VALUERS' JOURNAL

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NEW ZEALAND INSTITUTE OF VALUERS

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VALUERS' JOURNAL

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Chief Executive Officer & General Secretary: J G Gibson

Westbrook House, 181-183 Willis Street

P.O.Box 27146 Wellington

Phone (04) 384-7094 Fax (04) 382-9214

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 0 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 (1993) N.Z.V.J. June page.

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Another ride on the rural roller coaster

A rush of adrenaline resulting from an exciting roller coaster ride appears to be currently affecting the rural sector in New Zealand.

Farm prices have increased by an astronomical 79% and farm sales volume has increased by 41%. in the twelve months period to 31 March this year according to recent statistics. The largest increases in price are for dairy farms, particularly in Taranaki and for land suitable for dairy conversion, particularly in the South Island while sales of small farms and life-style blocks have been significant contributors to the number of farms sold.

It is widely recognised that the exhilarating effects of a ride on a roller coaster are caused by the rush of adrenaline produced in the body to match the excitement and possible danger being experienced. But the aftermath of even an only mildly exciting ride is often that the enjoyable parts of the ride are vividly remembered while the worst sensations of fear are quickly forgotten. So it would seem to be with current events in the rural sector. The worst effects of the drastic restructuring of primary industry when all subsidies were removed only a few short years ago have been forgotten, or are being ignored in the adrenaline rush caused by the current increased sales volumes for milk fat and meat products. Current high optimism in the dairy industry most probably comes from sales figures recorded by the NZ Dairy Board. The NZ Dairy Board has recently been under attack because of its total monopoly on the sales of export milk fat products. It has responded by pointing to sales figures which show that total export volumes increased by 12% between 1988 and 1992 and the value of those exports had risen by 63%. But it should be noted that about half of that value increase resulted from devaluation of the New Zealand dollar and commodity prices were in fact tracking down during this period. And while there has been much made of recent dairy company payouts it is a fact that the average price paid for milk fat in 1992 at $5.84 per kg is still considerably less thanthe $6.68 perkg paid in 1990. What justification can this provide for significantly higher dairy farm prices?

Similarly some sheep fanners are being buoyed up by high lamb prices paid by meat companies as they compete with each other, particularly between the North Island and the South Island, for reduced numbers of available stock. But those premium prices may not be sustainable forvery long if they are not supported by world meat market prices.

The lesson that had to be learned and not quickly forgotten by the rural sector in New Zealand following the previous major restructuring of primary industry in this country was that any future profitability expectations must not be expended before that profit is realised by paying significantly higher prices for farm properties. It cannot be denied that farm prices are driven by market demand but it is the rationale behind that demand that is in question. The current situation has the distinct appearance of the Supplementary Minimum Price (SMP) scenario all over again. Underthis subsidised price regime, what was perceived as being surplus income or profit was ploughed straight back into higher farm prices and resulted in low farm profitability and high debt repayment commitments. The sad outcome for some farmers and their families from that scenario was that they had to leave their farms when they were unable to meet their high debt commitments.

It was of no consequence whether that debt became unsustainable because of subsidy removal, of lower commodity prices or of higher interest rates.

It was the fact that it could no longer be sustained that caused the axe to fall. So, while most factors of farm profitability are currently favourable, with increasing primary produce sales volumes and lower interest rates, it must be anticipated that inevitable market cycles will result in some changes in balance at some time in the future. Farm profitability is a vital factor in the New Zealand economy as the positive effects of farmers having cash in their pockets or credit balances in their cheque books are soon felt throughout the rural servicing communities and eventually to the cities as the main distribution centres. It is suggested that significant increases in farm prices benefit very few but can have a very stifling effect on the national economy.

Trevor J Croot

John M Harcourt Memorial Award

The John M Harcourt Memorial Award for 1993 is conferred on William Alan Cleghorn FNZIV of the Rotorua/Bay of Plenty Branch of the NZIV.

The rules of the Award provide for the honour to be conferred on those persons, not necessarily members of the NZIV, who meet the criteria of having "given outstanding services to the profession whether during the calendar year or over a longer period".

Bill Cleghorn fulfils these conditions by virtue of his outstanding contribution to the profession in his role as Chairman of the Education Board, and in particular his initiatives which have led to the introduction of Continuing Professional Development programmes.

