, but nonetheless many recent leases have included inducements of one type or another.

Probably the most popular form is the rent holiday, but otherconcessions include the provision of office fitout or cash to pay for it, the acceptance by the lessor of the lessee's relocation expenses, the assignment to a lessor for the balance of a lessee's obligations under another tenancy etc. etc.

Several of the comparables which were most relevant to the Trust Bank review were the subject of such inducements, and indeed the concealment of those concessions was the purpose of the confidentiality agreements to which I referred above.

The manner in which valuers should treat the analysis of induced rentals has been a matter of dispute on both sides of the Tasman for some little time and a number of learned articles dealing with the problem have appeared in professional journals.

It was an issue which was discussed at length at the Trust Bank Arbitration notwithstanding that all of the valuers accepted that where a contract rental included an inducement, it was necessary to make some adjustment to relate that rent back to the equivalent true market rent on an un-induced basis.

Basically, argument centred around the period over which these inducements should be discounted. Obviously the longer period over which a given inducement is discounted, the less will be its impact in reduction of the contract rent.

The positions of the valuers can be summarised as follows:

i That the discount period should be over the maximum term of entitlement under the lease, that is to say including the lessee's rights of renewal.

ii That the discount period should be confined to the term certain, that is to say the period over which the tenant has an initial contractual obligation to occupy the premises, without regard to subsequent rights of renewal.

iii That where no ratchet was included in the lease then the discount should apply only over the period until the first rent review, on the grounds that the rental would then revert to whatever was the ruling market level at that time, and that any advantage to the lessor of the original contract rent would be gone.

In his Award Umpire Mahoney expressed his view as follows:

"Whilst is *it accepted that there is not total unanimity on this particular issue within the valuation profession, I accept at this period of time and the current understanding of this particular market feature, that the value of the incentives should in most cases be discounted over the full period of the lease term certain".*

He later recorded that:

"there is the further requirement for the valuer and umpire to have careful regard to the resultant answer (i.e. after discounting) and to determine whether the rental so calculatedisfairandlogical and is also consistent with the overall pattern of other market evidence". (My parenthesesi

It seems to me that Umpire Mahoney's position in this matter is the sensible and realistic one and while his Award contains nothing new on the subject it does serve to reinforce the general trend of rent review determinations toward good sense, moderation and equity.

"...his Award serves to reinforce the general trend of rent review determinations toward good sense, moderation and equity."

There were a number of other matters of interest but lesser immediate consequence argued in the Trust Bank Arbitration including:

- The relevance of tax effectiveness
- The usefulness of Building Quality Assessments
- The measurement of benefit rising from an *unratcheted* lease
- Tbeproperprocedures for adjustments to equalise differences in characteristics between one building and another.

It is fair to say that the Award did not attempt to deal definitively with any one of these. What it did do is to recognise that each and perhaps other items as well may have a relevance at other rent reviews different to that they were seen to have at Trust Bank.

Finally, I would like to consider the light which Trust Bank may shine into the future in two specific directions.

The first relates the invulnerability (or otherwise!) of Ratchet Clauses. Most of you will be aware that, in the past year or two, the fairness of ratchet clauses has become a very keen issue in the minds of a large number of tenants who have found themselves committed to contractual ratcheted rentals pitched at historic rates when current market levels may be only 50% or even less of those amounts.

It has been recorded *(Rent Reviews and Variable Rents,* D N Charles & J E Adams 3rd Ed, and *Handbook of Rent Review:* R Bernstein & K Reynolds) that the objective of a rent review may be seen as the means of restoring the position of theparties in the lightof changes in money values and in the property market from time to time.

I think it is certainly arguable that the inclusion of a ratchet clause effectively frustrates that objective in a falling market, notwithstanding that the ratchet may have been an inherent condition of the original contract.

We are all aware that ratchet clauses (or what the British call "upward only" clause) have been progressively more commonly inserted in leases in the course of the past two decades, and, given that over almost all that time property markets have been buoyant and inflation rampant, it is hardly surprising that lessees of the period took a relatively relaxed and acquiescent attitude to the practice.

"...the equity of any ratchet agreement must be questionable."

Now, when times have changed so radically and when it seems probable that rents will not in the foreseeable future return to the high points achieved about five years ago, then the equity of any ratchet agreement must be questionable.

One can, of course, understand the position of a building owner whose acquisition of a building may have been made upon the premise of the certainty which is carried by a ratcheted income stream, and one can assume that not only does he require this certainty for the purposes of his own financial stability, but that it may be required of him by his bankers or other financiers.

Now that must be a compelling argument to the individual owner, but is it not unfair to observe the imposition of aratchet clause which effectively transfers to the tenant some of the risk of ownership of the building investment.

Ratchet clauses are clearly a one-sided bargain and the fact that they have been entered into open-eyed does not necessarily make them fair or equitable. Or invulnerable?

In any event disc atisfaction with ratchet clauses is alive and well and living throughout Australasia.

Only a few weeks ago one of my colleagues received a letter from a valuer in Perth enquiring concerning the details of adecision allegedly issuedby the Courts in Wellington in which the provisions of a ratchet clause were overturned.

This information had been given to him authoritatively at a Seminar such as this in Perth. I cast around the city for information and was assured by the Property Manager for a major organisation that this had in factoccurmd in Sydney. I rang Sydney, they referred me to Melbourne. I rang Melbourne, they referred me to Auckland. I rang Auckland, they said "Oooh we heard something about Perth".

Whether a challenge to ratc het clauses will be mounted, and whatchance it would have of success, I am not competent to judge.

But it is interesting to consider that some clauses of Part II of the Commerce Act, 1986, might be argued to support the view that a ratchet clause is in fact a Restrictive Trade Practice.

Whether there is legal opportunity under that or other legislation I do not know, but it is possible to speculate on what the reaction of the Courts might be following from their response to the circumstances of Dickinson and Modick. It is of interest that in the latter Mr Justice Hardy-Boyes said at the start of his Judgment

"Rental reviewclausesweredesigned to protect a lessor under a long term lease against any increases in the value of the property or decreases in the value of money. A ratchet provision guarded against any aberration. There was an *underlying assumption that the lessee would be able and willing to pay the increase needed to bring the rent up to date; or if that if he were not somebody else could and would.*

The economic downturn in recent years tends to negate the purpose of such clauses and focuses attention, in a way *probably not previously necessary on the factors to be taken into account on review, least the assumption be invalidated too... "*

The future in respect of the ratchet clause argument is likely to be an interesting one, and one whose importance was recently summarised by my colleague Lewis Esplin from RYTs Auckland Office who wrote (See NZ Property 356, June 1992, Those Wretched Ratchets)

There will be no return to a strong market which can support growth until there is a return to the discipline of the marketplace unfetteredbyrental ratchet clauses and inducement packages.

The second pointwhich deserves consideration in the matter of future arbitrations is whether in the light of Trust Bank they will need to be of the same time, complexity and expense of that Hearing. I think it is fair to say many of the burdens of time, complexity and cost have been added to the rental arbitration process by the extent to which the legal profession has involved itself in the procedure.

I do not for one moment suggest that this involvement has been anything but helpful and positive in those arbitrations, such as Trust Bank, where the legal principles involved have been identified, stated and explained.

As I said earlier, I believe we have much reason to be grateful to legal umpires and legal counsel, such as Mr Bornholdt and a number of others, in this respect. What I seriously doubt, however, is the benefit arising from the involvement of lawyers in every case.

I think there are examples where that involvement has been both unnecessary andcounter-productive, andwherearesult of equal merit would have been obtained quickly, more cheaply and more effectively by the operation of an old fashioned "valuers arbitration".

I say this not to advance my own profession nor denigrate the legal profession, but rather in the interests of the process of Arbitration, much of whose appeal is founded upon its perceived advantages of effectiveness, speed and cost. If those advantages are not forthcoming, the purpose of the procedure is gone. A

The Role of Valuers and Lawyers in A Rent Review Situation

by B Bornholdt

Bruce Bornholdtis a Barrister and has been in legal practice far over 30 years lie has a ;; very keen! *interest in the rommercial and property ftelds r uw rsrlrh particular refer etce to property development and Ieastngs Ne has been appointed as Arbitrator and as lympire to a nurrtber of.:rerital disputes throughout New ?ealand. A*

A number of seminars have been held and articles written over the years on this topic.

I note from the seminar advice material that this subject is believed to be of particular interest to a range of professional and other commercial interests and I certainly hope that this will be the case. Judging from the list of participants, it is obvious that a great deal of interest has been generated across a wide spectrum of professional and other interests andl would venture to suggest that many attending are on a learning curve of experience in the area of rent reviews and their arbitrations.

I note from my list that only seven named valuers are in attendance while there are some 23 solicitors. That would accord with Mr R L Jefferies' comments in an article published in the *New Zealand Valuers' Journal* March 1992 titled *Judicial v Practical Rental Valuation: PrinciplesandMethodologyatp* 18 where he stated:

> *This paper seeks to expose the issues in the context of a "joust" between the legal and valuation professions; based on some case precedents and personal experience, and hopefull y point to some reformation taking place that may lift us out of the current dark eye of legal suffocation. Unfortunately for valuers, the lawyers currently have the longer "lances".*

As I mentioned at the outset, there have been many papers written over the years on or near to my topic and I do not propose to regurgitate all that might be in those papers. However, I would recommend that you read some of them if you have not already done so (a reference list is appended).

It might be said that there has been a plethora of paper written on the subject of rent reviews and arbitration which in the main has been caused through the "crash of 87".

From the recession caused by and through that crash it can be said that rental disputes have created much work for both the valuation and legal professions (not forgetting the economists and some property managers, dare I say accountants?) in carrying those disputes through to arbitration.

The "battleground" as MrRLJefferies calls it, has turned:

> *to the interpretation of the lease and the rental review process, driven in many cases by legal advice and precedents which are dividing valuers in terms of legal valuationprincipleswhich have tended to take over in importance from technical valuation methodology, opinion and skill. It is a realm of unreality bred by cunningly worded leases caught* up in *a web of legal interpretations, tests, regards, disregards, precedents and other artificialities. The effect has been to almost remove rental determination from down-to-earth common sense comparisons and into quasi-legal interpretive nightmare for those valuers at the "coalface" of advising lessors and lessees as to what rental should apply in any given circumstances.*
>
> *(Supra Jefferies p18)*

"For too long the valuation profession has remained somewhat blinkered..."

That is the legal suffocation of Mr Jefferies that I have earlier referred to; he also likens it to an obstacle course.

I have a great deal of respect for Mr Jefferies' sentiments and I sympathise with the position that he has found to exist in carrying out rental reviews subject to arbitration.

Where I would part company with Mr Jefferies is where he attempts to place a great deal of the blame on both lawyers and the legal system.

That is, in my view, only part of the problem. The remainder of the problem, in my experience, lies with the valuation profession.

Mr Jefferies would have us believe that.

> *"an array of different competing legal tests, lease formats, precedent and rental definitions are creating enormous problems for valuers, lessors, lessees, property owners and managers."*
>
> *(Supra Jefferies p19)*

My belief is, that if valuers (and some do) took time off to re-examine their valuation approach to a rent review or the methodology used (call it what you like) then we might get some sense out of the valuers. For too long the valuation profession in general terms has remained somewhat blinkered, suffering from tunnel vision, not being prepared to attack the problems in a logical and common sense

This paper was presented at the seminar promoted by Simpson Grierson Butler White, solicitors, in association with the Arbitrator's Institute of New Zealand , held in Wellington 1 July 1992

manner with the application of some lateral thinking to the problem at hand.

This is what I had to say in general terms in an Award of mine:

I have alreadytraversed in thisAward the market factors that I believe should have been examined by the valuers in this arbitration being the mosaic of the market plus the other market factors I have referred to leading to a "basket" of evidence.

There is evidence from all the valu*ers as to the various adjustments they made when arriving at their respective market valuations of the subject premises, but in making those adjustmentslbelieve they misread the market, that I believe from the evidence, existed at...1988.*

I do not accept at that any of the valuers researched and sourced the market in order to establish what it was doing at the time. They all had a perception, but that is as far as they could go.

They all appeared to be hidebound by their traditional valuation approaches.

I do not accept that the mosaic of the market plus other market factors leading to a "basket" of evidence, is *looking at this very difficult matter by way of hindsight ... It is my view that it is exactly the valuation approach that valuers should have been making over a long period of years, and the fact that they have not done so, in my view, goes back to my early comments of valuers being hidebound in their traditional valuation approaches and possibly "blinkered" also.*

I do not believe that I was being unduly harsh in those comments that I made about the valuers in that particular arbitration.

The real problem was the fact that none of them, and this would apply across the board, had had any prior experience of the problems resulting from a depressed market such as occurred some time after the "Crash of 87". But that, to my mind, did not excuse them.

Likewise, some lawyers can also be said to be "hidebound" and "blinkered" in some rent review situations.

In one of my arbitrations, a lawyer put to me the following submission:

..as a matter of valuation practice valuers have generally approached ground rental assessments in the following order of priority of application and manner:

Firstly, by the classic method otherwise known as the comparable rental evidence approach.

Secondly, failing the presence of comparable rental evidence and comparable land sales, *then the valuers with caution turn to the hypothetical building or asswned bui lding approac h, but* always *remembering that the best approach is the one that requires the least amount of subjective adjustments and subjective assumptions.*

The economic approach, with respect to ground rental assessments, has never been used or advocated in the past, not even as a check method, because it is specifically barred in terms of the lease.

My commentwas thatthe lawyermight well have been right in his statement of valuation practice as being the valuation practice generally approached by valuers in ground rental assessments, but I did not believe that it necessarily was the approach for a valuer to apply an order of priority in his approach to a ground rental.

So much to my mind depends upon the facts and circumstances surrounding a particular case, that it would be dangerous for a valuer to apply an order of priority in the manner as outlined. It was my view that a valuer must be free to choose whatever valuation method he considered to be appropriate in the circumstances and I believe that there could be inherent dangers when relying upon past precedent. I was only restating what I believe to be the stance taken by our Courts in this area over the years.

The Role of Valuers

In a rent review a valuer could play any of the following roles:

1. As an adviser
2. As a negotiator
3. Asa witness
   a) propounding a valuation, or
   In general valuation terms of some specific or specialised aspect of valuation
4. As an Expert
   e.g. Boma lease "... be deemed to be acting as an expert(s) and not as an arbitrator(s)"
5. As an arbitrator
   (In terms of the Arbitration Act 1908)

Most of the papers that I have mentioned refer to in part to all of the above roles and some explain them, so I do not intend to repeat the various comments made in this paper.

There is no doubt that in any role the valuer is playing under Ito 4 above, the valuer is an expert. As such the valuer is deemed to know his/her subject and I cannot stress enough that the valuer must prepare for whatever role the valuer adopts or is involved with.

> "Preparation is the key element in the valuers' tool box. Without it the valuer is lost."

Preparation is the key element in the valuers' tool box. Without it the valuer is lost.

Further, in this area, I can do no better than remind you all of the provisions of some of the objects of the Valuers' Institute Rules:

a. To ensure that members of the Institute render the highest standard of service to the public
d. To preserve and maintain the integrity and status of valuers
e. To provide opportunities for the acquisition and diffusion of knowledge in relation to the valuing of land and kindred subjects

AND the Code of Ethics:

SERVICE

1. The first duty of every member is to render service to his clients or his employer with absolute fidelity, and to practice his profession with devotion to high ideals of integrity, honour and courtesy, loyalty to his country and the Institute, and in a spirit of fairness and goodwill to his fellow members, employees and subordinates.

The Role of Lawyers

In arentreview a lawyer could play any of the following roles;

1. As an advisor
2. As a negotiator or mediator
3. As a legal counsel
4. As an arbitrator
5. As an advisor to an Expert or an Arbitrator

Again, some of the papers that I have mentioned refer to the role of a lawyer but in a limited manner.

I would make the same comment about lawyers as I havedonewith valuers. Again, I cannot stress enough the word "preparation". Again it is the key. The lawyer should be knowledgeable in the subject under discussion or dispute and he/she should be very wary of dabbling in a subject (rent review) that they know "not ought" and where they are coming in from the "cold".

Rent review arbitrations carry with them a specialist knowledge of their own and cannot or should not be treated lightly by lawyers.

A well trained and knowledgeable lawyer in rentreview arbitrations can assist the arbitrator but if the reverse is the case, he/she can only hinder.

I have earlier referred to the Valuers' Code of Ethics which I believe would equally apply to the role of lawyers in rent review arbitrations.

Conclusion

I hope that in the presentation of this paper, the "battleground" that I earlier referred to can become a "playground" as between the valuer and the lawyers where the game is the thing. A very serious game at that, where valuers and lawyers retain their objectivity together with their emotions, where with *preparation, preparation and preparation,* the game may even be enjoyable. A

Reference papers

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4. *Preparation and Presentation of Evidence-in-Chief* S S Williams (NZIV Wellington Branch Seminar 15 March 1984)
5. *Professional Negligence and Indemnity::* P J Mahoney and
6. *Duty of Care: when, why, how?:* R J Jefferies (Both articles in *The New Zealand Valuers Journal* December 190 at pps 14 & 20 respectively)
7. *Commercial RentReviews: A lawyer's Perspective:* J Marshall (New Zealand Valuers' Journal June 1991)
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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:

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2. The article shall not have been submitted to any other journal or publisher prior to being submitted for entry into the competition.
3. The article shall not exceed 10,000 words including any equivalent space where illustrations, diagrams, schedules or appendices are included.
4. The manuscript shall be typewritten.
5. The author shall 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.
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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 any topic and the following are provided as suggestions only:
    Valuation of publicly owned assets; forestry valuations; lifestyle blocks ruraVresidential property; valuation of chattels.

Recent Issues in Assessing Current Market Rent

By G J Horsley

'For we know in part and we prophesy in part' (Corinthians 8).

Graeme Horsley; is a Fellow of the NZ Institute of Valuers and was the recipient thisyear of the John M liarcour: Award'; lie is Chairman t f TheInternational As set Valuations Standards Committee acrd is a past *president ofN ' lIe has wide €. perienct* In *commercial valuat> mss in New Zealand and overseas Graeme' Horsley a partner of Ernst and Young and their; national director of variation; services*

Lessees and lessors can be excused for having a profound sense of bewilderment that longstanding "certainties" have been shaken by some recent robust judicial interpretation and refinements in valuation practice.

Many of these changes in methodology and concept have arisen under pressure from the decline in property market prices and activity and need to be seen in that broader context.

There are two broad views of the current property market.

The fast generally holds that the market is simply in *a cyclical* downturn, albeit of unprecedented severity. The second is that as economic activity improves and vacancy rates decline, the market will "come into a better balance" and property relationships will continue largely as before.

In my view, however, the market has undergone a significant struc tural change. As economic activity improves, new relationships will emerge which are fundamentally different from those to which we are accustomed.

The relatively new concepts to which this paper refers can be seen as b eing some of the "building blocks" for this structural change. At the very least, these concepts have such a fundamental impact that the "cyclical" view of implying the return of the status quo cannot be sustained.

The legal and conceptual issues which have arisen over the last four years or so must be seen against the backdrop of the old "certainties"

- high inflation (which tended to reduce the importance of the ratchet clause).
- open availability of rent review and new leasings evidence with disputes tending to be confined to technical matters.
- bankers preferring to lend against "bricks and mortar" rather than the underlying business value.
- certainty and predictability because of a closed economy.

These are now disappearing with the free fall in property values and the recession in the economy. The property market is driven by the economy and the New Zealand economy now has a completely different structure: the property market will change its structure accordingly. The issues of principle raised in this paper here are both the creator and the cause of this fundamental change in the property industry.

m... the market has undergone a significant *structural* change."