Bill has served the Institute well over many years, as Branch Secretary and committeememberbeforebeingelectedCouncillor. He is a foundation member of the NZIV Education Board and has been Chairman since 1988. His outstanding contribution in that role has been tireless and has led to a strong association related to education matters with the V aluers Registration Board, the Academic staff of the teaching universities and with the Australian Institute of Valuers and Land Economists.

It is fitting this award be made as the NZIV Continuing Professional Development Programme is being introduced, being largely a result of Bill's dedication and energy in the field of professional education.

This Award is the most prestigious made by the Institute and William Alan Cleghorn is a worthy recipient of this 11th John M Harcourt Memorial Award.

NZIV Young Professional Valuer of the Year Award

The "New Zealand Institute of Valuers Young Professional Valuer of the Year Award: is to be implemented with effect from 1 January 1993 with nominations called for by December 1993 for conferring of the Award in 1994.

ELIGIBILITY CRITERIA

1. Members or Affiliates of the Institute aged 30 years or less shall be eligible.
2. The criteria for the Award is:
   a) Significant professional participation within the NZIV, or
   b) Original research of outstanding significance; or
   c) Original authorship of outstanding significance;
      and
   d) i) outstanding technical and/or professional excellence; or
      ii) significant contribution to the community that brings credit to the Profession.

The research or authorship shall be available to the Editor of the NZVJ for publication at the Board's discretion.

3. There will be only one national award each year, and this shall only be conferred if the candidate is worthy of the award and shall not be automatic.
4. The award shall comprise the presentation of an appropriate "certificate" and the full expenses for the awardee to attend the NZIV AGM and National Seminar, at which the award will be presented.
5. Initial selection shall be at local Branch level with final selection being by a national award panel comprising chairmen of the Institute' Promotions Committee, Education Board, Editorial Board and President.
6. Nominations may come from any sector within the profession or outside (eg Branch committees, Councillors, employers, community service groups etc) but may not be by application from prospective awardees.

Nominations to be forwarded to NZIV's Chief Executive Officer by 30 November each year atP 0 Box 27-146 Wellington New Zealand endorsed "Application for Young Professional Valuer of the Year Award".

Advice of the availability of the Award will be published in the NZVJ and Valuers NewsLine, by way of advice to all members, in the first issue of the Journal and NewsLine each year. Members are encouraged to advise their employers of the award, and to assist employers with nominations the NZIV has prepared an information kit to aid them in making nominations for the award.

John Gibson
Chief Executive Officer

NZIV Presidential Triumvirate

The Presidential Triumvirate elected at the April 1993 Council meeting comprises John P Larmer of Taranaki Branch, President, William A Cleghorn of Rotorua, Bay of Plenty Branch, Senior Vice President and lain W Gribble of Auckland Branch, Junior Vice President.

Vice President (Senior)

William Alan Cleghom is a Fellow of the NZIV and is apartner in Cleghoan, Gillespie, Jensen and Associates at Rotorua. Bill is the Chairman of the NZIV Education Board and he was awarded the 1993 John M Harcourt Memorial Award for his contribution to the profession, particularly in the development of theContinuingProfessionalDeve1opmentpro-grammes. Bill is a rural valuer with specialist skills in the valuation of forestry land

President

John Patrick Larmer is a Fellow of the NZIV and is a partner in Larmers, registered valuers, property managers and consultants at New Plymouth. John specialises in rural valuation and farm management consultancy and he is a qualified arbitrator with specialised expertise in rural sector disputes.

Vice President (Senior)

lain William Gribble is a Fellow of the NZIV. He is a principal of Robertson Young Telfer Northern) Limited at Auckland. lain is a general practitioner valuing all classes of urban property in the Auckland region. He has formerly served on the NZIV Council as the Valuer General's Nominee in 1986 and 1987.

Fellowship Citations

Ronald Blakely Shera
Auckland Branch

Ron Shera is Managing District valuer for the Manukau Office of Valuation New Zealand. Born in 1935, Ron was educated in Te Papapa Primary, Manukau Intermediate and Auckland Grammar. He completed his apprenticeship in building and spent 12 years in this trade.

Ron joined the government Valuation Department in Auckland in 1964 and was appointed to permanent staff in 1965. He completed the NZIV Professional Examination (urban), was registered in 1972 and in the same year was elevated to Associate status.

Ron was relocated to the new Manukau office in 1976 and in 1977 took up the Senior Valuers position. For abriefperiod in 1985 he returned to Auckland as a District Valuer but later in the same year returned to the Manukau office as District Valuer Senior. With the 1988 restructuring of the Department, Ron was appointed Managing District Valuer for Valuation New Zealand, Manukau.

During his time at the Department, Ron has gained wide experience in all aspects of urban valuation and has been responsible for the trainingof many young vauers. With his knowledge, experience and willingness to teach, Ron has helped lay the foundation of many valuation careers.

He has served as a committee member of the Auckland Branch of the NZIV and has encouraged his staff to be involved in Institute Affairs.

Ron has a philosophy that has guided his valuing career which was also the school motto of Te Papapa Primary: "that nothing great is easily won."

Ron and his wife Brenda have one son and two daughters and until recently had lived in Mangere for 32 years. They have been involved in community affairs with Ron acting as Chair of the Manukau City Association Football Club for five years and a Scout committee member. Both Ron and Brenda are life members of the Manukau City Football Club.

The Auckland Branch is unanimous in its recommendation that Ron Shera be elevated to the status of Fellow in recognition of the regard and repute he is held in by the community and his fellow valuers, and for the assistance he has provided to many valuers under his employ. 0

Geoffrey John Blackmore
Central Districts Branch

Geoff Blackmore was born in Reefton in 1950 and educated in Inangahua and at St Bedes College, Christchurch. He began his valuation career with the Valuation Department in 1969 completing his NZIV Examination in 1973 with Registration and Associate status gained in 1973 and 1975. His Valuation Department experience ranged from Senior Valuer in Hokitikain 1973 through to District Valuer in Invercargill and Palmerston North.

In 1985 Geoff began in public practice as a founding partner of Mackenzie Taylor & Co Ltd in Palmerston North. Through to the present day, Geoff continues to be active in all matters of urban valuation with a particular interest in rating, development advisory roles and going concern assessments.

Geoff has always undertaken an active role with the Central Districts Branch of the Institute. He is a past examiner for the NZIV, liaised on behalf of the NZIV with the early establishment of the BBS Valuation option at Massey University, is a past Chairperson of the local branch and is currently a member of the Land Valuation Tribunal.

Outside his valuation involvements, Geoff has an active interest in Rotary, with otherpursuits being golf, gardening and home renovating. Geoff is married with three children and lives in Palmerston North.

Geoff is highly respected for his valuation expertise and for the assistance he has provided the local NZIV branch. He is recognised as a valuer of integrity and fairness. His advice is sought from both colleagues and clients alike. His nomination for Fellowship has the full and unanimous support of the Central Districts Branch Committee.

Brian Edward D'Arcy
Otago Branch

Brian D'Arcy is District Valuer for the Dunedin City municpal area, having been appointed to the position in 1977 and has now completed three full city revisions for Valuation New Zealand.

Brian was born in Liverpool, England in 1934, came to New Zealand as a young famiy man in 1959 and worked in the building trade. He joined the Valuation Departmentasavaluerin 1964andstarted studies through NZ Technical correspondence Institute for the NZIV professional examinations. He completed the Valuation Professional (urban) qualification and gained registration as a valuer and Associate membership of the NZW in 1971.

Brian has spent the whole of his valuation career to date, in the Dunedin office of Valuation new Zealand and was appointed Senior Valuer in 1974 before his current appointment as District Valuer in 1977. He has had a particular interest in leasehold valuations and has written two papers on leasehold methodology which were published in the NZ *Valuers' Journal.* He has an interest in developing mass appraisal techniques for residential property.

While never having been a committe member of the Otago Branch NZIV, Brian has nevertheless taken avery active interest in the affairs of the institute through regular attendance at luncheon meetings, seminars and workshops. He was an examiner for the branch in the NZIV urban practical and oral examiniations for a number of years.

Brian has maintained a strong sporting interest throughout his life, having played South Island league soccer for the Mosgiel club for 10 years then 15 years playing in the social grades. He is a qualified first grade soccer coach and coached Otago University teams for a number of years. He was also involved with the Taieri high school soccer club for many years and has been involved in youth club activities both in Mosgiel and in Dunedin City particularly in the years when his two boys were growing up. He has one surviving adult son. Brian takes a strong interest in environmental issues and has a particular interest in historical buildings which he gives as one of the reasons he chose to settle at Dunedin on his arrival in New Zealand. Brian and his wife Maree enjoy pursuing a mutual interest in Latin American and ballroom dancing.