Definitions

The first issue I am addressing is the definition of what is meant by "current market rent". I note, though, that whilst this is the focus of most determinations there are still many contracts which use other descriptions such as "fair", "appropriate", "reasonable" and so on.

I do notpropose to traverse these alternatives although they are still important, because some of them have become through usage little more than synonyms for market rent and in other cases they are of less general importance.

The condition of being "current" applies to the date of valuation and contains two preconditions:

(i) allowance for a reasonable period of exposure to the market (Royal Institution of Chartered Surveyors)

(ii) post review evidence can be taken into account to provide corroborative support for the market as at review date (various Court dicta).

There is a nexus or linkage between *current and rent* or *value,* which, in my opinion, remains to be fully explored in terms of its impact on the valuation process and the rental or price outcome. The landmarkrulingsof 1991 and 1992address two fundamental parts of the valuation process:

(i) What is encompassed by *rent*

(ii) The comparability tests of *market,*

The Court of Appeal addressed the comparability issue first and I shall take them in that sequence.

Comparable Evidence of the Market

First, in *Modick* the Court held that,

> *"The question is what figure would notionally be agreed upon by the parties, acting freely and adequately informed. Thefiguresftxed by arbitration or rent reviews as between captive parties are not necessarily a reliable guide, since they do not represent the unfettered play of market forces, but rather the arbitrator's assessment (assuming that he has applied himself to the task correctly) ofwhatmarketforees should produce. It is* only a freely t

This paper was presented at the seminar promoted by Simpson Grierson Butler White, solicitors, in association with the Arbitrator's Institute of New Zealand , held in Wellington 1 July 1992

negotiated rent on a new letting that can confidently be taken to be truly comparable, *provided of course that there are also sufficient similarities in site and otherwise". (Cooke P) (My emphasis).*

(There were other issues at contention in *Modick* including whether the new tenant should have a rental uplift on improvements paid for by the tenant, restrictions on use of the premises and the relevance of the tenant's particular trading performance.)

In support, Hardie Boys J stated, inter alia,

`In particular, it shows that historical data isinadequate. Withoutmodification from con temporary material, traditional material such as existing rents can lead only to artificially high rents, failed businesses and empty premises".

New Zealand Courts and valuers seem to have taken a somewhat more robust approach to this issue than their Australian counterparts, although their more recentdeterminationsare following a similar pattern.

InHolmans, (Queensland,June 1992), the first issuebeforethe Courtwas whether the review could take into account new leasings evidence.

For the lessor it was contended that,

"because the parties do not have the option of walking awayfrom each other, rentals negotiated between parties who had such an option should not be considered".

Such a contention had been previously held by some valuers in New Zealand to the effect that sitting tenants were a sub-market and the search for comparables should be confined to them. Thus, evidence of new leasings and indeed the extent of vacancies should be disregarded.

In rejecting the lessor's contentions the Court's conclusion in *Holmans* was thus:

(i) The review rental is to be fixed "by reference to the markets where parties can (walk away from the transaction)". That is, in the rent review process (quoting from *Edmond Barton Chambers)* "the hypothesis requires the assumption to be made that although each is free to withdraw a bargain nevertheless results".
(ii) Evidence of both review rentals and new rentals is relevant.

I understand also that an Australian Court has recently determined that where landlords have not complied with certain lease requirements as at the review date then the rental shall be adjusted accordingly and with reference to new leasings in a similar condition.

Taken simplistically, it could beargued that the above dicta suggest that new leasings would be the *sole* evidential base. Nonetheless, I am not convinced that review evidence for sitting tenants *cannot* be taken into account.

The Courts in a number of rulings have been very careful to stress that they are not intervening in the valuation process but rather have simply sought to define the boundaries of evidence which ought to be taken into account in using aprocess which is consistent with the terms of the lease.

"This series of judgments clearly refutes any continued application of the so-called 'two-tier market'"

Conclusion

This series of judgments clearly refutes any continued application of the so-called "two-tier market".

Leases which require rentals to be reviewed to "current market" must take into account evidence of new leasings and, probably, afford that evidence the greater weight.

The implications of this are far-reaching. In a depressed market the sale of space will be on a marginal costbasis until the market is cleared. Average rentals will sink towards the marginal rental as existing tenants leases expire.

Clearly, in this market, the news is good for tenants but when markets improve the reverse spiral will apply to an extent we have not seen before. The strain will cause new relationships to emerge.

What is rent?

Up until 1988/89 market rent and contract rent were virtually synonymous terms. Even though, lessors had typically allowed a brief fitout period for tenants of perhaps up to three months or so, valuers would not make any specific deduction from appraised market rentals.

Such allowances were of marginal value (perhaps only 5% or so of the rental over the term certain) and also it could be reasonably argued that such allowances merely equated the position of a new leasing with the position of a tenant atrent review.

With the dramatic increase in vacancy rates, particularly in Auckland and Wellington, the value of such inducements has increased to the point where they may represent between a half and two-thirds of the contract rental.

From the lessor's perspective such inducements have served two primary purposes:

(i) they sustained the *apparent* capital value of the building by being, in a sense, an "off-balance sheet" transaction
(ii) with confidentiality conditions, they avoided giving marketsignals to other prospective tenants or to sitting tenants on review and this additionally sustained capital values.

The 1991 decision of the Court of Appeal *inDickinson & Others (The Trust Bank case)* stripped away that veil of confidentiality and has taken us closer to a sustainable definition of rent.

In Dickinson the Court was being asked to determine the question of confidentiality as to lease agreements for comparable sites.

In the words of the Court,

"But, for very many years, leases of commercial premises in New Zealand cities have to a large extent been fixed by rent review procedures. They are a major or at least a significant element in theNewZealand economy. Generally speaking, the leases authorising or requiring such procedures speak of market rents or use some similar formula such as fair rent".

The Court then referred to *Modick* and went on to say from the perspective of the arbitrator,

"But it is desirable that he should be able to get at the truth as to these allegedly comparable rents. Plainly, details will be required such as the terms of collateral contracts offering side benefits and the like".

And then,

But in the current economic climate it is plainly in the public interest that fair levels of rent be arrived at in our main *cities. One has only to consider the apparently extensive unlet areas in newly-constructed buildings to appreciate that unrealistically high levels are not in the public interest. In my opinion the overriding public interest is in as fair a fixation of market rents as possible".*

In support McKay J stated, inter alia,

"The rent review is under a clause which is apparently the standardBOMA

clause in general use in Wellington. Such rent review proceedings are commonplace, and have been for many years. Their effectiveness depends very much on the availability of accurate market information relevant to the particular premises including details of side agreements providing for rental holidays and the like without which the actual lease may give a false picture".

And later,

"It can hardly be said however, to be in the public interest that business *rentals should be based on a false appreciation of the market. There can be no injustice to either lessor or lessee in having reviewed rentals based on correct information as to true market levels".*

Following the Court's judgement, the evidence of inducements was duly taken into account in the Trust Bank arbitration.

Support has been received from the recent *Holman's* case in Queensland, mentioned earlier.

The second issue there was whether valuers were to simply appraise other contract rentals (the lessor's case) or whether they were to take into account the totality of the transactions (the lessee's case).

The Courtin *Holman* determined that:

(i) To argue that a rent review clause would preclude consideration of incentives would imply "an unusual and unnatural restriction upon the valuation process clearly contemplated by the lease".

(ii) Inducements should be appraised and adjusted to reach comparability in the same way as contract rentals are adjusted. "In any valuation exercise it is necessary to take into account the fact that so called `comparable' transactions are almost invariably not precisely comparable".

I note, in passing, that reference is occasionally made to two Australian cases, *Rosenblaums and Bowden* which also address the question of incentives.

In my view these latter two cases do not throw much light either way on the commercial leases prevailing in New Zealand.

In each of those Australian cases, the lease itself contained directions as to the valuation protocol. Valuers were directed to have regard to some factors and to disregard others and much of the argument flowed from those issues of construction.

There were also problems between the overriding purposes of the leases to set an open market rental-and the means of getting there.

The inclusion of the valuation protocols was inconsistent with the general purpose of the rent review clauses. There have been suggestions that leases in New Zealand should include such directions to valuers but in my view the apparent gains in clarity will be illusory.

Taken together, the *Dickinson and Holmans* judgements appear to me conclusive:

(i) In appraising rent, consideration must be given to all collateral transactions which may affect the contract rent.

(ii) The market rent is the effective rent

(iii) The market rent for the purposes of rent reviews is the net sum of the contract rent less any inducements and (by inference) plus any premiums. It is the transaction in its totality which must be appraised so that the *effective rents* are derived.

(iv)The sustainability of confidentiality clauses could be in serious doubt.

Measuring the Market/Effective Rent

In concluding that market rentals are to take into account premiums and inducements the issue remains as to how they are to be appraised.

There is no specific standard issued by the New Zealand Institute of Valuers but, I believe, a consensus is emerging. The Australian Institute of Valuers and Land Economists has issued a guideline which provides a useful reference point.

It requires the quantification of inducements and the derivation of the effective rent. In a number of contested arbitrations, methodologies are being applied about which the range of dispute is narrowing.

In essence, the process is to value the inducements over the term certain of the lease using appropriate discounted cashflow techniques.

There are however a number of unresolved issues which require further analysis:

(i) The treatment of tax

It is clear that inducements can be delivered in various forms which have significant tax advantages to lessees, lessors or both.

These advantages are not necessarily symmetrical but should not be ignored on those grounds. I am convinced that a significant impetus behind the configuration of some of the large inducement packages has been their "tax efficiency". On my analysis the effect of this could be as high as 10-15% of the contract or notional rental.

Some incentive structures are now under scrutiny by tax authorities in New Zealand and Australia.

(ii) Contingent liabilities

As well as direct inducements such as extended rent-free periods, there are indirect inducements which are much more difficult to quantify. These include take-outs of existing space held by the potential lessee and other transactions between lessor and lessee which may not bear directly on the demised premises.

(iii) The weighting to be given to tenant quality.

It is quite apparent that lessors are recognising differences in tenant quality but not so clear whether appraisers are fully taking this into account.

(iv) Ratchet Clauses

The value of ratchet clauses has been raised in recent arbitrations by my colleague John Isles and by Malcolm Hanna. Both have argued that in assessing rent review evidence it is necessary to appraise the value of any ratchet clause and adjust the rental accordingly.

Ratchet clauses do have a value to the lessor since they provide certainty of cashflow over the term certain of the lease. Further, given the greater exposure of the New Zealand economy to international market forces, it is likely that the domestic economy will show greater volatility. Therefore, all other things being equal, the intrinsic value of the ratchet clause would increase.

The practical application of the general proposition will depend on the particular cricumstances of the lease and the proposed method by which the ratchet clause is to be effected. This can have a significant influence on the quantum of effective rent.

The contentions of Isles and Hanna were accepted in the *Trust Bank* case but, as stated above, their application will vary according to the nature of the ratchet clause and the circumstances of each particular lease.

There are still some issues outstanding in respect of ratchet clauses in relation to their legality and to their treatment in subsequent rent reviews. However, it is clear that lessees entering new agreements with a ratchet clause need to closely contemplate its possible future effects and 0 the relationship it should have with the effective rental they are paying.

(v) Weakened BOMA conditions
These include changed ratchet clauses and also such features as parent company and personal guarantees, changed review periods, and sub-tenanting rights. If a comparison is being made between leases with varying terms then quantification of such differences ought to be made, no matter how complex. In my view insufficient weight is given to such factors in assessing comparables yet they have a major impact on the total value of the lease and the balance of power within it.

(vi) Exponential Effects of Inducements
In my view, as the gap between contract/ notional rentsand effectiverents increases, the cost of inducements will rise disproportionately. Thus it is not, as some have suggested, simply a $1 increase in inducements to match a $1 increase in contract or notional rent. The risks for the tenant increase geometrically with higher notional rents and these must be compensated.

(vii) Anomalies
There is sometimes an apparent gap between effective rentals paid by comparable tenants within the same building say, from $80/m2 to $200/mz and the issue is whether market rents are synonymous with effective rents when there is such a disparity.

Such gaps can be generally explained by:

- size discounts - valuers will need to make much greater allowances for large-scale leasings or head tenancies
- tenant quality
- timing (with a bonus for the early tenant) tax treatment of inducements.

(viii) Misrepresentations
I consider the practice of referring to "market rentals with inducements" to be extremely misleading. In some cases I have seen inducements of up to 30/40% of the face value of the contract implicit in such references and this negates the phrase "market".

In essence, the market rental must be the effective rent and thatviewis supported by a wider application of the "prudent lessee" doctrine: payment should be seen from the lessee's perspective.

It is meaningless to refer to a "comparable" rent of say, $200/m2 with inducements and contrast that to a rent of $150 with inducements.The inducements may vary in such a way that the rents are identical.

Market Value v Market Rental

An unstated issue permeating much of the judicial interpretation and valuation literature on rent clauses is whether there is adistinction between *marketrental* (price) and market *value.*

Very often the two terms are taken as being synonymous, but, in my view, this is not necessarily the case.

Where leases refer to *market rentals* then I think the meaning and intent is plain. The rental is that which would be obtained in the open market and under the various preconditions outlined in *Modick, Dickinson* and other cases. The rental is the price prevailing in the market and the appraiser's job is to make the technical adjustments to reach the "like for like" state.

However, some transactions refer to *value* as the point of reference for comparability for rental fixing and this also has implications for valuing for the purposes of the balance sheets of both companies and public sector organisations.

For instance, in many rental reviews for perpetual leases in the Wellington CBD, umpires have tended to implicitly assume a notion of value which is different from market price.

Having rejected much sales evidence, some umpires have substituted their own notions of investment value although in apparent contradiction of judicial guidelines. The full legal and economic implications of this have yet to be tested.

Similarly,I note the recommendations of the Property Economic Task Force commissionedby Ballieu KnightFrank in Australia.

The Task Force recommended, inter alia, that valuers prepared both a market (ie "realisable") and an investment valuation. They also recommended that valuers "seek alternatives to last comparable' sale' where market values are changing rapidly and to justify in detail any use of comparability criteria and sensitivities attaching thereto".

In these two instances it seems to me that a distinction is drawn between *value* and *rental/price.* The question is whether leases permit this.

I mentioned earlier that there was a nexus of meaning between *"value"* and *"current".* If we are appraising *current value* then that has a strong implication that we are appraising the likely . What would a buyer pay for it? The import of *current* can lead to a notion of a spot market price after adequate exposure to the market.

Value on the other hand can mean different things to different people. The absence of sales for instance may suggest that buyers and sellers have different ideas of investment value. *Value* is not a single fixed or objective test: it needs to be qualified in various ways which is not necessary when determining *price or rental.* Thus the adjective *current* when used with *value* may not in fact be implying *ing price* at all.

Thatprice would notnecessarily reflect the "value" to that lessor in particular, or lessors in general.

It seems to me that the "prudent lessee" test may tilt the balance to a degree in favour of the lessee and a wider application of this doctrine suggests that it is the value to the lessee.

The essential point of the foregoing is that the profession is struggling to encompass within the phrase *market value,* the concepts of current (which has an accounting definition) and net realisable value or price.

As well as the semantic difficulties this causes, the conceptual problems require furtherclarification of market value.

The point is that where there is limited sales evidence, does the appraiser have recourse to *"value"* which can be a subjective concept and an implication of a longer time frame or is the recourse to hypothesising a price and an implication of a shorter time frame at which a transaction would occur? These issues remain to be tested.

Conclusions

I note that in the brochure announcing this seminar it refers to achieving "a fair and equitablerental". Therein lies the problem which much of this paper has implicitly addressed.

First, rental is but part of the total relationship between lessor and lessee. Certainly it is an extremely important part and with the help of the judicial rulings it is much less uncertain than it has been up to 1991.

But there are other factors such as ratchet clauses, guarantees, and the rent review process which need to be very clearly contemplated before the lease is entered into.

The lease needs tobe seen in its market context and the parties should project forward their view of the state of the property market over the term of the lease so that the stress points are properly identified. Up to 1988 it was a lessor's

Rent Review Procedures

Contrasts between New Zealand and the USA

by J S Baen

' n New Zealand there are two basic methods of final determination in rent review disputes and they are., Arbitration and Expert Examination.'

Expert: An expert or experienced person; hence, once who has special skills or knowledge in a subject.

Arbitration: The hearing and determination of a controversy by a person or persons chosen by eitherparties oran appointee.

Umpire: (Old French: Nomper, Nonper) uneven as in third person fr non(not) per (even, equal,peer). Umpire without initial n, arose through the incorrec t division of n umpire as an umpire, a person to whose sole decision a controversy or question between parties is referred.

John Bien Ph[3 has recei tly returned to property consulting and real estate businesses; in Texas USA Wier ledu as *Professor of Real Estate; Valuation and;:: Property tl4anagerrranr ar Lincoln* 01 *uersity !.* Canterbury lie *also had various: reaching positrons at the ilruversity of North Texas and at North Lake College. Texas* A

In the United States, commercial rent reviews are generally established automatically by one of the following which usually commences with a "base rent' for the primary term adjusted by:

1. Consumer Price Index.
2. Government Treasury Bill Rates.
3. Percentage of gross retail sales with the right to audit retailer annually (varies by use, for example: Supermarket, Base + 20%, Laundry 3%, Restaurant 8%)
4. Negotiation utilizing valuers and/ property managers, lawyers etc and an independent mediator.
5. Arbitration (growing in popularity in various property matters and utilizing either a panel or single umpire).
6. Formal courtcase with judge and jury.

Most often, however, the terms of leases are for five years (fixed) plus variable expenses, with one or two rights of renewals at predetermined rental increases, specified in the leases at the signing of theprimary lease. Ifrental rates fall, the occupant always has the right but not the obligation to:

1. move to another location;
2. re-negotiate the next five-year lease with the landlord or his/her expert property manager;
3. accept the higher rental rate as set out in the initial lease.

In other words, valuers/appraisers do not make a significant portion (less than 5%) of theirannual income on rentreviews. Both tenants and landlords would find the New Zealand system cumbersome and expensive.

The longer lease terms (fixed) combined with readily available fixed mortgage financing, allows the market to have more stability with both tenants and landlords being able to plan finan-0

This paper was presented at the seminar promoted by Simpson Grierson Butler White, solicitors, in association with the Arbitrator's Institute of New Zealand , held in Wellington 1 July 1992

Assessing market rent... continued

market and most leases tended to reflect this balance of power. Now, it is a "tenant's" marketwith lessors having the added burden of pressure from financiers. But, over 12 years orso the marketmaychange to a different balance and that will bring with it new strains in the relationship. The problem then is to identify the appropriate "trade-offs" between rentals, ratchet clauses, review periods and so on.

Second, the rulings which are now favouring tenants in a depressed market may well favour lessors in more buoyant conditions.

Third, valuation techniques must continue to evolve and not be trapped into a fixed methodology for the sake of convenience and ease of application. They must continue to identify "true" and "genuine" rents (using the Court of Appeal's more powerful language).

Fourth, I consider that a fair and equitablerent may notnecessarily bea market rent. It may be higher or lower but the criteria are distinctly different. Therefore, before opting for the fairness and equity route parties shouldcarefully examine the criteria by which that would be judged in contrast to the market criteria.

Last, I reiterate the opening theme. The market is changing in structure and fundamentals, and cannot revert to the status quo ante. I consider that our leasing contracts will change. The "clutter" brought about by inducements will gradually disappearasparties seek simpler contracts without the need for complex appraisals of either face rentals or inducements. There will be a shift towards contracts ofthe US type with shorter terms certain andmid-temm reviews maybe fixed by reference to general price indices and. fitted-out premises. The role of valuers in this context will change markedly as will that of legal professionals. A cially with longer horizons. The cost of "Rent Review" is basically nil as these matters are negotiated between parties on the stated lease at the time of origin with payments requiredand option times, rents, etc that are predetermined.