Brian d'Arcy is highly regarded by the members of the Otago BranchNZIV for his knowledgeandexpertisein valuationgained during a long career in a very responsible and demanding position. He carries out his duties with a strong sense of fairness and makes himself available to the public and his fellow valuers whenever possible. He has always shown a willingness to share andimparthis wideknowledgeof valuation particularly with younger valuers.

The Otago Branch Committee supports the nomination of Brian D'Arcy for advancement to Fellow of the NZIV.

NZIV 1993 AGM Report

The 1993 Annual general meeting of the NZIV was held in the Fullwood Room of the Dunedin Conference Centre at 5.00pm on Monday 19 April.

President A P Laing welcomed Mr R M Westwood, President of the Australian Institute of Valuers and Land Economists, other invited guests and approximately 120 members.

The minutes of the previous AGM on 13 April 1992 were taken as read and approved as a true and correct record of the meeting. The Annual Reportand Accounts of NZIV for 1992/'93 were taken as read and adopted by the meeting.

Mr Barry D Wilson was re-appointed as auditor or a further one year term. The meeting passed two notices of motion in respect of rule changes for retired status and for postal ballots on any matter.

President A P Laing announced that the following members had been elevated to Fellows of the NZIV by Council: G J Blackmore, Central Districts; B E D' Arcy, Otago; R B Shera, Auckland.

He also announced that Peter Young of Auckland had been awarded life membership of the NZIV in recognition of his outstanding contribution to the profession.

President A P Laing announced that the John M Harcourt Memorial Award for 1993 had been awarded to William Alan Cleghorn for his outstanding contribution to the profession in his role as Chairman of the Education Board and in particular for his initiatives which have led to the introduction of Continuing Professional Development programmes and he presented the award to Mr Cleghorn.

The meeting closed at 5.25pm.

The Editor

April 1993 Council Meeting m. Report

The April 1993 meeting of the Council of the NZIV was held at Pacific Park Motor Hotel, Dunedin on Saturday 17 and Sunday 18 April commencing at 8.30am.

President A P Laing welcomed all councillors including Mr S A Ford the new councillor for Waikato Branch and invited guests, including members of Executive. He also welcomed Mr R M Westwood, President of the Australian Institute of Valuers and Land Economists (AIVLE) and Mr David Smith, representing the Institute of Plant and Machinery Valuers.

An apology was received from Mr A R Calderwood, The Valuer General's Nominee who was unable to attend on Saturday.

Minutes of the previous Council meeting were confirmed as a true and correct record.

In matters arising from the previous Council meeting, President A P Laing advised that a very satisfactory meeting had been held with the management of Landcorp and matters of concern had been resolved. Mr R V Hargreaves addressed the need for similar discussions to be held with the management of Works Consultancy.

Mr I W Gribble reported on the requirement for interview guidelines for Branches when conducting interviews with applicants for advancement to Associate status of NZIV. He outlined the concerns of the Auckland Branch that uneven standards are being applied to the interviews throughout the country.

Vice President W A Cleghorn advised that Kathryn Fraser of Multi-Serve Education Trust has been appointed to the new position of NZIV Education Development Officer and her duties will include:

1. Liaison between Branches, Council and the Education Board on education matters.

Citation for Life Membership: Robert Peter Young

Peter Young who resides in Auckland is well known throughout the country for his involvement in valuation issues whether it be through his former involvement as a member of the Valuers Registration Board, as a current member of the Education Board of the Institute or as a speaker at property related seminars in various parts of the country.

Peter's involvement with, and service to, the Institute dates back many years. He has been supportive of all initiatives undertaken by the Institute and has given unstintingly of his time to assist members of the Institute, and other property related professionals. Peter takes every opportunity to advance the cause of the valuation profession and in 1993 presented a paper to the World Valuation Congress.

Peter graduated with a Diploma in Urban Valuation from Auckland University in 1958 and obtained a Bachelor of Commerce Degree in 1964. His valuation experience commenced in 1954 and early work experience included a three year period valuing in Singapore for the Singapore Government. He was registered as a valuer in 1961 and advanced to a Fellow of the Institute of Valuers in 1976. He moved into private practice in 1969 and currently is Chairman of the national valuation practice of Robertson Young Telfer Ltd.