Litigation in property matters does, however, frequently involve valuers/appraisers and the preparation of reports, depositions and trials which approximates the arbitration/expertexamination process here in New Zealand.

Comments on the New Zealand Arbitration Game

Over the past three years, I have observed the arbitration process in New Zealand and read the many articles which debate various aspects of the methodology and system.

As both an academic and an outsider studying real estate, valuation and property management, I am amazed at the vast differences in values that appear between two "independent" valuers who theoretically have:

1. similar qualifications
2. professional standards
3. abilities to analyse data
4. similar data bases or access to market information

It would be hoped that regular and predictable overlaps of leasing data and information would be utilized by two different valuation firms rendering opinions and reports on a market rental determination/estimation.

This would, indeed, be an interesting area of research that needs to be conducted. The differences, sometimes, are just too wide to be indicative of truly "independent" or "professional" analysis. But perhaps opinions can vary that much, or perhaps one or the other valuer is "wrong"?

In New Zealand:

"Rental disputes are big business, particularlyina depressed market where the professionals involved are making a meal ticket out of diverging opinion, in advising lessors who are desperate for cash flow to *buoy up falling property values; while on the other* hand *advising lessees who are frequently hard pressed to keep up with present rental payments in a contracting economy, let alonepayincreases, howeverjustified."*

(Rod Jefferies, *New Zealand Valuers' Journal March* 1992 p18)

Logic suggests that perhaps there may be even more at work here than suggested by Mr Jefferies.

In the US property litigation arena, often the "side" with the biggest and best property expertise and reputation seems to have a major impact on the outcome of judges/juries and arbitrations.

The same may or may not be true in New Zealand. There is certainly more at stake, financially, for a large property owner who owns four office towers on Queen Street in Auckland, to spend more on key rent review leases, than for the individual tenants.

It stands to reason that the large property owner would also have a standing stable of valuation firms that represented "him/her" during rent reviews, while a single tenant would have to investigate and hire valuation firms on a very irregular basis (rent review time only).

As valuers, our professional opinion of value should not be affected by which party we are "representing". We should have the primary aim of "natural justice and fairness" in an efficient and low cost system serving both parties involved. The phrases "we won" or "they lost", or "they were on the other side" denote a gaining and scheming attitude in the eyes of the public.

Valuers should perhaps adopt the attitude that justice prevailed or the arbitration system worked and our/ their valuation was found to be correct/incorrect.

The apparent practice of switching from "client advisor" to "independent valuer" to "impartial arbitrator" is also a bit of a worry.

"I would certainly accept that once having reported to a client as a valuer, that valuer, technically and legally is not properly in a position to take off the advocate's hat as a client advisor and replace it with the judicial hat of an arbitrator. Please note that I used the term "advocate" within the definition of a person who pleads his client's case in a court of law rather than the champion of a cause."

(R M McGough 16 April 1992 Arbitration in Rent Reviews.)

Further indications of metamorphosis are evidenced, but not frequently mentioned in the literature that

Accordingly, common practice over many years has seen the valuer advisors becoming arbitrators. Should they not agree, the final decision will be that of the umpire. When objections on technical grounds are made to that procedure... Umpires become sole arbitrators and valuers become witnesses with astonishing speed when it is realised that the costs of two arbitrators can be eliminated with the same end result."

(McGough opt cited). (Same end result,, emphasis added.)

Changing hats and/or horses mid stream seems extremely curious to the outsider, who can only marvel at the entire process and wonder how advocate conclusions reached in one report (as advisor) can be totally objective when used for a different purpose and theme after "transformation".

With early activities apparently geared more toward advocateMegotiator valuers, it has been said that

"Valuers who can relate in the true spirit of fairness will more often than *not be able to persuade the parties to reach agreements themselves... the valuers act in the role of negotiators or mediators."*

According to Mr McGough, the arbitration process is cost effective in New Zealand with:

1. At 50% of rent review proceedings neither party (landlord/tenant) is even present.
2. Only 10% require an involvement of legal counsel.
3. Hearsay evidence is admissible while the umpire has the authority to rectify or clarify the evidence.

While the whole process is quite different from the"American Model" it would seem that the various roles and objectives of each player would naturally be:

1. Landlord-to maximise the rental for the next period.
2. Tenant to minimise the rental for the next period.
3. "Landlord's" valuer - to offer an independent market value of the rental.

"Tenant's" valuer - to offer an independent market value of the rental.

5. Umpire to fairly consider the two valuers" (3 and 4) estimations of value, data and methodology used and to determine a new rent.

To this extent, there seem to be similarities to the US legal system which utilizes judges and juries who, however, are sometimes influenced not only by the quality of the information provided by both "sides" but also in the style of the delivery.

Often a "good" lawyer and witness can "sway" a jury as seen on the TV programme, LA Law. A

'Source Websters New Collegiate Dictionary/ Merriam Co 1949.

Valuation of Leased Fee and Leasehold Interests in Calgary Eaton Centre

by G E Burns

Graeme Burris Is aFellow of theN I nstitute of Yal tiers and 00F 1160of ike Properly Man ;s agemeiit Institute lie has een a'former Chairman o;the Qtago Branchb a} each;of these Institutes lie hasbee t ►nvolved in all aspects of urban valuation. including residential in .,X&-:,: trial', commercial, tourist and recreational! properties since beginning his career with the;: ValuaiionDeprirt»rentinX953andconi rtetenga< Dipiama in Urban Valuation at Auckland Uni-` versify College in 1Q57 Graeme ;urns is a director of tl acpherson Valuation in Dunedin :!'.

The theme of this Congress "From the Ground Up- The Building of Value" focuses on the valuation and counselling issues associated with a major mixed use retail/office building, the Calgary Eaton Centre, located in the Central Business District of Calgary in Canada.

Property

The Calgary Eaton Centre comprises a four level retail podium (ground floor and three upper levels), together with a four level underground (basement) carpark and storage area, and above the podium, a 40-storey office tower.

Completed in August 1990, the podium with retail bridges over two of the adjoining streets on the three upper levels, incorporates a four storey galleria with specialty retail stores and boutiques, as well as a food court. The office tower, known as the Canada Trust Tower, and opened in April 1991, provides first class office accommodation in both complete and part floor suites.

The building, intended for investment purposes rather than owner occupation, is not fully let or income producing.

Tenure

The land owned by Weston Properties Ltd is leased to Oxford Developments Ltd for a term of 99 years from 1 January 1988.

The annual ground rent is either the base rent fixed at 10% of the value of the land at the commencement of the lease and reviewed every ten years, or 15% of all income collected from the building in a year, whichever is the greater.

Assignment

1) A request has been received from a New Zealand client to assess the market value, as at 1 January 1992, of,
   a) the leased fee or lessors interest, that is the interest of Weston Properties Ltd, in the 99 year lease.
   b) the leasehold or lessees interest, the interest of Oxford Developments Ltd, in the 99 year lease.
2) In New Zealand what are the required rates of return or market yields for a similar downtown property on leasehold land?
3) Adopting these New Zealand returns, what is the resultant market value of the leasehold interests in the Calgary Eaton Centre?

Valuation Methodology

The New Zealand Valuer would normally consider two broad methods of approach to the valuation,

1) The summation method of assessing the value of the land as if vacant, and adding to that the value of the building and site development, to give a total value.
2) The investment approach of capitalising the nett maintainable income at a market sourced yield or nett rate of return, to produce a total value.

The s aluation ofa leasehold interest is generally derived from the freehold value. The leased fee or lessors interest is assessed as being the value of the continuing rental income during the unexpired term of the lease and any renewal(s), together with the rights to the freehold on the expiry of the lease. The lessees interest is assessed from the benefit in the existing rent for the unexpired term of the lease, together with the benefit of any renewal(s). The sum of the lessors and lessees interests does not necessarily equate to the freehold value.

Summation

The value of the land plus the value of the building and site development.

Land

The land is valued as if vacant, and to the highest and best use.

With central city commercial lands, both the depth table and area methods are used to analyse sales of vacant or near vacant land, adding where necessary the cost of demolition or removal of any existing buildings. These analysed sales then form the basis for the valuation of the subject land, bearing in mind the variables such as location, dimensions, area, zoning, permitted density, etc.

Building

The value of the building can be assessed from either;

a) The depreciated replacement cost, that is the estimated replacement cost of the building less an allowance for depreciation and obsolescence.
b) The selling value based simply on the analysed sales of similar buildings.

In both cases the value is aster-

This paper was presented by Graeme Burns at the 16th Pan Pacific Congress of Real Estate Appraisers. Valuers and Counsellors at Calgary, Alberta, Canada held from 31 May 5 June 1992

tained from the floor area of the various components of the building, such as basement parking, retail, or office levels, with additional sums in the depreciated replacement cost approach for items such as lifts and escalators, depending upon the number of floors.

Where the value of the building is assessed from sales of similar buildings, the replacement cost can also be ascertained to determine the actual sum for depreciation, whether it be physical or functional depreciation, and the percentage rate of depreciation.

The value of the property is then determined by the summation of the value of the land, derived from sales of land, and the value of the building, derived from either the depreciated replacement cost or sales of similar buildings.

Investment

The investment approach focuses on the rental or earning capacity of the property. The gross rental, either actual or estimated, is established, and from this sum is deducted the operating expenses to be borne by the owner to arrive at the nett maintainable income, before depreciation and taxation.

This nett sum is then capitalised at an investment yield or rate of return, adopted from sales of similar properties, to produce the total value. The most commonly used rate of return is the Overa*ll* or Basic Capitalisation Rate, although other discounting methods such as the Present Value and the Internal Rate of Return are being increasingly used.

The value of the land, assessed as previously outlined, is deducted to arrive at the value of the building and any site development.

These then are the two broad methods generally adopted by the New Zealand Valuer in arriving at a valuation.

With leasehold property the valuer will normally arrive at a valuation as if freehold, before assessing the lessors or lessees interest.

In New Zealand leasehold property in the Central Business District invariably relates to the land only; the building and any site development usually belongs to the lessee.

The lease is generally for a term of 14 or 21 years, with a right of renewal for a similar term, the one right of renewalbeing included in each renewed lease. Thus the lease is often referred to as a lease with a perpetual right of renewal. The rent is reviewable on renewal, that is every 14 or 21 years, or in some cases, and in newer leases, every seven years.

The lessees' interest in the land is the present value of the benefit in the annual rent, that is the difference between a market rent and the actual or contractual rent, for the unexpired term, together with the benefit in the right of renewal, in both cases usinga compoundinterestrate similar to first mortgages. To this value of the lessees interest in the land is added the valueof thebuildingandsitedevelopment. The lessors' interest is simply the present value of the rent for the unexpired term of the lease and any renewal, again using compound interest tables; there is little if any reversionary interest in the land, due of course to the lessee having a continuing right of renewal.

And the summation of the lessees and lessors interests in the land does not necessarily equate to the full freehold value; it could be less or it could even be more.

Calgary Eaton Centre

The valuation of the Calgary Eaton Centre as a freehold entity has been covered by other speakers in Plenary 4 , and there is no need for me to dwell on this aspect.

Furthermore, with the intensity of use and ability to generate a rental flow, the value, whether itbe freehold or a leasehold interest, is largely determined by the investment or income approach.

The summation method of valuing the property has therefore been purposefully avoided and thispaperconcentrateson the investment or income approach. The Guidance Notes provided set out in detail the following;

- retail rentals per square foot and floor area of each tenancy;
- retail percentage or turnover rentals;
- office rentals per square foot and floor area of each tenancy;
- parking rentals;
- storage rentals;
- occupancy costs for the complete building, apportioned into retail, food court, and office uses

The Notes also indicate a vacancy factor for both retail and office use for several years, the expected rate of increase in the market level of rentals, and inducements payable on the leasing of the vacant office accommodation, as well as the formula for fixing t e ground rent payments.

In other words the Notes provide details to ascertain the total actual rentals for retail, office, parking, and storage use, the vacancy factor for retail and office use for several years, the expected rate of increase in the level of rentals, and the occupancy costs and operating expenses of the building to be borne by the lessee, Oxford Developments Ltd.

For this valuation an eight-year projection or horizon has been adopted, that is the rentals and occupancy costs and other outgoings, have been assessed for each year from and including 1992 to 1999.

This is set out in a Summary Schedule, shown as Appendix A, and the following explanations are given for each item.

Retail Rentals: leased accommodation

Retail rentals for each tenancy have been established and totalled to give the total rental each year for retail premises currently leased see Appendix B and Bl.

Retail Rentals: vacant accomodation

Rentals for the vacant retail premi ses have been estimated to give a total rental in 1992, if let, of $669,795. This is equivalent to an average of $29.42/ft2 on the existing vacancy level of 14.13% or 22,770 ft2.

In 1992 the vacancy factor is expected to reduce to 14%, an increase in the leased accommodation of 210ft2 at $29.42/ft2, or $6,163; in 1993 the vacancy factor is reduced to 10% and the cumulative increase in the rental for the newly leased accommodation is $195,790. For the following years a similar principle is applied, with of course allowance made for the increase on the reviews see Appendxi B2.

Retail Rentals: percentage or turnover

The percentage or turnover rental is taken at the advised $74,000, plus the growth of 4% per annum from the beginning of 1994 - see Appendix B2.

Office Rentals: leased accommodation

Office rentals for each tenancy have been established and totalled to give the total rental each year for the office premises currently leased see Appendix B3.

Office Rentals: vacant suites

Rentals of the vacant office suites have been estimated to give a total rental in a similar manner as the vacant retail premises. Thus the total rental for the vacant office suites in 1992 is estimated at $2,609,991, anav erage of $18.66/ft2 for the current vacancy level of 22.52% or 139,906ft2.

Again applying the same principle as

for the retail accommodation, the rental for the newly leased office accommodation is assessed cumulatively for each of the years on the assumption that in 1992 the vacancy level is reduced to 15%, in 1993 to 10%, and from 1994 is held at 7.50% see Appendix B3.

Parking & Storage rentals

The rentals for parking and storage are adopted from the Guidance Notes at $580,000 and $167,000 per annum respectively in 1992, with a growth factor of 4% per annum see Appendix B3.

Rentals total

The rentals for each of the seven categories are then totalled to arrive at a total rental, actual and estimated, for each of the eight years.

Occupancy costs

Occupancy costs for the vacant areas (retail and office), are payable by the landlord, that is Oxford Developments Ltd, until the premises are leased.

The Guidance Notes advise that the 1992 occupancy costs for the retail are $2,520,503, for the food court an additional $91,385 including a fixed sum for capital recovery of $56,835, and for the office tower $4,986,883.

The occupancy costs, apart from the fixed sum for capital recovery in the food court, are assumed to increase at the rate of 3.5% per annum in order to establish the total occupancy costs each year for the retail and food court on one hand, and the office tower on the other.

The vacancy factor for retail and food court is then applied to the costs to establish the sum payable each year by the landlord for the vacant retail and food courtaccommodation; a similar exercise is applied for the office accommodation.

The summation of the two gives the total occupancy costs for the vacant accommodation payable by the landlord see Appendix C.

Inducements

Inducements payable relate to the leasing of the office accommodation. The Guidance Notes itemise the inducements payable per square foot to lease the vacant accommodation, and this equates to an average of$33.55 /ft. Thus in 1992, when it is expected that the vacancy factor will be reduced from 22.52% to 15%, 7.52% of the total floor area of 621,267 ft2, that is 46,719ft2 will incur an inducement payment of $33.55/ft2, or $1,567,332; the inducement payment occurs again in 1993 and 1994 at differing sums see Appendix C.

Ground lease payments

The last item is the rent payable in terms of the lease of the land for 99 years from 1 January 1988.

The rent for the first ten years is $1,620,000 per annum, or 15% of the annual income collected from the building, whichever is the greater. On the first and each review the rent is to be 10% of the then value of the land, or 15% of the income collected from the building, again whichever is the greater.

The rent on the formulated basis of 10% of the value of the land is estimated tobe$2,383,710 perannum asat 1 January 1998, whereas 15% of the income for the 1998 calendar year is likely to produce a sum of $2,996,291 per annum.

It is therefore assumed that the rent will equate to 15% of the income collected from the building.

Outgoings

The occupancy costs, inducements, and ground lease payments, are then added to arrive at a total sum for outgoings for each of the eight years.

Nett income

The total rentals less the total outgoings then give the nett income for each of the eight years.

Valuations: leased fee or lessors' interest

The ground lease payment or rent likely to be received by the lessor, Weston Properties Ltd, for each year in the projected eight year period, is set out in Appendix A.

The New Zealand client looking to purchase the leased fee or lessors interest in the lease will at this stage probably only recognise the rental flow.

The lease still has 95 years to run before the building becomes the property of the lessor, and the chances of the New Zealand client now placing any monetary value on the building is probably nil. The benefit of any future capital gain in the building is more likely to be reflected in the capitalisation rate.

Therefore the leased fee or lessors interest is simply the capitalised value of the present and predicted rental.

The ground lease payments increase from $2,403,091 to $3,015,457 over the eight year projection (1992 1999) and in determining the value of the leased fee or lessors interest three methods have been used as set out in Appendix D.

1) Overall (Basic) Capitalisation Rate

   The Guidance Notes indicate that for freehold property the nett return would be 8% to 8.50%.

   For this leasehold interest with an assured rental growth andafuture capital gain in the building, small at this stage, an increase of say 0.50% is necessary, making the capitalisation rate 8.50% to 9%.

   Applying both of these to the 1992 rental of $2,403,091 produces a value at 8.50% of $28,271,659, and at 9% $26,701,011.

2) Present Value

   Assuming a Reversionary or Terminal Capitalisation Rate of 9 %, that is 0.50 % greater than the Overall Rate, and a discount rate of 13% reflecting the security of income, the present value is calculated to be $26,006,255.

   A similar calculation using 9.50% and a discount rate of 13.50% produces $24,657,780.

3) Gordon Constant Growth Model

   With first mortgage rates at 11% and internal rates of return 11.50% to 12% (see Guidance Notes) the overall commercial sector return is assumed to be 13% and expected long and short term growth rates 4%. This slightly modified version produces a value of $27,769,052.

   A similar calculation using an overall return of 14%, and long and short term growth rates of 4.50% and 4% respectively assesses the value at $26,307,523.

The three methods indicate a value of around $26,000,000 - $27,000,000, and as a check of these two probabilities the Internal Rate of Return is calculated to be 12.50% and 12.30% respectively; the payback (or cash on cash) would then be 9.29 and 9.60 years respectively.

The Guidance Notes suggest an Internal Rate of Return of 11.50% to 12% for freehold property, and bearing in mind the assured rental growth and future capital gain in the building, it is considered an Internal Rate of Return of around 12.25% would be acceptable.

This is substantiated by a basic simulation exercise ("@ risk") revealing a dispersion of returns from 10.63% to 13% see Appendix F.

Accordingly the value of the leased fee or lessors interest is assessed at $27,000,000. 0

Valuation: lessees interest

The lessee, Oxford Developments Ltd, has at the present time a substantial interest in the property, receiving close to 85% of the rental income.

The New Zealand client will see this as a major factor influencing the value of the property, but at the same time will be conscious that the building in 95 years will revert to the lessor. Some allowance should now be made for the reversion, in that on a resale in say eight years the then purchaser will have a similar argument.

The nett income from the building, after the payment of the ground rent, over the eight year horizon increases from $10,936,489 in 1992 to $16,413,278 in 1999.

As with the valuation of the leased fee or lessors interest three methods have been used as shown in Appendix E.

1) Overall (Basic) Capitalisation Rate
For this leasehold interest with effectively a diminishing interest in the building, the capitalisation rate is assumed to be 1% greater than those indicated in the Guidance Notes for freehold property of 8% to 8.50%, that is 9% and 9.50%.
The 1992 nett income of $10,936,489 at 9% produces a value of $121,516,544; at9.50%$115,120,937.
2) Present Value
Assuming Terminal Capitalisation Rates of 9.50% and 10%, that is 0.50% greater than the Overall Rate, and discount rates of 14% and 14. 50% respectively, the present values are calculated to be $127,595,795 and $121,235,032.
3) Gordon Constant Growth Model
The overall commercial sector return is taken at 13%, the expected long term growth rate is estimated to be 3.50% and the expected short term growth 4%; the resultant value is $119,725,774.
A similar calculation with the commercial sector return 14%, and long and short term growth rates of 4% produces a value of $113,739,486.

The three methods produce values ranging from $113,739,486 to $127,595,795, with three of the six sums close to $121,000,000; adopting $121,000,000, the Internal Rate of Return is calculated to be 15.01%. The payback (cash on cash) equates to 8.69 years.

Again the Guidance Notes indicate an Internal Rate of Return of 11 .50% to 12% for freehold property, and bearing in mind the leasehold nature of this property and effectively the diminishing interest in the building it is considered the Internal Rate of Return should be 3% to 3.50% greater, that is say 15%.

A basic simulation exercise ("(@) risk") indicates a dispersion of returns from 13% to 16.25% see Appendix F.

The value of the leasehold or lessees interest is therefore assessed at $121,000,000.

New Zealand conditions

In the Central Business Districts of both Auckland and Wellington, the two major cities in New Zealand, the nett rate of return (overall or basic capitalisation rate) fora prime multi-storey officebuilding on freehold land is expected to be around 8.75% to 9.25%; for a building of international quality the return could be as low as 8%.

For leasehold land, land with a lease for say 21 years with a right of renewal for a similar term including a further right of renewal, effectively a lease with a perpetual right of renewal, the nett return for the lessees interest is generally from 0.50% to up to 1% greater than those buildings on freehold land.

There are few if any ground leases in New Zealand with a terminating term of 99 years and a rent based on the income coming from the building as exists for the Calgary Eaton Centre. However if a similar lease is to be valued in New Zealand then the nett return would probably be up to I% greater than the traditional leasehold or lessees interest returns of 9.25% to 10.25%, that is up to say 11.25%.

Furthermore the New Zealand office market is dominated by comparatively large vacancy factors and the flow-on effect of inducements. The vacancy factor in Auckland is currently 31.5% equating to around 35 hectares or 88 acres, in Wellington 21.6% being 21 hectares (53 acres), and in Christchurch 28.9% or 12 hectares (30 acres) measured over office accommodation available for leasing rather than space vacant and not generating a rental.

In other words the vacancy factor includes office accommodation currently leased and rental being paid, but no longer physically occupied due to the downsizing or relocation of the existing lessee or tenant. Inducements can come in many forms, such as rental and/or operating expenses holidays, the provision of partitions and fit outs, up front payments to the lessee/tenant, and are often made on confidential terms.

This then poses the question of how reliable or factual are the rentals and operating expenses and hence the "analysed" nett return of the property.

The confidentiality of these inducements has been overcome in a recent Court of Appeal decision regarding the arbitration of a rental in the Trust Bank Centre in Wellington (CA 268/91). The Court has ruled that for the review of rentals, inducements given for comparablepremises must be disclosed to ensure that genuine market rental levels can be determined.

In another Court of Appeal decision, the Modick case (CA 12/90), genuine market rents were defined *as* being those rents freely arrived at an negotiation between the parties for new leases

> *"It is only a freely negotiated rent on a new letting that can confidently be taken to be truly comparable, provided of course that there are also sufficient similarities in site and otherwise".*

For the New Zealand valuer, these two recent decisions of the Court of Appeal overcome the difficulties being experienced by the Australian valuer in the assessment of rentals on review, referred to by Mr John Martin in his paper this morning.

One other aspect of conditions in New Zealand is the use of metric measurements and areas. Land dimensions are expressed in metres, and areas in either square metres or hectares. Measurements made by the valuer are in metres and areas in square metres. Therefore rentals are expressed in metric terms; retail shops in dollar terms per square metre on an area basis, and offices per square metre.

Application
New Zealand to Calgary

New Zealand conditions suggest that for a good quality multi-storey office building on perpetually renewable leasehold land, in a good location within the Central Business District of Auckland or Wellington, the nett return (overall or basic capitalisation rate) would be around 9.25% to 10.25%.

Fora terminating lease as exists for the Calgary Eaton Centre it is expected the nett return for the lessees interest would be increased by up to 1% making 10.25% to 11.25%.

Adopting say 10.50% this would then produce a value for the interest of Oxford Developments Ltd of $104,157,038, say $104,000,000; applying a similar principle as before with the Terminal Capitalisation Rate 0.50% greater than the Overall Rate, the Internal Rate of Return equates to 16.67%

For the leased fee or lessors interest of Weston Properties Ltd, adopting a slightly lower return of 10% the value would be $24,030,910, say $24,000,000 and the Internal Rate of Return 13.11%.

1) The value as at 1 January 1992 of the respective interests are;
   a) Weston Properties Ltd $ 27,000,000
   b) Oxford Developments Ltd $121,000,000
2) In New Zealand the return or market yield for a similar property on perpetually renewable leasehold land would be around 9.25% to 10.25%.
3) Adopting these New Zealand returns to the terminating lease of the Calgary Eaton Centre the value of the respective interests is;
   a) Weston Properties Ltd $ 24,000,000
   b) Oxford Developments Ltd $104,000,000

Conclusion

In recent years, property investors often referred to the three ingredients of a good investment as being "location, location, and location".

I think that we as valuers or appraisers or counsellors, entrusted with providing sound professional advice to our clients, would suggest the three essentials be "location, quality of building, and quality of tenant and lease".

In conclusion, I would like to record my appreciation of the assistance given by Mr Marcus Jackson in some of the technical aspects of this paper. A

APPENDIX A: CALGARY EATON CENTRE SUMMARY TABLE

		1992	1993	1994	1995	1996	1997	1998	1999
RENTALS	Retail Actual	$4,917,053	4,925,493	4,931,521	5,177,629	5,536,520	546,743	5,565,816	5,592,304
	Retail New Lettings	$6,163	195,790	385,418	385,418	385,418	386,188	409,872	433,556
	Retail Percentage	$74,000	74,000	76,960	80,038	83,240	86,570	90,032	93,634
	Office Actual	$9,404,829	9,421,718	9,424,126	9,424,126	10,409,337	10,754,386	11,042,314	11,042,314
	Office New Lettings	$,871,563	1,451,060	1,740,808	1,740,808	1,740,888	1,849,666	1,922,045	1,958,235
	Parking	$580,00	603,200	627,328	652,421	678,518	705,659	733,885	763,240
	Storage	$167,000	173,680	180,627	187,852	195,366	203,181	211,308	219,761
	Total:	$16,020,608	$16,844,941	$17,366,788	$17,648,292	$19,029,207	$19,532,393	$19,975,272	$20,103,044
OUTGOINGS									
	Occupancy Costs (For vacant area)	$1,113,696	$786,274	$568,288	$588,058	$608,521	$629,700	$651,620	$674,309
	Ground Lease Pyaments (15% Of rentals)	$2,403,091	$2,526,741	$2,605,018	$2,647,244	$2,854,381	$2,929,859	$2,996,291	$3,015,457
	Inducements (Office Letting)	$1,567,332	$1,042,109	$521,054					
	TOTAL	$5,084,119	$4,355,124	$3,694,360	$3,235,302	$3,462,902	$3,559,559	$3,647,911	$3,689,766
NETT INCOME		$10,936,489	$12,489,817	$13,672,428	$14,412,990	$15,566,305	$15,972,834	$16,327,361	$16,413,278

APPENDIX B: CALGARY EATON CENTRE

RETAIL TENANTS RENTAL CASH FLOW

UNIT	AREA	1992	1993	1994	1995	1996	1997	1998	1999
CONCOURSE									
100	6168	$215,880	215,880	215,880	215,880	215,880	215,880	215,880	215,880
TOTAL C/F		215,880	215,880	215,880	215,880	215,880	215,880	215,880	215,880
MAIN FLOOR									
100	332	$11,620	11,620	11,620	11,620	11,620	11,620	11,620	11,620
101	392	$17,640	17,640	17,640	18,943	21,550	21,550	21,550	21,550
109	500	$20,000	20,000	20,000	20,680	21,632	21,632	21,632	21,632
113	344	$29,240	29,240	29,240	30,035	31,626	31,626	31,626	31,626
117	291	$20,370	20,370	20,370	21,582	23,280	23,280	23,280	23,280
119	894	$33,972	33,972	33,972	35,127	36,744	36,744	36744	36,744
121	6668	$200,040	200,040	200,040	213,932	233,380	233,380	233,380	233,380
127	2110								
150	15986	$399,650	$399,650	$399,650	432,954	479,580	479,580	479,580	479,580
124	489	$24,450	$24,450	$24,450	26,487	29,340	29,340	29,340	29,340
TOTAL C/F		$756,982	756,982	756,982	811,360	888,752	888,752	888,752	888,752
SECOND FLOOR									
200	1739	$78,255,	78,255	78,255	80,916	84,641	84,641	84,641	84641
201	774	$40,920	40,920	40,920	43,400	48,360	48,360	48,360	48,360
205	1451	$79 805	79,805	79,805	82,518	86,317	86,317	86,317	86,317
212	1071	$53,550	53,550	53,550	58,012	64,260	64,260	64,260	64,260
213	908	$38,136	38,136	38,136	38,914	41,248	41,248	42,999	48,253
217	2685	$102,030	102,030	102,030	105,500	110,356	110,356	110,356	110,356
221	3301	$132,040	132,040	132,040	134,733	142,814	142,814	142,814	142,814
224	10036	$250,900	250,900	250,900	271,808	301,080	301,080	301,080	301,080
225	2729	$109,160	109,160	109,160	120,531	136,450	136,450	136,450	136,450
236	5934	$148,350	148,350	148,350	160,712	178,020	178,020	178,020	178,020
237	1400	$46,200	46,200	46,200	48,067	51,800	51,800	51,800	51,800
238	55	$4,400	4,400	4,400	4,630	4,9	4,950	4,950	4,950
241	3394	$0	$0	$0	$0	$			
244	500	$35,000	35,000	35,000	37,084	40,000	40,000	40,000	40,000
245	2907	$101,745	101,745	101,745	111,435	130,815	130,815	130,815	130,815
248	347	$13,880	13,880	13,880	14,352	15,012	15,012	15,012	15,012
249	695	$41,700	41,700	41,700	43,117	45,102,	45,102	45,102	45,102
250	801	$52,065	52,065	52,065	53,835	56,313	56,313	56,313	56,313
253	268	$26,800	26,800	26,800	27,711	28,987	28,987	28,987	28,987
255	257	$19,275	19,275	19,275	19,930	20,848	20,848	20,848	20,848
256	720	$46,800	46,800	46,800	49,200	54,000	54,000	54,000	54,000
260	200	$7600	76007600		7933	8,400	8 400	8,400	8,400
TOTAL C/F	1,428,611	1,428,611	1,428,611		1,514,338	1,649,773	1,649 773	1,65 1,524	1,656,778

APPENDIX B7

RETAIL TENANATS — RENTAL CASH FLOW

UNIT	AREA	1992	1993	1994	1995	1996	1997	1998	1999
THIRD FLOOR									
300	829	$33,160	33,160	33,160	36,613	41,450	41,450	41,450	41,450
301	870	$34,800	34,800	34,800	35,983	37,640	37,640	37,640	37,640
304	955	$42,975	42,975	42,975	44,567	47,750	47,750	47,750	47,750
305	1203	$48,120	48,120	48,120	49,756	52,047	52,047	52,047	52,047
312	1104	$44,160	44,160	44,160	45,661	47,763	47,763	47,763	47,763
313	1124	$33,720	33,720	33,720	34,867	36,472	36,472	36,472	36,472
316	1220	$48,800	48,800	48,000	51,342	54,900	54,900	54900	54,900
317	2679								
320	3578		$0	$0	$0	$0	$0	$0	$0
321	5250	$193,375	199,500	203875	210,000	214,375	220,500	224,875	231,000
324	2786	$83,580	83,580	83,580	86,422	90,400	90,400	90,400	90,400
325	4282	$214,100	214,100	214,100	221,380	231,570	231,570	231,570	231,570
328	3124	$93,720	93,720	93,720	96,269	101,367	101,367	101,367	101,367
332/334	6072								
335	67		$0	$0	$0	$0	$0	$0	$0
336	762	$32,385	32,385	32,385	33,486	35,028	35,028	35,028	35,028
337	1546	$69,570	69,570	69,570	71,935	75,247	75,247	75,247	75,247
340	880	$30,800	30,800	30,800	31,847	33,313	33,313	33.313	33,313
341	4748	$118,700	118,700	118,700	123,646	130,570	130,570	135,516	142,440
344	700	$38,500	38,500	38,500	40,687	43,750	43,750	43,750	43,750
345	930								
349	2 8	$42,800	42,800	42,800	44,583	47,080	48,863	51,360	51,360
350	10024	$8,000	8,000	8,000	8,417	9,000	9,000	9,000	9,000
353	268	$22,780	22,780	22,780	23,896	25,460	25,460	25,460	25,460
357	568	$45,440	45,440	45,440	46,676	49,148	49,148	49,148	49,148
TOTAL C/F		$1,279,485	1,285,610	1,289,985	1,338,033	1,404,330	1,412,238	1,424,056	1,437,105
FOURTH FLOOR									
400	701	$21,030	21,030	21,030	21,745	22,746	22,746	22,746	22,746
401	1984	$69,1	71,424	73,077	75,392	77,045	79,360	79,360	79,360
404	1846	$49,842	49,842	49,842	53,688	59,072	59,072	59,072	59,072
409	826		$0	$0	$0	$0	$0	$0	$0
412	1222	$26,884	26,844	26,844	28,920	31,772	31,772	31,772	31,772
415	600	$27,000	27,000	27,000	27,918	29,203	29,203	29,203	29,203
417	7710	$154,200	154,200	154,200	159,443	166,783	166,783	166,783	166,783
420	3300	$115,500	115,500	115,500	119,427	124,925	124,925,	124,925	124,925
424	2826	$70,650	70,650,	70,650	76,537	84,780	84,780	84,780	84,780
425	1365	$61,425	61,425	61,425	63,513	66,437	66,437	71,139	77,721
429	2755	$123,975	123,975	123,975	129,715	137,750	137,750	137,750	137,750
431	187	$13,090	13,090	13,090	13,446	14,158	14,158	14,960	16,563
432	271	$10,840	10,840	10,840	11,208	11,725	11,725	11,725	11,725
433	301	$25,585	25,585	25,585	26,456	27,673	27,673	27,673	27,673
434	5334	$133,350	133,350	133,350	144,462	160,020	160,020	160,020	160,020
435	450	$45,000	45,000	45,000	46,530	48,672	48,672	48,672,	48,672
436	80		$0	$0	$0	$0	$0	$0	$0
437	404	$40,400	40,400	40,400	41,774	43,697	43,697	43,697	43,697
439	2152	$96,840	96,840	96,840	101,323	107,600	107,600	107,600	107,600
440	502	$62,750	62,750	62,750	64,883	67,870	67,870	67,870	67,870
441	346		$0	$0	$0	$0	$0	$0	$0
445	355		$0	$0	$0	$0	$0	$0	$0
447	333		$0	$0	$0	$0	$0	$0	$0
449	289	$24,565	24,565	24,565	25,400	26,570	26,570	26,570	26,570
451	200	$25,000	25,000	25,000	25,850	27,040	27,040	27,040	27,040
452	434		39,060	39,060	40,388	42,247	42,247	42,247	42,247
TOTALC/F		$1,236,095	1,238,410	1,240,063	1,298,018	1,377,785	1,380,100	1,385,604	1,393,789

APPENDIX B2

ESTIMATED VACANCIES (RETAIL)

UNIT	AREA	EST RENT CASH FLOW	1992 POTENTIAL RENT	1993	1994	1995	1996	1997	1998	1999
127	2110	30	$63,300	63,300	63,300	63,300	63,300	71,206	71,206	71,2
241	3394	30	$101,820	101,820	101,820	101,820	101,820	114,537	114,537	114,537
317	2679	25	$66,975	66,975	66,975	66,975	66,975	75,340	75,340	75,34
320	3578	25	$89,450	89,450	89,450	89,450	89,450	100,622	100,622	100,622
322/334	6072	25	$151,800	151,800	151,800	151,800	151,800	170,760	170,760	170,760
335	67	100	$6,700	6,700	6,700	6,700	6,700	7,537	7,537	7,537
345	2930	25	$73,250	73,250	73,250	73,250	73,250	82,399	82,399	82,399
409	826	30	$24,780	24,780	24,780	24,780	24,780	27,875	27,875	27875
436	80	90	$7,200	7,200	7,200	7,200	7,200	8,099	8,099	8,099
441	346	65	$22,490	22,490	22,490	22,490	22,490	25,299	25,299	25,299
445	355	95	$33,725	33,725	33,725	33,725	33,725	37,937	37,937	37,937
447	333	85	$28,305	28,305	28,305	28,305	28,305	31,840	31,840	31,84
TOTAL AREA	22770									
TOTAL CIF			$669,795	669,795	669,795	669,795	669,795	753,451	753,451	753,451
TOTAL LETTABLE AREA		161162								
EXPECTED VACANCY LEVEL (CURR 14.13%)			14.00%	10.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
% VACANT AREA LEASED		0.13%	4.00%	4.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
EST FLOOR AREA GROWTH			210	6446	6446	0	0	0	0	
EST RENTAL/FT of VACANT SPACE			$29.42	$29.42	$29.42	$29.42	$29.42	$33.09	$33.09	$33.09
EST RENTAL GROWTH(Cumula8ve)			$6,163	$195,790	$385,418	$385,418	$385,418	$386,188	$409,872	$433,556
PERCENTAGE RENTS										
RETAIL SALES PROJECTED INCREASE:0.00%			0.00%	0.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
AMOUNT PAYABLE:			$74,000	$74,000	$76,960	$80,038	$83,240	$86,570	$90,032	$93,634
TOTAL RETAIL RENTAL			$4,997,216	$5,195,283	$5,393,899	$5,643,085	$6,005,178	$6,019,501	$6,065,720	$6,119,494

APPENDIX B3

OFFICE TENANTS RENTAL CASH FLOW

UNIT	AREA	1992	1993	1994	1995	1996	1997	1998	1999
THIRD FLOOR									
700	93170	$1,863,400	1,863,400	1,863,400	1,863,400	2,142,910	2,236,080	2,236,080	2,236,080
1200	37268	$819,896	819.896	819,896	819,896	903,749	931,700	931,700	931,700
1500	9634	$163,778	171,004	173,412	173,412	181,528	184,234	184,234	184,234
1510	9000		$0	$0	$0	$0	$0	$0	$0
1600	18634		$0	$0	$0	$0	$0	$0	$0
1700	37268	$670,824	670,824	670,824	670,824	782,628	819,896	819,896	819,896
1900	37998	$835,956	835,956	835,956	835,956	914,264	940,367	940,367	940,367
2100	6000	$102,000	102,000	102,000	102,000	112,500	120,000	120,000	120,000
2120	12999		$0	$0	$0	$0	$0	$0	$0
2200	37998	$607,968	607,968	607,968	607,968	607,968	607,968	721,962	721,962
2400	6000	$150,000	$150,000	150,000	150,000	159,368	168,735	168,735	168,735
2420	12999		$0	$0	$0	$0	$0	$0	$0
2500	94995	$1,899,900	1,899,900	1,899,900	1,899,900	2,184,885	2,279,880	2,279,880	2,279,880
3000	10,000	$220,000	220,000	220,000	220,000	235,000	240,000	240,000	240,000
3020	9326		$0	$0	$0	$0	$0	$0	$0
3100	14400	$244,800	244,800	244,800	244,800	261,600	273,600	273,600	273,600
3120	4296		$0	$0	$0	$0	$0	$0	$0
3200	38652	$840,681	850,344	850,344	850,344	937,311	966,300	966,300	966,300
3400	57978	$985,626	985,626	985,626	985,626	985,626	985,626	1,159,560	1,159,560
3700	19326		$0	$0	$0	$0	$0	$0	$0
3800	19326		$0	$0	$0	$0	$0	$0	$0
3900	17000		$0	$0	$0	$0	$0	$0	$0
4000	17000		$0	$0	$0	$0	$0	$0	$0
TOTAL C/F		$9,404,829	9,421,718	9,424,126	9,424,126	10,409,337	10,754,386	11,042,314	11,042,314