Peter is a member of the Auckland Branch of the NZIV and was chairman of that branch for two terms. He has presented papers to the Pan Pacific Congress of Valuers at both Vancouver and Kuala Lumpur.

Peter was appointed to the Editorial Board of the *NZ Valuers'Journal* in 1991 and has been appointed to the Education Board as a nominee of the Valuers' Registration Board in 1992. He has had responsibility for preparing the Ethics Course for the Institute as well as assisting in preparation of the updating of the Casebook.

Peter was a member of the Valuers Registration Board from 1979 to 1991. His involvement as an institute nominee was during a period when the number of complaints were increasing significantly and Peter had a deep involvement with the Board's activities over this period. He was deputy chair of the Board for the last few years of his membership. He retired from the board in order to allow others to get involved. He was awarded the New Zealand Medal in 1991.

Branches of the Institute have called on Peter to present papers at their branch meetings and seminars andPeter has given freely of his time. His particular expertise has been sought in relation to insurance valuations, rental valuations as well as valuations of major central city properties. He is called upon as an Umpire to adjudicate on valuation matters by members throughout the country due to his standing within the profession.

Peter has very high ethical standards and personalrntegrity and as such is looked up to by other members of the profession. He sets an excellent example and is always happy to give of his time to junior valuers needing help in both technical and personal matters. To this end he was appointed as a member of "Helpline" run by the Institute.

Peter's contribution to the Institute at both a national and local level has been tremendous and is reflected in his standing amongst members of the "property" group of professions.

Peter's interests and professional endeavours are wide and he finds time to support through committee involvement the less privileged youth of Auckland.

In recognition of Peter's service to the valuation profession including his involvement with the Valuers Registration Board, his promotion of the Institute and involvement with both Editorial and Education Boards of the Institute as well as his assistance to the young members of the Institute over a long period, the Council of the Institute unanimously recommend to the 1993 Annual General Meeting that Life Membership be conferred on RobertPeter Young.

2. Co-ordination, implementation and review of the Institute's education activities.
3. Assessing the post-graduate education needs of the profession.
4. Promotion of continuing professional development and the NZIV education resources.
5. Providing recommendations on the ongoing development of all facets of NZIV education activities.

MrJ N B Wall advised that a memorial plaque had been made for erection in the NZIV library to the memory of R J Maclachlan and the plaque was approved by Council.

General Secretary J G Gibson reported that proposals are still being sought for upgrading of the NZIV computer system.

Awards/Honours

Mr I W Gribble presented a citation for life membership of the NZIV for Peter Young of the Auckland Branch which was unanimously agreed by Council.

President A P Laing advised that the J M Harcourt Memorial Award Committee had made the Award for 1993 to William Alan Cleghorn of the Rotorua/Bay of Plenty Branch for his outstanding contribution to the profession in his role as Chairman of the Education Board and in particular his initiatives which have led to the introduction of continuing professional development programmes.

Council approved the advancement of the following members to NZIV Fellowship status:

G J Blackmore	Central Districts
B E D'Arcy	Otago
R B Shera	Auckland

Forum session

In a session chaired by G H Kelso, the Council informally discussed the role of the NZIV Chief Executive Officer and the relationship of the National Office with the Branches, following the presentation of the report of the sub-committee which had comprised Councillors Kelso, I W Gribble and A W Gowans and Branch Chairmen P Wright, K Coleman and C Orchard.

Mr R M Stone chaired an informal Council discussion on the development of computer software packages for valuation practices and the issue of whether NZIV Services Committee should be involved in the promotion and development of computer software.

Committee Reports

Vice President W A Cleghorn presented a report by a sub-committee comprising himself as Chairman and Councillors R M Stone and A J Stewart on a review of NZIV publications. Council agreed that the Editorial Board should review the publication of the *New Zealand Valuers' Journal* with the objectives of attaining more market appeal, greater readability, greater human interest and enhanced legal case-note reporting.

Council agreed *that Statscom* and*NZtV Building News* be merged as a quarterly publication offered by subscription.

Council considered reciprocity issues and agreed that Executive should consider ways in which to strengthen the NZIV international linkages with particular emphasis on continued sponsorship of the Pan Pacific Conference.

Following the earlier Forum Session discussion Council agreed that the NZIV Chief Executive Officer/General Secretary will be available to visit branch committees with the intention that he will be able to keep them up to date with current issues.