ESTIMATED VACANCIES (OFFICES)

	EST RENT		INDUCEMENTS	RENT EXCL INDUCEMENTS							
1510	9000	15	(270,000)	$135,000	135,000	135,000	135,000	135,000	151,862	151,862	151,862
1600	18634	18	(559,020)	$335,412	335,412	335,412	335,412	335,412	377,305	377,305	377,305
2120	12999	16	(422,468)	$207,984	207,984	207,984	207,984	207,984	233,961	233,961	233,961
2420	12999	19	(422,468)	$246,981	246,981	246,981	246,981	246,981	277,829	277,829	277,829
3020	9326	17	(326,410)	$158,542	158,542	158,542	158,542	158,542	178,344	178,344	178,344
3120	4296	17	(150,360)	$73,032	73,032	73,032	73,032	73,032	82.154	82,154	82,154
3700	19326	20	(676,410)	$386,520	386,520	386,520	386,520	386,520	434.796	434,796	434.796
3800	19326	20	(676,410)	$386,520	386,520	386,520	386,520	386,520	434,796	434,796	434,796
3900	17000	20	(595,000)	$340,000	340,000	340,000	340,000	340,000	382,466	382,466	382,466
4000	17000	20	(595,000)	$340,000	340,000	340,000	340,000	340,000	382,466	382,466	382,466
Totals:	139,906		(4,693,546)								
TOTAL C.F				2,609,991	2,609,991	2,609,991	2,609,991	2,609,991	2,935,979	2,935,979	2,935,979

TOTAL LETTABLE AREA 621267								
EXPECTED VACANCY tEVEI (Curr 22.52%)	15%	10%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
VACANT AREA LEASED	7.52%	5%	2.5%	0.0%	0.0%	0.0%	0.0%	0.0%
EST FLOOR AREA GROWTH	46719	31063	15532	0	0	0	0	0
EST. RENTAVFTOFVACANT SPACE	$18.66	$18.66	$18,66	$18.66	$18.66	$20.99	$20.99	$20.99
EST RENTAL GROWTH (Cumulative)	$871,563	1,451,060	1,740,808	1,740,808	1,740,808	1,849,666	1,922,045	1,958,235
TOTAL OFFICE RENTAL	$10,276,392	10,872,778	11,164,934	11,164,934	12,150,145	12,604,052	12,964,359	13,000,549
PARKING INCOME (4%pa)	$580,000	$603,200	$627,328	652,421	678,518	705,659	733,885	763,240
STORAGE INCOME	$167,000	173,680	180,627	187,852	195,366	203,181	211,308	219,761
TOTAL Est Income for complex as leased:	$16,020,608	16,844,941	17,356,788	17,648,293	19,029,207	19,532,393	19,975,273	20,103,044

APPENDIX C: OCCUPANCY COSTS

Take 1992 as advised From 1993 on allow 3.5%pa inflation	1992	1993	1994	1995	1996	1997	1998	1999
RETAIL:	$2,520,503							
Food court excl cap recovery	$34,550							
TOTAL (increasing at 3.51 %)	$2,555,053	$2,644,480	$2,737,037	$2,832,833	$2,931,982	$3,034,601	$3,140,813	$3,250,741
Plus food ct cap recover:	$56835	$56,835	$56,835	$56,835	$56,835	$56,835	$56,835	$56,835
TOTAL RETAIL/FOOD COURT:	2,611,888	2,701,315	2,793,872	2,889,668	2,988817	3,091,436	3,197,648	3,307576
Vacancy factor:	14.00%	10.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.60%
RETAIU/FD COURT VACANT	$365,664	270,131	167,632	173,380	179,329	185,486	191,859	198,455
Offices (increasing at 3.5%)	$4,986,883	$5,161,424	$5,342,074	$5,529,046	$5,722,563	$5,922,852	$6,130,152	$6,344,707
Vacancy factor:	15%	10%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
TOTAL OFFICES; VACANT:	$748,032	$516,142	$400,656	$414,678	$429,192	$444,214	$459,761	$475,853
SUM TOTAL VACANT:	$1,113,697	786,274	568,288	588,059	608,521	629,700	651,620	674,308

Office inducements payable	1992	1993	1994	1995	1996	1997	1998	1999
Est Floor Area Growth:	46719	31063	15532	0	0	0	0	
Est Inducements/Ft of leased space:	($33.55)	($33 55)	($33.55)	($33.55)	($33,55)	($33.55)	($33.55)	($33.55)
INDUCEMENTS PAYABLE	($1,567,332)	($1,042,109)	($521,054)	$0	$0	$0	$0	$0

APPENDIX D: CASH FLOW ANALYSIS

LESSOR (Weston Properties Ltd)

		1992	1993	1994	1995	1996	1997	1998	1999
Cash flow stream:		$2,403,091	2,526,741	2,605,018	2,647,244	2,854,381	2,929,859	2,996,291	3,015,457
COMPOUNDED GROWTH (pa)	2.88%								

METHOD 1

Basic Capitalisation

Rate:	8.50%	9.00%
Value:	$28,271,659	26,701,011

METHOD 2

Present Value

Discount Rate:	13,00%	13.50%
Terminal Cap Rate:	9.00%	9.50%

(Reversion value based upon expected rental in yr 2000, 4% escalation)

	Rentals	Reversion (1999)	Total Cashf low	Rentals	Reversion (1999)	Total Cashf low
1992	$2,403,091		$2,403,091	$2,403,091		$2,403,091
1993	$2,526,741		$2,526,741	$2,526,741		$2,526,741
1994	$2,605,018		$2,605,018	$2,605,018		$2,605,018
1995	$2,647,244		$2,647,244	$2,647,244		$2,647,244
1996	$2,854,381		$2,854,381	$2,854,381		$2,854,381
1997	$2,929,859		$2,929,859	$2,929,859		$2,929,859
1998	$2,996,291		$2,996,291	$2,996,291		$2,996,291
1999	$3,015,457	$34,845,281	$37,860,738	$3,015,457	33,011,319	36,026,776
Present value:			$26,006,255			$24,657,780

METHOD 3

Gordon Constant Growth Model

Overall Commercial

Sector Return:	13,00%	14.00%
Exp Long Term Growth:	4.00%	4.50%
Exp Short Term Growth:	4.00%	4.00%
Value:	$27,769,052	$26,307,523

CHECK

Terminal Cap Rate:	9.005	9.50%
Value (say):	($27,000,000)	$26,000,000)
1992	$2,403,091	2,403,091
1993	$2,526,741	2,526,741
1994	$2,605,018	2,605,018
1995	$2,647,244	2,647,244
1996	$2,854,381	2,854,381
1997	$2,929,859	$4,929,859
1998	$2,996,291	$2,996,291
1999	$37,860,738	36,026,776
INTERNAL R 0 R:	12.30%	12.50%
PAYBACK (YRS):	9.60	9.29

APPENDIX E

CASH FLOW ANALYSIS
LESSOR (Oxford Developments Ltd)

		1992	1993	1994	1995	1996	1997	1998	1999
Cash flow stream:		$10,936,489	12,489,817	13,672,428	14,412,990	15,566,305	15,972,834	16,327,361	16,413,278
COMPOUNDED GROWTH (pa)	5.21%								

METHOD 1
Basic Capitalisation

Rate:	9.00%	9.50%
Value:	$121,516,544	$115,120,937

METHOD 2
Present Value

Discount Rate:	14.00%	14.50%
Terminal Cap Rate:	9.50%	10.00%

(Reversion value based upon expected rental in yr 2000, 4% escalation)

	Rentals	Reversion (1999)	Total Cashf low	Rentals	Reversion (1999)	Total Cashf low
1992	$10,936,489		$10,936,489	$10,936,489		$10,936,489
1993	$12,489,817		$12,489,817	$12,489,817		$12,489,817
1994	$13,672,428		$13,672,428	$13,672,428		$13,672,428
1995	$14,412,990		$14,412,990	$14,412,990		$14,412,990
1996	$15,566,305		$15,566,305	$15,566,305		$15,566,305
1997	$15,972,834		$15,972,834	$15,972,834		$15,972,834
1998	$16,327,361		$16,327,361	$16,327,361		$16,327,361
1999	$16,413,278	$179,682,201	$196,095,479	$16,413,278	$170,698,091	$187,111,369
Present value:			$127,595,795			$121,235,032

METHOD 3
Gordon Constant Growth Model
Overall Commercial

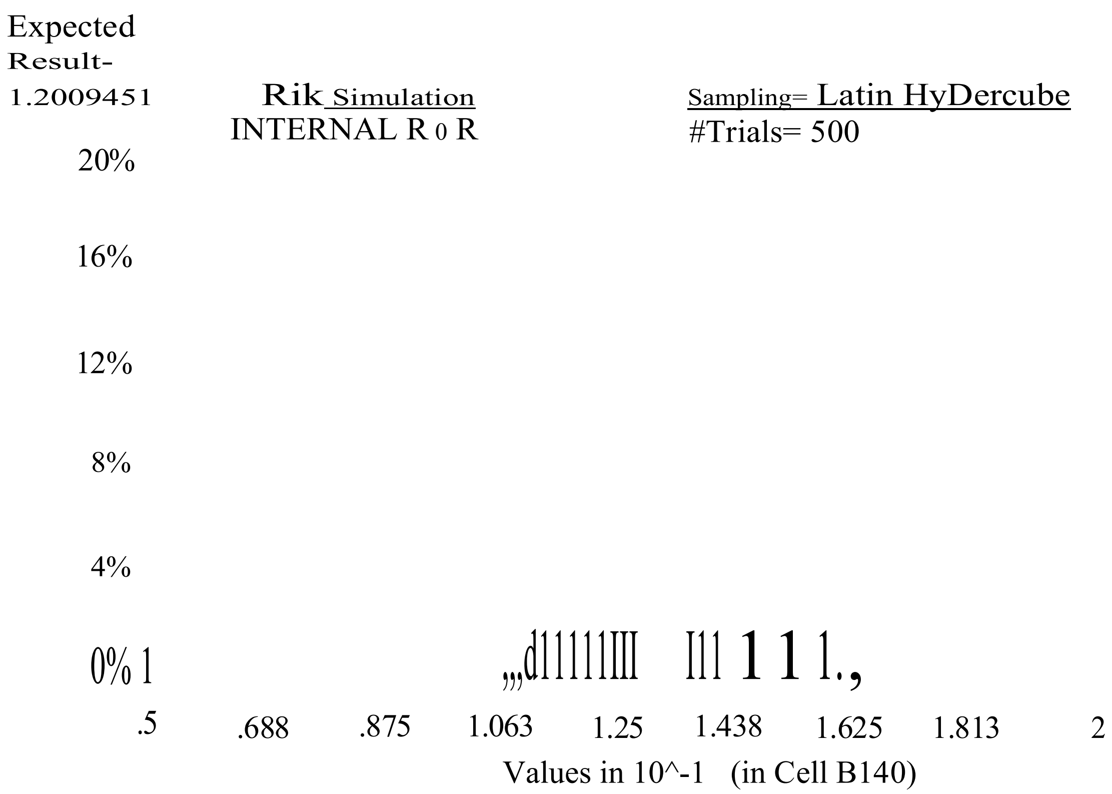
Sector Return:	13,00%	14.00%
Exp Long Term Growth:	3.50%	4.00%
Exp Short Term Growth:	4.00%	4.00%
Value:	$119,725,774	$113,739,486

CHECK

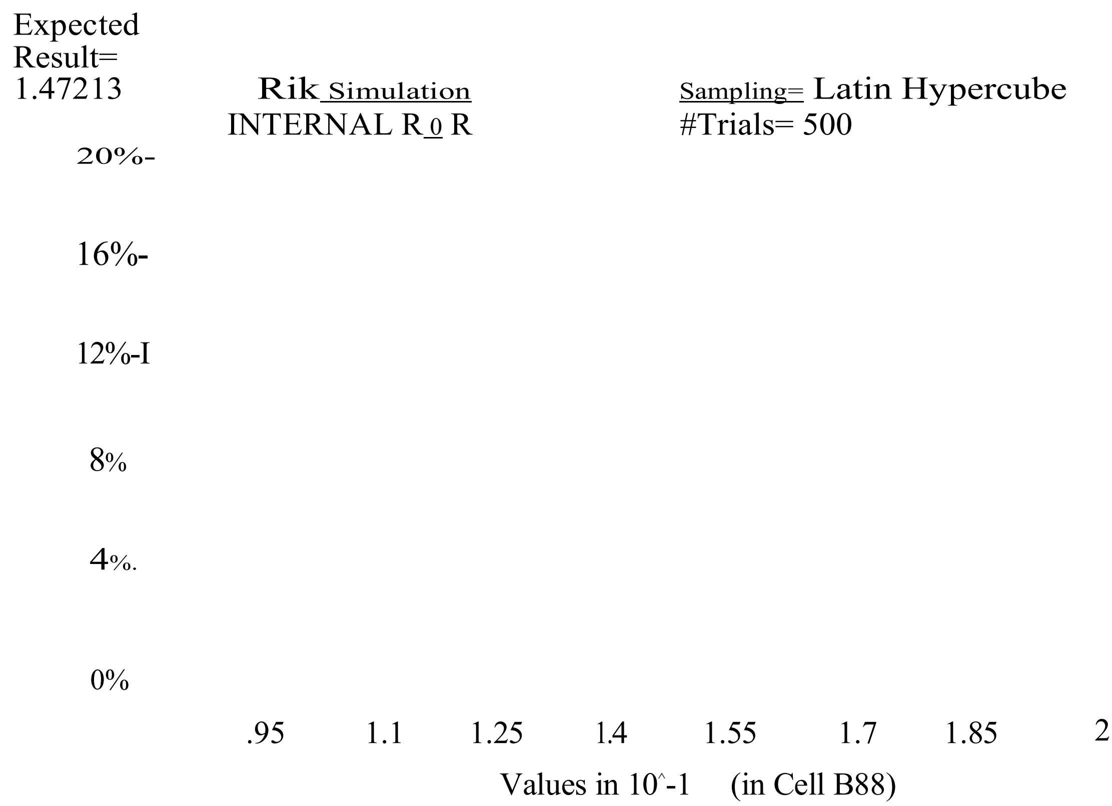
Terminal Cap Rate:	9,50%	10,00%
Value (say):	($121,000,000)	($115,000,000)
1992	$10,936,489	10,936,489
1993	$12,489,817	$12,489,817
1994	$13,672,428	$13,672,428
1995	$14,412,990	$14,412,990
1996	$15,566,305	15,566,305
1997	$15,972,834	15,972,834
1998	$16,327,361	$16,327,361
1999	$196,095,479	187,111,369
INTERNAL R 0 R:	15.01%	15.25%
PAYBACK (YRS):	8.69%	7.95%

APPENDIX F

Weston Properties Ltd



Oxford Developments Ltd



Legal Decisions

IN THE DISTRICT COURT AT DUNEDIN
IN THE OTAGO LAND VALUATION TRIBUNAL

IN THE MATTER OF THE LAND ACT 1948

AND

IN THE MATTER OF an objection to valuation for lease renewal purposes

BETWEEN William Grigor WALKER
Objector

AND The Commissioner of Crown Lands
Resn o ndent

Hearing: 20,21,22, & 25 November 1991
Counsel: N H O'Malley for the Objector
W J Wright for Crown
Reserved Judgment: 24 June 1992

RESERVED JUDGMENT OF THE TRIBUNAL

AAP WILLY DCJ, W 0 HARRINGTON, I MCN DOUGLAS

Mr and Mrs William Walker are the owners of a leasehold property situated some 15 kilometres from Clinton. The Walker family has farmed theproperty since 1908. It comprises 490.3146 hectares. In 1919, Mr Walker's father and mother purchased the property from an uncle, and on 1 March 1951, the present lease was negotiated.

The question at issue in these proceedings is what should be the rent payable by the lessee from 1 July 1984. The Crown, which asserts it is the owner of the land, has obtained two valuations, both of which vary widely. Mr and Mrs Walker have obtained a valuation which differs from both of those obtained by the Crown. The question is one of some importance in that it relates to the correct method of approaching the valuation of land, exclusive of improvements, for the purposes of fixing rentals for leasehold farm land, pursuant to the Land Act 1948.

At the outset of the hearing, it became clear that there was to be a significantly different approach taken by the valuers respectively for the lessor and the lessee. Mr Passmore, an employee of Valuation New Zealand Ltd, who was the first valuer retainedby the Crown, places the emphasis entirely upon evidence of sales which he contends are truly comparable. Mr Newson, a private valuer later retained by the Crown, takes the view that the law as it presently stands requires him to give primacy to comparable sales, but within the requirements of S 131 of the Land Act 1948 is prepared to acknowledge that because of the almost total absence of any wholly unimproved land in the district, it is necessary to have regard to other considerations in arriving at a valuation for rental purposes which is fair between lessor and lessee.

Mr Laing, the valuer retained by the lessee, acknowledges that evidence of recent comparable sales is to be taken into account. Like Mr Newson, he recognises that due to the absence of sales of comparable unimproved land, another approach is necessary. He contends for what he describes as a market approach.

We will deal with the rival contentions in more detail later in this decision. Suffice to say, we are informed by counsel that this is the first occasion in which this Tribunal has been invited to have regard to a range of considerations outside of comparable sales. Counsel submits that there are no other cases in which this Tribunal or the Courts have been called upon to consider (in the context of valuation of rural land) the effect of the 1971 amendment to the Land Act of 1948 and in particular the proviso to S 131 then introduced. So be it.

We begin by setting out the factual background. We will then deal with the valuation evidence, followed by reference to the relevant statutory provisions and such case law as there is. We will conclude with a decision of what in our view ought to be the rental valuation.

Factual Background

The property in question is the subject of a renewable lease of farm land issued under the Land Act 1948. The lessee was originally Mrs Janet Walker; the lease is dated 1 March 1951; the term is 33 years commencing on 1 July 1951; the rental value then fixed was 119 pounds 14 shillings, calculated on a rental value of 2,660 pounds. The lease provides that the lessee will pay rates, taxes and assessments of "whatsoever nature that may be assessed, levied or payable in respect of the land". The lessee has the obligation to insure all buildings. In the mutual agreements between lessee and lessor (paragraph (b)), it is provided that after the expiration of the term granted the lessee shall:

> *"He ve a right to obtain In accordance with the provisions of S63(4) of the Land Act 1948, a newlease ofthe land hereby leased at a rent to be determined In the manner prescribed by Part Viii of the saidAct fora term of 33 years computed from the expiration of the term hereby granted and subject to the same covenants and provisions as this lease, Including this present provision for the rental thereofand all provisions ancillary or In rotation thereto."*

Paragraph (c) of the covenants between lessor and lessee (in the printed form) provide that the lessee should have a right of purchase. In fact, that right has been deleted and it is clear from the lease that the lessee shall have no right of acquiring the fee simple of the land. Neither party made any particular representation as to what effect this clause, if any, might have on the present valuation. We therefore say no more about it.

We are told by counsel, and it is confirmed by Mr Walker informally at the hearing, that there is a gooddeal of controversy surrounding precisely who is the person entitled to receive the rent under the lease. On 1 November 1954, there was endorsed on the lease document a proclamation (No 6697) which reads:

> *"Closed road adjoining the above to be added to the Lower Clutha River Trust endowment"*

Part of that memorial has been crossed out, leaving uncancelled the words:

> *"The above described land River Trust Endowment."*

Whether it was intended to delete the whole of the memorial is not clear.

Mr Wright contends that the land is currently vested in the Otago Regional Council as the successor to the Otago Catchment Board which in turn inherited the functions and endowments of the Lower Clutha River Trust. Mr O'Malley, for the lessee, contends that the land is unalienated Crown land. In the event, nothing turns upon the apparent confusion surrounding the identity of the true owner; suffice to say that the rent, when fixed, will be paid either to the Crown or such party as it nominates.

The date for the fixing of the rental is, as we have previously mentioned, 1 July 1981. Counsel informs us that the reason for the substantial delay down to the present time has been occasioned partly by the failure of the parties to agree upon the correct method of valuation and partly by the taking of proceedings in the High Court and the Court of Appeal relating to matters which are no longer in issue in this case but which the parties considered needed resolution before the rental value could be fixed. Notwithstanding those difficulties, there has been a lengthy and unexplained delay in bringing these matters on for hearing between the date that the Court of Appeal gave its judgment on 27 March 1989 and the hearing in this Tribunal on 20 November 1991. That delay significantly adds to the problem of the valuers and this Tribunal in arriving- at a rental valuation which is consistent with the relevant statutory requirements.

The matter is further exacerbated by the fact that Mr Passmore deposes that Valuation New Zealand wasfast requested to value the property in October 1982. That valuation was in fact carried out by a Mr Johnston then employed by the Valuation Department. Mr Passmore, who valued the property in January 1990, did in effect review that valuation by reanalysing information relied upon by Mr Johnston. He then endeavoured to backdate his valuation to 1981. MrNewson was first requested to value the property on 8 November 1991. Mr Laing, for the lessee, does not disclose the date upon which he carried out his valuation. In considering the valuation evidence, we must do our best, as did the valuers, to endeavour to value this property as it was in 1981 and in the economic and social conditions then prevailing.

Description of Property

All valuers agree that the property may be described as a sound economic sheep and cattle farming unit with well developed farm land and very good structural improvements. The management at the relevant time (and no doubt today) is described as very good. It is situated near Clinton in South Otago. That is a well established farming area, with good sealed road access to the gravel road which serves the property. The community facilities include a railway line, sale yards, primary school and a shopping centre at Clinton. The closest high school is at Balclutha which is 42 kilometres distant. That town has a full range of farm and domestic suppliers and the Finegand Freezing Works situated nearby. The property is serviced by telephone, electricity, rural mail delivery and a school bus. The annual rainfall is 1,100 millimetres, well spread throughout the year, and reliable. Snow falls only infrequently and is considered a minor risk to stock and access, although there may be lambing difficulties occasioned by cold southerly storms during that part of the season. The altitude of the land is between 290 and 300 metres above sea level, and of the total of 490.3146 hectares, it comprises some fully cultivated pasture, some tussock (which has been oversown and topdressed) and some swamp. Unfortunately, the valuers are unable to agree upon the precise areas which should be assigned to each category. Mr Passmore considered there to be 200 hectares of fully cultivated land, 200 hectares of oversown tussock hills and 50 hectares of swamp. Mr Newson considered that as at 1981/82, there was 301 hectares of permanent pasture and crop cultivation, 128 hectaresofoversown tussock and 61 hectares of peat swamp and rough waste. Mr Laing considered there to be 302 hectares of developed pasture and the balance partly developed peat land.

The correct categorisation of the land is important to the ultimate valuation and it is necessary we resolve the difference. Having had the opportunity of seeing and hearing the respective valuers give evidence, we prefer the conclusions reached by Mr Newson, closely followed as they are *by Mr* Laing. In doing this, we mean no disrespect to Mr Passmore, but we are not satisfied that he made any detailed enquiry of the precise categorisation of the land. We come to the conclusion that he relied substantially upon what Mr Johnston had earlier told him, and although he did go on to the property, he does not appear to have made any independent assessment of the precise land utilisation. In addition, Mr Passmore is by training and expertise a valuer; he is not a farm consultant, although of course we accept that he will in the course of his career go on to many farms for valuation purposes. Mr Newson, on the other hand, is not only a valuer, he is also a farm consultant. He is familiar with the property in question and made a point of establishing with some precision the correct categorisation of the land. In doing that, he relied heavily upon what Mr Walker told him, but in doing so, first satisfied himself that Mr Walker kept reliable records of his history of farming the land. In addition to that, he drove over the property in company with Mr Walker. Mr Laing adopted a similar procedure, and in doing so, arrived at conclusions which are for all material purposes the same as Mr Newson.

We therefore conclude that this property has 301 hectares of permanent pasture and cultivation, 128 hectares of oversown tussock, and 61 hectares of peat swamp and rough waste, making a total of 490 hectares (rounded up).

All of the valuers are agreed that many tonnes of superphosphate and lime have been added to the property over the years. Indeed, Mr Newson considered that something like 3,700 tonnes of superphosphate and 14,000 tonnes of lime have been applied by Mr Walker since he has farmed the property. That of itself represents an investment of in excess of $1 million in top-dressing, which is solely the lessee's improvement. In addition to topdressing, the property is'fenced with some 3,000 to 4,000 metres of permanent fencing and has some 35 kilometres of field tile drains and some concrete culvert piping. Some of the wet gullies have been bulldozed and drained, thereby altering the general topography of parts of the property and making it easier to work and allowing better drainage. In addition to those improvements, there is a substantial house and curtilage, wool shed, cattle yards, shelter belt planting, a number of tracks, stables, water supply.

All valuers are agreed that the adjusted 1981/82 stocking rate of the property was 4,200 stock units, which comprises a flock of 2,800 Perendale sheep and approximately 200 cattle. It is common ground that this stock performs particularly well on this land, with lambing percentages of in excess of 130% and calving of 90%. All surplus stock can be fattened on the property for sale. With the exception of the categorisation of various areas of farm, it is immediately apparent that there is substantial agreement among the valuers concerning the description, management and carrying capacity of this property. Notwithstanding that consensus, the valuers arrive at the following valuations:-

Mr Passmore	$
Capital value	700,000
Value of land exclusive of Improvements (LEI)	245,000
Value of Improvements	455,000
Mr Newson	
Capital value	705,000
Value of LEI	180,000
Value of improvements	525,000
Mr Laing	
Capital value	720,000
Value of LEI	195,000
Value of improvements	525,000

It is immediately apparent from the foregoing that the capital value is not in dispute. Where Messrs Newson and Laing part company with Mr Passmore is in the value placed on the improvements. It is also of some significance that Mr Laing and Mr Newson, who were each asked to value for different interests, have reached an identical conclusion about the value of the improvements, and within the difference of their capital value figures, they have therefore arrived at a similar conclusion about the value of the land exclusively of improvements.

Further complicating our task in this case is the fact that Mr Newson arrived at his conclusion purportedly using the same methodology as Mr Passmore. Mr Laing arrived at his valuation by relying significantly upon what he describes as the "market approach to valuation". That dichotomy illustrates just how subjective are the conclusions arrived atby the valuers when it comes to valuing the LEI and the value of improvements. The significance, of course, of the difference between the valuers on the question of value of the improvements and LEI is that the higher the value of improvements the less will be the LEI.

Those, then, are the general background matters. We now turn to consider the valuations in more detail.

Mr Passmore

In his evidence, Mr Passmore said that:-

"The Land Act 1948 and the associated case law requires a valuer to *ifrstly assess the capital value on the basis ofcomparable sales. Secondly, to assess the value of LEI, also on the basis of comparable* sales. *The difference* between these two *figures can be taken to represent the added value of Improvements. "*

He refers to Maori Trustee v Wright [1959] NZLR 920. He goes on to say:-

"The LEI state and the comparable evidence forassessingits value can however be a contentious Issue in some situations."

He concludes that there is available from various sources sufficient information to:-

"Establish within reasonable limits the probably natural state of the property. "

He further considers that there exists a:-

"Numberof sales which although not entirely unimproved land were close to that *state."*

From that information, Mr Passmore concludes that those sales can be:-

"Readily analysed to provide a net sale price for LEI."

He considers that this procedure is endorsed by the case of *Valuer General v Sullivan,* a decision of Archer J given in the Land Valuation Court, Dunedin Registry, on 18 October 1962. Mr Passmore considers that there is:

"Adequate sales evidence to show the extremely buoyant nature of the property market In the early 1980's."

He considers this illustrates the great desirability of land with potential for improvement.

It is, therefore, clear that Mr Passmore relies primarily upon evidence of sales, and historic records from which the pre European state of the land can be in his view fairly assessed. He does not, however, rely entirely upon those methods. At page 4 of his evidence, Mr Passmore says:

"We are also *aware* that *valuers are required under S131 tl)(c)(1) of* the *Land Act 1948 to value land and improvements with equalemphas/sand under S131(1)(c)(ii) to recognise the relationship between lessee and lessor. "*

Mr Passmore is here referring to the 1971 amendment to the Land Act. It provides as follows:

"The value of the land includedln the lease exclusive of the Improvements referred to In paragraph (a) of this *subsection:*

Provided that, *subject to the provisions of this Act,*

(I) In ascertaining the values under paragraphs (a) and (c) of this subsection, equal emphasis shall be placed on the value to be ascertained under each paragraph:

(Ii) The values shall be ascertained on an equitable basis, having regard to *the relationship between lessor and lessee:*

(iii) The sum of the values underparagraphs (a) and (c) of this *subsection shall be equal to the capital value of the land.*

Mr Passmore considers that the effect of these provisos is unclear, although points to some guidance to be obtained from *the case of Commissioner of Crown Lands vAssociated Taverns,* a decision of the High Court, Christchurch, given on 23 June 1983. We will deal later with these authorities. That case is the only one known to counsel which considers the provisions of Part VIII of the Land Act 1948, and in particular 5131, after its amendment in 1971. All of the other authorities referred to by counsel relate either to the Valuation of Land Act 1951 or predate the 1971 amendment to S131.

Mr Passmore endeavours to give effect to the requirements of S 13l(1)(c) by making a generous allowance in the assessment of improvements. He considers that:

"Anymore liberal view would be contrary to established valuation principles and without definition."

Against that general approach, Mr Passmore values the improvements as follows:

Structures on the property	196,000
Land development	259 000
Total value of improvements	$455,000

He values the LEI as follows:-

200 hectares easy undulating and with tussock cover at $700 per ha	140,000
Peat swamp and tussock 90 hectares $280	25,000
Moderate to steep tussock hills 200 hectares at $400	80,000
Total value of LEI	245,000
Capital Value	700,000

In arriving at that conclusion, he has regard to a number of what he considers to be are comparable sales. These fall into various categories as follows:

- Sales of improved properties which are relied upon to support his valuation of the capital value;
- Sales which he considers support his valuation of LEI; and
- "Freeholding transactions" which

he says "Are considered to be valid evidence for comparison."

We note that Mr Newson valued the same improvements in a different way. He divided the improvements into buildings, planting, access, drainage and fencing, to all of which he assigned a value of $286,000. He separately valued the fertility of the various pastures at $239,000 and arrived at his total figure for improvements of $525,000. It is, therefore, clear that although the two valuers purported to use the same methodology in valuing the LEI, MrNewson introduced adifferent concept from those relied upon by Mr Passmore. He placed a separate value on the fertility of the pastures because in his view virtually all of that fertility was introduced by the lessee and must therefore be considered as a lessee's improvement.

Mr Laing appeared to adopt a significandy different approach from either of the other two valuers. He endeavoured to express, in terms of stock units, the productivityresulting from the improvements introduced by the lessee. Central to any assessment of the increase in carrying capacity expressed in stock units is, of course, the extent of the fertility added by the lessee overand above the land as it was in its natural state. That exercise is of central importance to his approach because once the valuer determines the extent of the added fertility and the resulting increased productivity, and any other improvements such as buildings, the result gives a valuable check on any assessment of the land in its natural state arrived at from a consideration of historical records and other sources.

Further to that, it became clear from the questions asked of Mr Passmore, both in cross-examination and by the Tribunal, that he too would not ignore other considerations such as the carrying capacity, added fertility and value of other improvements, when checking the figure for LEI he arrived at by his method of comparable sales.

In assessing the relative merits of the approaches adopted by the valuer, it is clear that Mr Passmore relied almost entirely on his analysis of sales. We must, therefore, make some attempt to assess the comparability of the properties which he considered under this head. In doing so, it is important to compare like with like. In each of the "comparable" properties considered, MrPassmorecalculated aprice per hectare and a price per stock unit. His valuation of the capital value of Mr Walker's property ($700,000) did not present any problem in so far as he was much in agreement with the other valuers, though we do find it difficult to reconcile his sales with the figure he has arrived at.

Those sales chosen were used to establish the capital value of the subject property, and although there is no great difference between the valuers on the final figure for capital value, it is apparent that there are significant differences between the dollar values for sale price per hectare and sale price per stock unit compared with those for the subject property.

Mr Passmore then considers a series of comparable properties from which he draws his valuation of the LEI. The figure arrived at for the 490 hectare Walker property by this method is $500 per hectare and $58 per current stock unit.

His analysis of the other properties are:

Mathieson to Howard (264 ha 230 su)	$
LEI Sale price per hectare	492.00
LEI Sale price per original stock unit	525.00

The explanation of that very high figure is that this property comprises 264.3 hectares but as at 1982 had estimated carrying capacity of only 230 stock units.

Ashton to Brown (336 ha 300 su)	$
Sale price per hectare	491.00
Sale price per stock unit	550.00

(based on an estimated carrying capacity as at 1981 of 300 stock units)

Ashton to Homer (464 ha 400 su)	$
Sale price per hectare	442.00
Sale price per stock unit	412.00

This property was said to be scrub covered, on poor soils and devoid of any tangible improvement other than yards and fencing. It is described as "greatly inferior in contour, access, services and potential carrying capacity".

Mr Passmore then summarises the physical makeup of the land in each of these sales, assigns the dollar value per hectare and compares that with Mr Walker's property; not from the basis of any external evidence, but purely in the exercise of the valuer's art and in such a way as reflects in Mr Passmore's view the general superior nature of the Walker property when compared with the others. Quite apart from the complete lack of geographical proximity of these properties to Mr Walker's property (both are situated at Waitahuna which is some 50 kilometres north of Clinton), we are unable to see how these sales can amount to any more than the most general and unreliable guide to assessing the value of the LEI of the Walker property. They are simply too different in type and location to be fairly called "comparable".

It is significant that Mr Laing also considered some of those properties for comparison purposes in his Appendix 4 and he reached the conclusion that they were not in any sense comparable sales and must be rejected. We agree.

Mr Passmore then considered a series of sales which were geographically more proximate to Mr Walker's property. In his view, they are "considered to be valid evidence for comparison". Each of them involved a purchase by the lessee of the freehold. They are as follows:

Value of LEI for freeholding purposes per hectare	S
Everett	744.00
Johnstone	519.00
Dodd	173.00
Brown	491.00

Other than the fact that these properties are situated in and around the Clinton area, we have difficulty in understanding how they can be taken as comparable sales. The Everett sale comprised 164 hectares. The property is described as smaller, better located and with superior housing than the Walker property. The Johnston sale comprises 443 hectares. It is, therefore, closer in size to the Walker property but is more remote, has less rainfall, is less desirable and is subject to leaching. The Dodd property is substantially larger than the Walker property. It is described as higher country, cold, and consisting of high tussock, back-lying tussock, with fern and scrub and bush. The property is substantially underdeveloped. Further complicating this sale is that the freehold was sold to a forestry company, within a few months of the transaction relied upon by Mr Passmore, for the sum of $885,000.

The Brown property comprises 336 hectares. It is described as inferior to Mr Walker's property in terms of contour, access, services and ultimate potential carrying capacity. Having been purchased in 1981, it was freeholded in 1982 and, as with the Ashton to Brown and Ashton to Homer, the property adjoins substantial forestry interests, so it possesses an influence which the Walker's does not.

In our view, the variables present in each of the properties selected are such that collectively they provide little or no guide to a valuer in assessing the value of the LEI or for that matter the capital value of Mr Walker's property. Absent that guidance, there is really no basis left to Mr Passmore from which he can justify his valuation of the LEI of the Walker property.

What in fact he is then left with is his estimate of the capital value, his value of the improvements, the resulting figure being the value of the land without improvements. As we understand his approach, what he was endeavouring to do was to ascertain that LEI separately by trying to analyse properties in the area which were closer to their unimproved or natural state and from which he could make certain assumptions as to value.

In our view, and as the evidence demonstrates, by the year 1981 all of the allegedly comparable properties had been improved, at least to the extent where any assumptions made about their carrying capacity in a natural unimproved state is little more than guesswork.

It may be that in 1951 when this lease was granted, comparable unimproved sales were available, but we are not persuaded the sales submitted have much relevance to valuations made in this district in 1981.

In the case of the Walker property, Mr Newson did not consider it was capable of carrying any stock in its natural state because it had no fences or other improvements necessary to carry on pastoral farming, irrespective of whether or not there was sufficient fertility in the soil and nutriment in the tussock growing on it to support stock. Mr Laing has made an assumption that the land was capable of carrying 400 stock units in its natural state. Mr Newson, when pressed, was constrained to agree that some stock could have been depastured on the land but unable to say how many. It is only by deducting that assumed figure from the known carrying capacity in 1981 that one can arrive at a differential figure which can then be related to the improvements made to the land by the lessee.

Mr Newson

We now summarise the approach favoured by Mr Newson and look to see if there is on the evidence any other way of valuing the LEI which does not rely for its validity on comparable sales.

Mr Newson, who was called to give evidence for the Crown, recognised this difficulty. He says:

> *"Sales evidence can be readily found to support the estimate of capital value while evidence from sales to support an LEI estimate* is scarce to *beat the point ofalmost nonexistent":*

While acknowledging that case law in his view "indicates thata valuermustlook to evidence of comparable sales when assessing the LEI", Mr Newson concentrated his attention on the extent of the improvements (in the wider sense of the word comprehended by Section 2 of the Land Act 1948) and the value to be assigned to those improvements in the context of the relationship between the value of improvements and the capital value of the land.

In doing this, Mr Newson began, as we have indicated, from an assumption that in its unimproved state the land had almost nil ability to carry stock. He makes the interesting observation that even by the 1950's and after many years of grazing and improvement, the carrying capacity of this farm was still only 500 stock units. This, Mr Newson says, highlights thepoor quality of the soils in their original state. That quality was improved by extensive top-dressing with lime and superphosphate and expensive drainage works.

It would seem that Mr Newson's reservations about the accurac y of the original carrying capacity of this land are well founded as its history shows. We are told that the first recorded European owner of this land was one, Robert Wright, in 1856. He transferred the pastoral licence sometime between then and 1859 to one, Robert Steel. In 1859, Mr Steel declared that he had 150 sheep but that was for his total holdings, and there is no clue as to what was the carrying capacity of this land.