Council considered the report of the Working Group for the review of the NZ1V Insurance certificate and an expanded Working Group is to receive submissions from members of the Institute and Branch Committees and then report to Executive who will make recommendations to Council.

VicePresident W A Cleghornreported that a telephone conference discussion was held between Education Board members and eight women valuers in reference to Womens' Suffrage Year.

Professional Practices Committee

Mr J N B Wall, Chairman, reported that a high volume of complaints is still being received and that it is of concern to the Committee that too many member to member complaints are being submitted. He commented that part of the reason for the high number of public complaints could be because there seemed to be such little cost involved for a complaint to be pursued by a complainant. He was concerned, however, that the cost to a valuer to defend a complaint was often very considerable. Mr Wall intimated that this situation may be addressed in some future legislation.

Promotions Committee

Mr A J Stewart, Chairman, reported that the committee has reviewed the effectiveness of communication lines between NZN and its members,of the need to raise public awareness of the valuing profession and of the relevance of all Council committee activities. He advised that the Committee considered the most pressing need was for the realisation at Branch level that public relations could be best achieved through regular media contact on local property market reports and commentary.

Education Board

Vice President W A Cleghorn, Chairman of the Education Board, advised that he had been involved on an appointment committee for the appointment of a Professorof Property Studies at Lincoln University and that Dr Terry Boyd has now been appointed to the position. Mr Cleghorn reported that he had attended the Educators Conference in Sydney, Australia in January this year. He advised that a handbook for Councillors and for Branch Committee members on Continuing Professional Development is being produced, and that all published references in future to CPD will be in terms of "mandatory" not "compulsory" requirements. Mr Cleghorn reported that a two volume publication of the Land Valuation Casebook is now being completed by the Education Board.

Council agreed to the Education Board entering into a contract withthe author Mr R A Bell to rewrite the text book *Investment Property Income Analysis and Appraisal* for use in 1994 by the teaching Universities.

Council received a letter from Rotorua - Bay of Plenty Branch referring to the publication of Registration Board decisions by NZIV and expressing the opinion that the recently published second edition was of less educational value than the first edition because of the deletion of names and other details.

Services Committee

Mr R M Stone, Chairman, reported that the Modal House review has been completed by the consultants to the Services Committee. He advised that discussions have been held with Valuation New Zealand, the Inland Revenue Department and the Land Registrar in respect of GST content in property sales recording. Both the Inland Revenue Department and the Land Registrar currently have no requirement for any party to publicly record their status in regard to G.S.T.

Mr Stone advised that the Services Committee is committed to the continuation of Statscom and is concerned currently at the low level of contributions to the publication particularly after statistical officers having been appointed at every branch. He suggested that branch members should be encouraged to produce modal costings from analyses of actual house building costs, adjusted to Modal by simple formulae and this could alleviate the problem of the lack of Modal statistics in some districts.

Council agreed that Services Committee engage a consultant to advise on the member requirement for development of information technology, particularly computer software programmes, at a cost of between $8,000 and $13,000 with the final cost to be approved by Executive.

Editorial Board

Mr W A Burgess, Chairman, reported that a sub-committee of the Editorial Board has been appointed to consider the updating of the format of the *New Zealand Valuers' Journal.* He advised that there has been a disappointing response by members in all centres to the forthcoming Editorial Board sponsored Lecture Tour to date but that present numbers are at approximately break-even point.

Mr T J Croot, Editor of *The New Zealand Valuers' Journal,* reported that a satisfactory flow of articles is being submitted for publication with the majority of papers being received from University based contributors but there is also an encouraging trend for a greater number of papers coming from Branch seminars. Satisfactory service continues to be received from Vicki Jayne, the Publication Editor and from Devon Colour Printers.

Massey University Foundation

Vice President, W A Cleghorn, advised that Mr Graham Brigands has been appointed to the Foundation and that Dr Stuart Locke has resigned as a Trustee.

Real Estate, Valuation and Properly Management Education Foundation

President, A P Laing, advised that NZIV commitment to funding of the three valuation and property management teaching universities will be completed in 1993.

Institute of Plant and Machinery valuers

Mr E F Gordon, the NZIV Executive delegate to IPMV reported that Mr Brian Kellett was elected President of IPMV at the Annual General Meeting held at Wellington in March. He advised that membership of the Institute had increased only slightly during the year. The rules of IPMV had been changed to require member participation in Continuing Professional Development programmes and for professional indemnity insurance cover being compulsorily held by members.