There is evidence the land was sold again in February 1888 but no record of its carrying capacity. Between 1881 and 1951, there is no evidence of what was the carrying capacity of this land. Mr Walker told us that in 1908 the land was bought by his mother but farmed by Mr Walker's late uncle until 1919, at which date Mr Walker's father bought the property. There is no historical evidence of what stock this property was capable of carrying at any time before 1951. At or about that date, it seems that from a Lands and Survey report it is possible to glean that the property had 40 acres of two year pasture and was carrying a total of 495 stock units. That statistic is, however, in our view of limited value for the purposes of endeavouring to ascertain what is the carrying capacity of the land in its state exclusive of all improvements, because by the year 1951 the property had been continuously farmed for some 90 years.

We decline to speculate on whatwould have been the level of improvements effected to the land during that time. We are told that in 1907 an adjoining property had a carrying capacity of 347 stock units, but we are given no information which would enable us to make any sort of sensible comparison between it and the subject property, and in addition, it suffers from the further defect that we know nothing about the way in which that property was farmed and improved during the time it was first settled by European farmers as at 1907.

Because of those factual deficiencies and the commercial unreality of expec ling valuers to carry out historical research of the sort required, Mr Newson instead carefully researched the cost of what he called "the development inputs" into the property expressed in 1980's costs.

Heallowsareduction for the tax benefit which was obtainable by the farmer in carrying out such work at that time. He notes that at the relevant time, land prices were high and buyers were "happy to pay `key money' or something extra over and above the added value of the improvements to gain land to commence a development programme".

In Mr Newson's view, and we accept it as being factual, these premium payments became reflected in the LEI and they disappeared immediately following the removal of the regime of farm support and subsidies which existed until 1984. Mr Newson recognised these premiums were attempts by purchasers to get tax relief for other sources of taxable income, while building up the capital value of the land. He gives a graphic illustration of this: a property in the general area had an LEI in May 1983 of $490,000, which dropped by approximately 70% to $150,000 by July 1986.

Mr Newson says in our view correctly that this sort of example shows the effect of essentially political decisions upon the value of farmland and specifically the LEI. Unfortunately for many established leasehold farmers, the inflated values resulting from these political decisions became built into the LEI.

Mr Newson therefore concludes that in such a distorted period of farming practice, management, and sale and purchase, it is necessary, in order to be fair to both lessee and lessor, to give full recognition for the value of the improvements effected by the lessee over the years and, in doing so, thereby reduce the LEI to a more realistic figure.

Wemention these views of MrNewson for two reasons: firstly, we found 0 them to be particularly persuasive and helpful; and, secondly, because they re-lfected, in our view, the fact that although apparently constrained by the emphasis in some of the earlier authorities upon the need to have regard to comparable sales in order to establish a value of LEI, Mr Newson is in fact having regard to a much broader range of considerations which more truly reflect the realities of farming and those, who would be, farmers in this exceptional era in the history of farming in New Zealand.

We agree with Mr Newson that it is right and proper that such considerations should at least be taken into account, particularly where there is no evidence (as in our view there is not) of comparable LEI values. Following this general approach, Mr Newson concluded:

> *"1 consider that it is reasonable that the LEI value of properties maintain a similar relationship to the values agreed to at the previous rent review date".*

He then dutifully considered the range of allegedly comparable sales which had been supplied to him by Mr Passmore. In summary, he does not find them to be of much assistance.

Having worked through that exercise, MrNewson then applies the wider considerations mentioned earlier in his evidence to his valuation of Mr and Mrs Walker's property. He describes it in much the same way as the other valuers, with the important difference that he agrees with Mr Laing about the area of improved land. By inference, he does not accept Mr Passmore's assessment of that matter and, as we have previously indicated, on the evidence we prefer the views of Mr Newson and Mr Laing on that important matter.

Mr Newson deals with each of the general category of improvement and assigns values to them. In the case of some, such as the value of the drainage work, he takes a conservative figure which favours the lessor, while recognising that it is the drainage work carried out over the years which makes Mr Walker's property the productive unit that it is.

Having made a detailed assessment of the effect that the improvements have had on the value of this property, Mr New son then feels able to, as it were, imagine what the property would have been like before those improvements were effected and to assign a value to it. In doing that, he recognises a degree of arbitrariness which we accept is inevitable and which in part reflects the valuer's art. Approaching the matter in that way, Mr Newson considers that the LEI as at the valuation date was $180,000, the capital value $705,000 and the improvements $525,000.

Towards the end of his evidence, Mr Newson was asked what value he would have placed on the LEI if he had not felt constrained by the earlier valuation cases and the imperative to have regard to comparative sales and to arrive at the value of improvements by deduction of LEI value from the capital value. His reply was that if he were not under those constraints, he would have valued the LEI at about $150,000.

That is the evidence led for the Crown. We now deal with the evidence on behalf of the lessee.

Mr O'Malley called three witnesses for the lessee, all of them valuers. The primary witness was Mr A P Laing. The other two valuers, Messs Widdowson and Taylor, gave evidence which in general terms supported the approach contended for by Mr Laing.

Mr Laing

As with the Crown valuation witnesses, Mr Laing's qualifications are impressive and, as was the case with Mr Newson, he has the added advantage of being involved on a regular basis with farm advisory and financial services. He is also a chartered accountant. We think it is worth mentioning that Mr Laing's standing among fellow valuers is currently reflected by his position as National President of the New Zealand Institute of Valuers. He has been in private practice for 25 years, engaged significantly in rural valuation. He has done a number of lease renewals for local authorities and has been engaged in valuations for the purposes of Maori land leases in Nelson and Taranaki. He is currently the Manager of Valuation Services for Ernst & Young, Chartered Accountants.

Mr Laing values the LEI of the Walker property at $195,000, the capital value at $720,000 and the value of improvements at $525,000. His LEI is therefore $50,000 less than that contended for by Mr Passmore and $15,000 more than that contended for by Mr Newson. As is the case with Mr Newson, it is readily apparent that the difference between Mr Laing and Mr Passmore is in the value of improvements. Mr Laing assigns an additional $70,000 to that head.

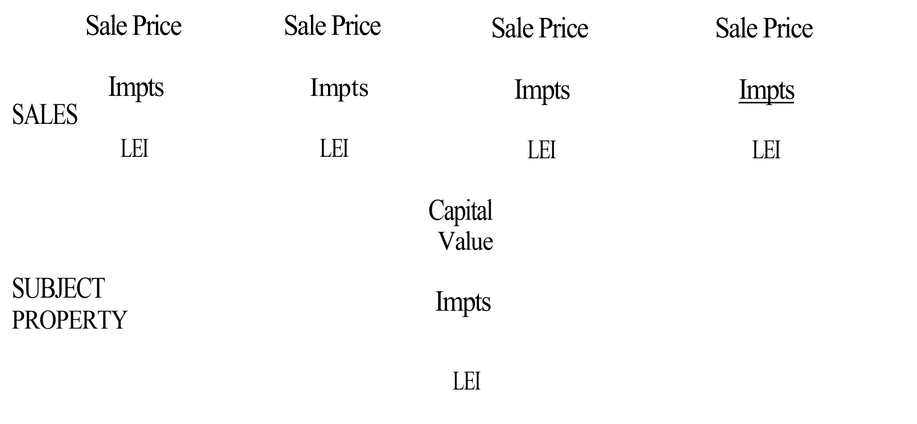
It is now necessary to consider in more detail the valuation method favoured by Mr Laing.

Mr Laing first referred to *Valuer General v Sullivan* 1962. *CCL v Kinney* 1964, *Butler v CCL NZLR* [1964] 760 and to*Assistant Commissionerof CrownLands vAssociated Taverns Ltd* Chch M214/82. From these judgments, he drew the Tribunal's attention to the difficulties expressed by earlier Courts in assessing the value of unimproved land (LEI), a difficulty which led the Court in Sullivan to suggest "that in the course of time some alternative method of assessing values for rating and allied purposes may have to be adopted".

Mr Laing considered that the Courts had been reluctant to endorse the residual approach to valuation; that is determining the LEI simply by subtracting improvements from the assessed capital value.

He noted the need for fairness to both lessor and lessee in respect of the value of the land for rental purposes and also with regard to the timing of the valuation *(Kinney)* and he noted the directive of the Court to assess the value of the unimproved land (LEI) independently and without regard to the improvements, and that any added value of any improvements must equal or approximate any difference between Capital Value and LEI *(Butler)*. Once again, he re-emphasised the need for a fair balancing of values between the lessor and lessee *(Associated Taverns)*.

Further developing the rationale to his alternative approach, Mr Laing presented to the Court his diagrammatic interpretation of the residual method of sales analysis.



He felt this methodology was, at times, suspect because it presumed both buyers and sellers were fully aware of the impact of tax and fiscal incentives and the costs of developing on unimproved land. It also presumes that the costs remained constant between different districts.

He went on to say in his written evidence that the practice of analysing improved sales back to an LEI value is one where the valuer is merely using the same benchmarks for the value of improvements that he would use for the valuation of (improvements) of the subject property. In his opinion, this results in an unsubstantiated opinion from the valuer concerned and it does not comply with the methodology referred to in the legal precedents. It is therefore, in Mr Laing's opinion, a subjective judgment.

He believes that the chance for error is significantly raised by adopting the residual approach. Finally, he questioned how this approach can differentiate between fluctuations in values resulting from differences in the quality of management.

He presented an example of two 400 hectare properties of similar types but dissimilar management to show the potential difference in an analysed LEI using the residual approach to sales analysis.

SALE PROPERTY 1

5,000 su @ $150 per su	$750,000
Less improvements	$500,000
Residual LEI	$250,000
	($625/ha)

SALE PROPERTY 2

4,000 su 0 $160 per su	$640,000
Less improvements	$500,000
Residual LEI	$140,000
	($350/ha)

In continuing his hypothesis, Mr Laing asked himself the question: that in order to reduce the risks involved in making so many subjective judgments on costs, incentives, management etc., would it not be less risky to follow a technique of restricting the apportionment exercise to the subject property alone? He told the Tribunal that this approach is unfortunately suspect for it does not comply with the approach outlined in Court precedents, particularly Butler's case.

He then presented what he called his "Market Method".

According to Mr Laing, this methodology follows the legal precedents in that it focuses on the condition of the land in its unimproved state, from the point of view of buyer and seller.

It allows that a prospective purchaser would be aware of what the land might carry when developed. It assumes the market will understand that there is a direct relationship between the cost of development per stock unit and potential available increases in the carrying capacity of the land involved. Above all, it presupposes an informed buyer, which is what the law assumes.

Mr Laing's use of the "Market Approach" to arrive at the values to be determined relies on a schedule of comparable farm LEIs, agreed between valuers (his Schedule 2). He analyses the base LEI down to LEI/Original SU (Col 11) and LEI/Current SU (Col 12).

His use of this data in respect of the Walker property valuation is formulated as follows:

	VALUATION PROCESS		SOURCE
(a)	Developed carrying capacity	4,000 su	Farm Records
(b)	Undeveloped carrying capacity	400 su	Historic Data
(c)	Improvement due to lessee	3,600 su	(a-b)
(d)	Current cost of land development	$107/su	NZIV Data
(e)	Allowance for management input	11 su	Valuer Judgment
(f)	Land Development Margin	$118/su	(d+ e)
(g)	Value of Buildings	$100,000	Cost less deprn
(h)	Capital Value per Developed SU	$180/su	Comparable Sales
	CALCULATION OF VALUES		
(i)	Capital Value	$720,000	(a x h)
(j)	Value of LEI	$195,000	(i - k)
(k)	Value of Lessee's Improvements	$425,000	(c x f) + g
(l)	LEI per developed SU	$48.75	(j % a)
(m)	LEI per undeveloped SU	$487.50	(j % b)

Mr Laing explained that at this stage his methodology could well be likened to the residual method of valuation about which he had previously expressed some reservations, in so much as the Value of Improvements is deducted from the Capital Value to produce a residual LEI.

However, he pointed out that it is necessary, having reached this point, to then check ones LEI's/SU with the analysed LEI's in the Schedule 2.

If, in the valuer's opinion, the LEI/Original Su and the LEI/Current Su fit within the parameters of the agreed schedule figures, then the LEI may be accepted as fair and consequently the Value of Improvements maybeconfirmed.

Mr Laing later presented evidence collated from the New Zealand Meat and Wool Board Economic Service.

This showed that in 1982 the average rate of return from a South Island intensive fattening farm unit, comparable to the Walker's, was 2.9%, whereas the lessor was receiving 4.0% per annum return on its capital in a similar unit.

Mr Laing considered, in light of the Associated Tavern's decision (viz that "inequality would result where the value of either party's resources produced an unduly large or small share of the income now or in the foreseeable future") that the fairness of the assessed LEI was to be measured against the following formula:

$$\frac{\text{Lessee's Return on Capital}}{\text{Lessor's Return on Capital (i.e. net rent)}} \times \text{LEI}$$

In otherwords,ifequity. wereachieved then the resultant figure will be equal to the assessed LEI.

$$\frac{2.9}{4.0} \times \$195,000 = \$141,000 \text{ Value of LEI}$$

Applying this formula, Mr Laing's assessed LEI of $195,000 appeared high. During examination, Mr Laing agreed that his figure for LEI could well reduce to say $160,000.

That would appear to be a little less than the average of the two figures, and however one views it, has no actuarial or mathematical basis.

While we generally accept Mr

Laing's approach and supporting evidence for the valuation of the Capital Value of the Walker property, and we accept his emphasis on the equity of apportionment where lessee's improvements and LEI are concerned, we cannot accept his valuation of $195,000 as conclusive. In coming to this view, we note that Mr Laing presented evidence of three sources of information in verification of the original or unimproved carrying capacity of Mr Walker's property,

viz: -

Lands & Survey Report 1951	495su
Lands & Survey Report 1907	347su
MAF Invermay Report	156su

For reasons which he proffered as being no more than valuer's judgment, Mr Laing adopted a figure of 400su. This is significantly greater than the figure produced by MAF.

Given that MAF figures are based on digestible dry matter content (and therefore have some scientifically verifiable basis) and bearing in mind the small pockets of red tussock which have been conserved in their original state in the Clinton/Pukerau district, we would have expected that the MAFfigures might have been given greater credence than they were.

Applying the MAF figure of 156su to the Laing formula (i.e. for 400 su read 156 su), the following valuations emerge:

Capital Value	$720,000
Value of LEI	$166,400
Value of Lessee's Improvements	$553,600

This produces a LEI per developed stock unit of $41.60 which would appear to fit within the parameters of Mr Laing's lease analysis (Col 12, Schedule 2). We note, however, that the LEI per undeveloped stock unit is $1,066.

This is significantly greater than the analysed figures in Col 1 1 of Schedule 2, but that flows from the apparent differences in calculating the base stock unit figures (i.e. Mr Laing as against MAF), a matter to which we have previously adverted as being crucial to the utility of the particular methodology chosen.

It will, therefore, be apparent that we think there is considerable utility in Mr Laing's valuation method in that it does not rely on purportedly similar sales or values which in reality are not comparable. As with the case of Mr Newson's approach, it has the merit of concentration on verifiable source data. The weakness, in our view, is that Mr Laing is driven to make two crucial assumptions: the undeveloped carrying capacity and the allowance for management input.

That, however, is not a fatal weakness because the Court or Tribunal dealing with the matter must always make its own findings of fact as to what those figures should be in any given case.

In our view, acceptably accurate valuations can be arrived at in this very difficult area by an amalgam of the methods used by MrNewson and Mr Laing. As the evidence in this case discloses, properly and carefully applied either approach yields a figure for LEI which may be checked against the other.

Both approaches recognise the realities of farming and contain a minimum of speculation. They also eschew the artificiality of relying upon sales which are in no sense comparable.

We will consider later whether such approaches are possible as a matter of law; but we stress that what we are here dealing with is valuing leasehold land exclusive of improvement where equity between lessor and lessee is a statutory requirement. Nothing we say should be uncritically applied to valuation for other purposes where the hallowed methods may be factually possible.

Mr Taylor

In coming to these conclusions, we have been influenced by the evidence of Mr Taylor, a valuer called by Mr Walker. Mr Taylor is a Registered Valuer and Farm Management Consultant based in Alexandra. He has sixteen years' experience, particularly in the tussock grasslands and the pastoral industry. He holds a Batchelor's degree in Resource Management.

Mr Taylor also agrees that there is a lack of comparable sales of unimproved land. In an effort to draw some significance from the results of other sales, he says that three yardsticks are available to the valuer for the measurement of comparable or near comparable property: land area, which is commonly used in the intensive stocking and cropping industries, Output Production which is more appropriate to dairy and orchard and livestock numbers (generally expressed as Stock Units) for the pastoral industry.

He told the Court that it has become obvious that the purchasers of pastoral land more commonly relate the purchasing decision to the cost per stock unit than to the cost per hectare. Therefore, in assessing property values relevant to sales, this is an appropriate measure.

Mr Taylor went on to say that the number of stock which a property has carried at various points in time is very relevant to accurately assessing the LEI. The weight given to data provided may depend on the degree of confidence his organisation (Landcorp) have in the available information.

Other factors which might be taken into account in arriving at a determination of LEI are the vegetative cover on the land (assuming no imporvements had been made at the date of valuation) and the underlying soil types.

He said that land sales indicate a "clean" property on fertile soils may attract a higher value per base stock unit than one which will require higher costs to achieve its potential. This we take to mean that the lower the subsequent costs of development, the greater will be the initial price paid for the land and therefore great care, experience and expertise is required in the analysis of sales and the valuation process itself to ensure that like is matched with like.

Mr Taylor concluded by saying that in assessing the LEI, the carrying capacity of the property at the date of valuation (assuming no improvements had been carried out) is a valuable means for comparison.

This evidence is clearly supportive of Mr Laing's approach and we find no grounds to disagree with or discount it.

We have endeavoured to summarise the views of the various experienced and qualified valuers. Having done so, we are left with the overwhelming impression that in most cases they have approached their task feeling constrained by what they understand to be the effect of earlier decisions of this Tribunal and the Courts. In the case of Mr Newson and Mr Laing, in particular, we are left with the clear impression that free to do so they would not approach their task in the way in which the Courts have previously directed.

This is all most unsatisfactory, both from the point of view of the lessor and lessee, and the professional valuers. We think that the best course is for us to return to the legislation, review the authorities and endeavour to apply the evidence having regard to what we take to be the statutory requirements guidedby previous decisions.

The Legislation

The application seeks an order pursuant to

S 133 of the Land Act 1948 "determining the rental value of the land described in the affidavit of Murray Robert Mackenzie". That, of course, is the subject land.

S 133 allows a lessee who so requires to have the values specified in S 132(1) or S 132A(1) of this Act to be determined by the Land Valuation tribunal as provided in those sections. Ss(2) imposes an obligation on the Tribunal to determine the values as required by the lessee or any of those values as the case may be. The proviso to ss(2) enjoins that the Tribunal shall not determine the value of the improvements referred to in S131(1)(b) to be less than the value of improvements on the land at the commencement of the lease as recorded in the schedule to the lease. The lease in question is renewable lease of farm land under the Land Act 1948 "F 193 Lower Clutha River Trust". There are no improvements recorded in the schedule annexed to the document and therefore the proviso has no application.

The operative sections for the purposes of the valuation are S 131 and S 132. S 131 provides as follows:

"(1) Not earlier than two years and not later than *one year* before the *expiry of a renewable* lease, *the Board shall cause the following values to be* ascertained:

(a) *The value* of the *Improvements* which *are then In existence and unexhausted on the land included in the lease;*

(b) *The value* at the *commencement of the lease of all improvements Included in the rental value at the* commencement of the *lease;*

(c) The *value of the land Included* In the *lease exclusive of the improvements referred to In paragraph (a) of this sub section:*

Provided that, *subject* to *the previsions of this Act:*

(I) *In ascertaining the values under paragraphs (a) and (c) of this subsection, equal* emphasis shall be *placed on the value to beascertalned under each paragraph;*

(ii) *The values shall be ascertained on* an *equitable* basis, *having regard to the relationship between lessor and lessee;*

(iii) *The sum of the values under paragraphs (a) and (c)* of this *sub-section shall be equal to the capital value of the land.*

(2) *For the purposes of the* last *preceding* subsection, the *expression "capital value"means the sum which the land and improvements thereon might be expected to realise* at *the time of valuation If offered for sale, unencumbered by any mortgage or other charge thereon, on such reasonable terms and conditions as a bona fide sellermightbe expected to require.*

(3) *In respect of the Improvements referred to in paragraph (b) of subsection (1) of this section, the lessee shall,* (as *the Board may determine), either:*

(a) *Purchase the Improvements at the value determined either for cash or by Instalments, together with interestat such rate* as *maybe fixed by the Minister ofFinance, over such period not exceeding 30 years as may be determined by the Board; or*

(b) *(Pay interest at the rate of 4 1/2 percent per annum on the value so determined, in the same manner as rent.)*

(4) *The rental value of the land for the (first period of 11 years of the) term of the newlease shall be the value of the land as determined under paragraph (c) of sub-section (1) of this section, and where* the lessee *(is required) pursuant to the last preceding subsection to pay* interest *on the Improvements referred to in paragraph (b)* of sub-section *(1) of* this section, shall *Include* the *value of those improvementsas determined underthat paragraph.*

(5) *The yearly* rent for the first *period of 11 years of the term of the new lease shall be 4 1/2 percent of the rental value* as *defined In sub-section (4) of* this section.

(6) *As soon as possible after the values have been ascertained under subsection (1) of this section, and not* laterthan (9 months) before *the expiry of a renewable lease, the Commissioner shall deliver* to *the lessee a notice In writing informing _him of* those values *and requiring him to elect whether he will accept a renewallease at the rentbasedon those values (for the first period of 11 years* of the *term* of the *lease)...*

(7) *If the Board omits to cause the said values to be ascertained, or the Commissioner omits to deliver the said* notice to the lessee *within the prescribed times, the lessee mayrequlre the values to be ascertained and notice* to *be given at any time thereafter so long* as he *remains* in possession *of the land, whether the term of his lease has or has not expired, and his right to a renewal of the lease shall not be affected byany such omission or delay.*

Section 132 gives the lessee an election where he desires a renewable lease but does not accept the values specified in S 131(1). He may have those values fixed by the Land Valuation Tribunal. Section 132A applies to the review of annual rent under a renewable lease and specifies the time limits within which the rental for the renewed lease is to be fixed. It also specifies the percentage of rental to be paid on the value as specified in S131(1)(b) and the value of the land included in the lease, exclusive of the improvements which were in existence and unexhausted on the land when it was first leased.

The crucial legislative provision relevant to this case is S131(1) and (2). As previously indicated, the outcome in this case turns upon a construction of S131(1)(a) and (c); (b) is not relevant because, as we have indicated, there is no figure for existing improvements on the land "at the commencement of the lease" included in the rental value at that time. What the valuers and now the Tribunal is enjoined to do by the statute is to value the land included in the lease exclusive of the improvements which were on the land at the date at which the valuation is required to be struck, ie 30June 1981. The Tribunal must therefore deduct the value of those improvements from the value of the land included in the lease. The resulting figure is the value of the land exclusive of improvements on the land as at the date for the renewal of the lease. As Mr Newson says at page 10 of his evidence:

"With the LEI we must *visualise a prospective purchaser In 1981/82 looking at this particularblock ofland In Its natural state (without even the benefit of a ring fence."*

This probably goes further than the cases require but it does capture the essence of the enquiry. The great difficulty, Mr Newson says, a valuer had in the 1981/83 year was:

"Allocating a sum for the benefit of Improvements In his capital value. Sales *evidence can be readily found to support the estimate of capital value while the evidence from sales to support an LEI estimate Is scarce to the point of* almost *non-existent."*

That is certainly the case here. In order to overcome that difficulty, Mr Newson takes what we consider to be the only sensible course. He looks at the improvements which were on the property as at the valuation date, item by item, and values them at a figure of $525,000. (Mr Laing arrives at the same figure by a different method.)

The improvements which Mr Newson has considered are: fencing (which he considers gives an added value of good quality fencing at the relevant time of $2.00 per metre); fertility Mr Newson considers that the soils of this property in their unimproved state had no ability to carry stock and is reinforced in this conclusion by the fact that after something approaching 90 years of continuous occupation, the property was still only capable of approximately 500 stock units.

He calculates, on a conservative basis, the amount of fertiliser which would have needed to be added to this property to bring it to its state of fertility at the valuation date and the amount of money expended on that improvement alone (he estimates something approaching a million dollars) would far exceed the total capital value of the property as at the valuation date.

He then considers the monetary effect of the drainage work carried out on the property. There are some 19.351 miles of field tiles which would have a laid cost, together with cartage, as at the valuation date of something approximating $160,000.

To this must be added the value of the buildings which he puts at approximately $100,000; cattle yards $6,000; garden and forecourt $15,000; painting and shelter belt areas $8,000; access and tracks $10,000; fencing $60,000; and a most conservative estimate of fertility at $239,000 (thereby heavily discounting the actual costs of the inputs of fertiliser as estimated by recourse to historical data.

The addition of those items is $525,000, that being the total value of the improvements.

All valuers agreed on the capital value being in the region of $700,000. The resulting value of the land, as at the date of valuation, is therefore by simple arithmetic process $175,000.

One can, of course, criticise such attempts to value improvements in this way, but there is at least some verifiable evidence to support such a procedure. Provided the resulting figure is sensibly discounted, particularly as to the component of "fertility", we think it provides a reliable basis for arriving at the resulting value of the LEI.

Mr Newson considers that the figure he arrives at, which is almost 34 times greater than the LEI calculated, at the previous renewal, and more than double the farm land price index over the same period, is weighted in favour of the lessor.

Were it not for the fact that he considered he is constrained by the case law to take into account evidence of other sales, he would have arrived at a higher figure for the value of improvements and a figure not exceeding $150,000 for the value of the land, exclusive of improvements. As we have previously indicated, Mr Laing came to substantially the same view ($160,000) and for the same reasons.

As we have said, we consider that the approaches taken by Mr Newson and Mr Laing both find favour with the Tribunal because they are substantially based upon actual and verifiable data as to the amount by which this property has been improved by the lessees during the relevant period, in the case of Mr Newson, and in the case of Mr Laing, the stock carrying capacity.

Unless there is something in the case law which drives us to some other conclusion, we are of the view that the value of this land, exclusive of improvements, on the evidence before us does not exceed the sum of $160,000, and we now turn to consider the authorities.

The Authorities

The only case to which we are referred which is directly in point is *Assistant Commissioner of Crown Lands v Associated Taverns Ltd.*

The copy of the decision made available to us is apparently found to be contained in a valuation publication, *The Valuer.* The judgment is that of Roper J, sitting with Mr Ralph Frizzel, and was given on 30 August 1983.

The case concerned a question of the value of the leased land, exclusive of improvements. The land in question was used for the purposes of a tavern at Bishopdale in Christchurch and the valuation was carried out under S 122 (5) of The Land Act 1948 as amended in 1970. That section is not relevant to this case, other than the formula for valuing the LEI for the purpose of purchase pursuant to that section is the same as that provided for in S131.

The *Court* in *Associated Taverns Ltd* approached its task in the following way, by adopting a passage from a judgment of Archer J in re Wright's objection [1959] NZLR 920 page 922 where His Honour said:

> *It Is well recognised that a valuer must disregard Improvements when assessing the unimproved value of landandinassessing the capital value of land by reference to what it would realise In the open market It seems neither necessary nor desirable to attempt to value the improvements either Individually or as a whole. Having made an assessment of the capital and unimproved values, the valuer Is entitled to assume that the difference between these values Is the added value given to the land by Improvements "in other words that It is the value of the Improvements."*

At page 924, His Honour said:

> "Most *of the valuers were disposed to admit that they had no reliable basis for their assessments of the values of In visible improvementsand we venture to question whether any good purpose was served by their attempt to place separate values thereon. The dangerofthe practice Is that valuers who have made such a valuation of the Improvements may be tempted to deduct the amount of that valuation from the capital value In order to find the unimproved value. Such a method Is contrary to the directions of the highest courts but we suggest that it may still be practised and its followers may seek to Justify their procedure by reference to the opinion of Hoskin J In Thomas v Valuer General [1918] NZLR 164.*

The Court noted that the observations of Archer J had been approved by the Court of Appeal in *Atihau-Wanganui v Malpas* (1979] 2NZLR 545, where at page 550 His Honour, Mr Justice Cooke, noted that:-

> *"It Is well settled In NewZealand that underthe kind ofstatutoryprovisions now relevant, the value of Improvements is a residual figure being the difference between the capital and unimproved values. The capital value will usually be the easiest figure to arrive at ... a sale of* the *whole property as it actually stands Is to be envisaged and evidence of more or less comparable sales Is more likely to be available. Whether* there *are Improvements and If so how the capital value is to be divided between the unimproved value and the value of improvements are Inevitably more hypothetical or artificial questions. The value of the Improvements Is to be arrived at by deducting the unimproved value from* the *capital*

value. The starting point is not the value of Improvements either Individuallyoren bloc. At best, an attempt to value them separately In one or other of these ways might perhaps in some cases *be some help as a check on the proportion of the capital value allocated to the unimproved property. To start by attempting to value them separately would be to ignore that Improvements normally have little or no real value apart from the whole property of which they form part. For substantially these reasons the residual method of valuing Improvements was laid down In* Wright's case *and the procedure Indicated by Judge Archer in that case was approved and applied In this Court In the judgment delivered by McCarthy P in re 110 Martin Street, Upper Hutt [1973] 2NZLR 15,18. At the earlier stage of the latter case In this Court, McKee v Valuer General [1971] NZLR 436440 Turnerand Richmond J J had been of the same opinion."*

The Court was not assisted by dicta to the contrary in the decision of *Paterson v Commissioner of Crown Lands* (GR6l71 Timaru Registryjudgment 29 April 1972) page 6 where Wilson J and Mr A D Carson Esq pointed out that:

"it must constantly be borne In mind that the object of the enquiry was to ascertain the market value of the unimproved value of the property. That value and the value of Improvements make up the capital value."

In that case, however, the value of improvements was agreed between the parties.

We must accept the authorities, as did the valuers in this case, that it is not now possible, at least for this Tribunal, to depart from the method of valuation established during the long tenure of Archer J as a Judge of the Land Valuation Court, approved as it is by the Court of Appeal.

We would note, however, that both in *re Wright* and *Malpas* were cases decided upon The Maori Vested Lands Administration Act 1954, legislation which Archer J considered to be not materially different from the provisions of The Valuation of Land Act 1951.

We are here dealing with The Land Act 1948. That is an Act which is primarily for the setting of rentals on Crown Lands. The legislation fixes the rental rate (i.e. 4.5% per annum gross) usually for eleven years, hence the valuation of the rental value (usually LEI) is vital of the subsequent rental and to the financial viability, if not the financial future of the lessee.

The legislation and the precedents clearly express a need for fairness, subjectivity, business agreement, viability and equity (see *Associated Taverns)*. There is no similar expression in The Valuation of Land Act precedents, nor is there such specific implication within the legislation. Improvements to the land are defied; the Land Exclusive of Improvements (LEI) is not defined.

The reverse applies in The Valuation of Land Act. Because the ability to pay a rental depends on the ability of the whole property, and its management, to produce that rental, the LEI (being the rental value) must relate to the whole parcel of land.

It is therefore inappropriate to attempt to value separate individual components, whether they be soils, contour, cover etc., without regard to the consequences to the whole entity (i.e. the lease). Valuation New Zealand's seemingly strict adherence to an approach of analysing sales back to soil type, contour etc., and building back up on the subject property by a similar mathematical application, is inappropriate for Land Act valuations.

The Valuation of Land Act, on the other hand, is primarily for assessing values for rating purposes.

The legislation confines itself to the valuation process. It identifies no responsibility for any subsequent fiscal consequences.

It is the "user" party (e.g. local authorities) who set the tax/rent/rate upon the third party (e.g. taxpayer/lessee/ratepayer). Rates and taxes based on The Valuation of Land Act assessments are generally less onerous on the eventual recipients than is a long term rental. Consistency between ratepayers is of much greater consequence than equity between rating authority and ratepayer. Hence the use of the residual method of sales analysis to aper hectare valueby the central valuing authority Valuation New Zealand is quite appropriate for valuations made pursuant to the Valuation of Land Act.

Further, The Valuation of Land Act breakdown is limited to land value. Valuers are not required to attempt to isolate out "invisible improvements" such as drainage, management, fertility build up etc. Valuations are reviewed every three years. Therefore, any errors may not have prolonged significance. A significantly higher number of valuations under The Valuation of Land Act are conducted annually than are done under The Land Act. Hence both trainee and practicing valuers are much more familiar with The Valuation of Land Act.

It may be that the subtle differences between the two Acts are not always fully appreciated and, more importantly, the consequences of using the methodology appropriate to The Valuation of Land Act to determine the value under The Land Act.

It further troubles us that an uncritical application of principles evolved under The Valuation of Land Act to the requirements of The Land Act can lead to real inequity between lessor and lessee. As Archer J observed in re *Robertson's* objection (a Valuation of Land Act case) [1959] NZLR 301 at page 302:

"The assessment *of unimproved value Is always a difficult matter In the case of a property like this. The valuer Is bound to rely to a great extent on assumptions and on opinions for it Is seldom that sales of similar land In an unimproved state can be found for guidance. He Is entitled to be guided byanalysing sales of Improved properties and to have regard to the general state of the property market and to the unimproved values which have been assessed in respect of similar properties. The onus to sustain his objection Is placed by statute upon the objector."*

The Tribunal, however, is not relieved of its task because of a dearth of evidence supporting a contended for value of the land in its vrigin or unimproved state.

Where that is the case, as it is here, the Tribunal can only be guided by the views of the experts which are manifestly verifiable upon the evidence such as it exists.

On the evidence, we agree with Mr Newson that one method of valuation left to the Tribunal is to consider what is the improvements component of the capital value?

We also agree with Mr Laing that the stock carrying capacity of the property in its unimproved state compared with those at the date of valuation, coupled with an analysis of the respective return on capital of both lessor and lessee, is an equally valid method of valuing LEI. That is particularly so where the one is used as a check on the other. Where there are no comparable sales, then in our view the task of separately assessing the unimproved or LEI value is virtually •

impossible. Thevaluerhas to imagine this land devoid of all of the improvements defined in S2 of The Land Act and then put some sort of monetary value on that land.

In our view, both elements of the exercise lack precision without the sort of verifiable methods proposed by Mr Newson and Mr Laing.

It is also clear that with the passage of time and the continued improvement of rural land, the "comparable" sales approach disappears further into the mists of unreality.

If there is some general similarity, the valuer knows he has not assigned grossly too much or too little value to the effect of the improvements on the land. He may then obtain some further (albeit very general) guidance from the sale prices of other land in the general proximity having similar stock carrying capacities.

Having done that, he should then arrive at a figure for LEI which is "ascertained on an equitable basis having regard to the relationship between lessor and lessee" (see S131(1)(c)(iii)). In the *Associated Taverns* case, the Court put it this way:

> *"In the absence of any prior judicial Interpretation, we must do the best we can with this elusive provision. We consider* that *a lease under* the *Land Act is essentially an agreement between two parties to carry on a* business *of which the Crown, in this* case, *provides the land (for which It receives a rent) and the company provides the capital (for which it receives the Income less the rent).*
>
> *"The Crown receives a fixed term rental of 4.5% on its resources and the company receives the remaining Income* on its *resources.*
>
> *"Inequality would result where the value of either parties resources produced an unduly large or small share of total Income available, now and in the forseeable future.*
>
> *"To this extent, the land resource should be utilised freely by the Investment of appropriate improve-*ments *to achieve this. The lessee should not be expected to pa ya rental based on unexploitable short term potential use of the land, and conversely the lessor should not be expected to forego his fair share of the income from the land and provide a return on inappropriate development* to *the lessee. The lessor further should not be expected* to *forego income because of the inferior management skills of a lessee."*

We think that the requirement to arrive at the valuation on an equitable basis is most important and throws light on the valuation method to be used.

Clearly, it would be inequitable to rely upon sales which are not fairly comparable or to make guesses about the historical carrying capacity of the property in its virgin state.

Equally, it is inequitable to allow the lessee the whole credit for improvements in fertility which are of a transition nature in the sense that they are consumed (at least in part) yearly in producing the stock or crop.

Other permanent improvements are readily valued and discounted by well established procedures. At the end of the day, it is then proper for the valuer to exercise his judgment and skill, his sense of the market and all of the factors that influence it.

It may be that the final judgment is not susceptible to any precise analysis but it is none the worse for that. Certainly, in our view, it is better than attempting to fit that judgment into the procrustean bed of recent sales or values which are not in fact comparable.

Decision

Approaching the matter in that way, we accept the views of Mr Newson that the value of the Walker land, exclusive of improvements, is $150,000. We therefore fix the valuation as follows:

Capital Value	$700,000
Value of land exclusive of improvements	$150,000
Value of improvements	$550,000

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Sunday 18 April

Early Registration	5.00-7.00pm
Icebreaker	7.00-9.00pm

Monday 19 April

Registration	8.00-9.00am
Welcome and opening	9.00am

Session 1
Income based valuations and key factors of business valuations
Shannon Pratt-visiting USA expert.

Session 2
Accommodation industry development-Example of income based valuation
1. Barry Robertson-Valuer, Queenstown
2. Bankers perspective

Session 3
Field trip-Albatross Colony, Taiaroa Head
Development of intangible asset.
1. John Dunckley-Valuer, Otago Branch Chairman
2. Otago Peninsula Trust Representative.

Lunch at Taiaroa Head

Session4
Rural property-Improving land use
1. Howard Paterson-Tasman Agriculture Ltd
2. Processing/Marketing perspective
3. Allan Brady-Wine Producer

Session 5
Annual General Meeting

Evening-dinner at Larnach's castle
Transport departs Pacific Park 7.00pm

Tuesday 20 April

Session 6
Health Industry-Importance of Management
1. Ian Farrant-Accountant, Chairman, Regional Health Board
2. Phillip Davies-Accountant, Coopers & Lybrand, Auckland

Session 7
City Utilities
Public Good v Sustainable Value
1. Murray Douglas-CEO Dunedin City Council
2. Beca Carter Consultant-Auckland

Session 8
Added Value-Management or Sale
1. Trevor Scott-Chartered Accountant, Dunedin
2. Graeme Horsley-Valuer, Ernst Young, Wellington

Session 9
Debate-"Benefits of a cashflow driven economy."

Panel to include Trevor Scott, Ian Farrant, Shannon Pratt, Howard Paterson, Graeme Horsley.

PARTNERS PROGRAMME

Sunday 18 April
Early registration and Icebreaker 5.00-9.00pm

Monday 19 April
Welcome and opening.
Join Albatross Colony Field Trip to Taiaroa Head then afternoon visit to Glenfalloch Gardens.
Larnach's Castle for cocktails and dinner-transport departs Pacific Park at 7.00pm.

Tuesday 20 April
Vintage transport to tour of Olveston Stately Home-
Devonshire tea.-

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7. *Encourage* research *and develop viable services of benefit to members.*
8. *Develop closer association and cooperation with other professional bodies both in New Zealand and overseas*

ISSN 0113-0315