Westbrook House Body Corporate

Mr J G Gibson, Chief Executive Officer reported that a maintenance provision continues to be made for the NZIV floor of the Westbrook House building at Willis Street and that a valuation of the Unit Title for the floor had been satisfactorily completed.

International Affairs

Mr R M Westwood, President of the Australian Institute of Valuers and Land Economists (AIVLE) addressed Council and advised thatplant and machinery valuers in Australia will shortly become eligible for membership of AIVLE following changes in legislation and the Institute rules. He said that there had been much criticism of valuers following the collapse of the commercial property market in most areas of Australia, but that the AIVLE has turned to profit the wide publicity that the property collapse has generated.

He advised that Continuing Professional Development will become compulsory for AIVLE members next year and that Education Training Officers are being appointed in various states.

Mr Westwood said that the valuation profession in Australia is currently under the threat of complete deregulation by the Government as a result of there being two states in the country where registration of valuers is not compulsory. He advised that the AIVLE is currently addressing this problem.

Pan Pacific Congress

Mr J G Gibson, Chief Executive Officer reported on a meeting he had attended with Dr George Webb, Chief Executive Officer of AIVLE for discussions leading to a joint paper to the Pan Pacific Congress (PPC) recommending various procedures for future conduct of the PPC. A significant recommendation was for CEOs of each participating Institute to attend PPC as official delegates. This was recommended because CEOs usually have longer term appointments than the terms of office of Institute Presidents and it would consequently provide greater continuity of participation.

Mr I W Gribble advised that Auckland Branch has responded positively to the NZIV invitation to host the year 2000 Pan Pacific Congress and a small subcommittee of the Branch has been appointed to investigate possible venues, themes and topics. Council agreedto AucklandBranch appointing a professional conference organiser for discussions of possible hosting of the Pan Pacific Congress by NZIV in the year 2000 at Auckland.

Standards Committee

Mr G J Horsley, Chairman, reported that the Committee had been active in producing practice guidance notes for small commercial properties and for rural properties. He said that published standards should be seen as guidelines that could be continuously refined and amended as circumstances dictated.

Mr Horsley reported that seminars had been conducted on valuation practice for infra-structural assets, on intangible assets, public sector valuations and NZIV standards but the attendances at all the seminars had been disappointing. He advised that Dr S M Locke had resigned from the Standards Committee.

Land Professionals Mutual Society

Mr A L McAlister, the NZIV nominee to LPMS reported that membership of the Society has increased to a total of 273 firms but that valuer membership has remained static.

He advised that there are currently 72 open files for valuer claims although 37 of these would be "notifications" only of possible claims.

Since October last year 8 claims have been settled at a cost of about $530,000 to the insurers. Mr McAlister expressed the concern of LPMS at the high number of claims emanating from a small number of valuation practices and he attributed the causes of many claims to poor standards of report writing, and over-valuation of properties.

He advised that the professional indemnity insurance market remains "hard" and combined with the relatively high claim rate being recorded against valuers there is likely to be substantial increases in premium in the future.

Mr McAlister reported that mainly well attended Loss Prevention Seminars had been held in most centres throughout the country by LPMS with Napier and New Plymouth being two centres where seminars have still to be held.

TIAVSC

Mr G J Horsley reported that TIAVSC has adopted a new definition of market value which recognises the concept of willing buyer as well as willing seller. He advised that his term as Chairman of TIAVSC has ended but he would retain a position on the Board as Immediate Past Chairman.

Council adopted the TIAVSC definition of Market Value and the draft explanatory notes.

Branch reports

Councillors reported on their Branch activities and many advised that cash reserves held in their branch were being used for educational funding purposes either by the expenditure of interest being received on the capital sum or in some cases by expenditure of part of the reserve fund.

Financial reports

Mr J G Gibson, Chief Executive Officer, presented details of the financial position of NZIV as set out in the published annual report of the Institute.

Branch remit

Mr S A Ford, Councillor for Waikato Branch, explained the basis of the proposed branch remit being promoted by his Branch. Council did not accept the remit for consideration at the Annual General Meeting.

Election of Officers

Mr J P Larmer, Councillor for Waikato Branch was elected president for the ensuing two years term.

MrW ACleghorn,CouncillorforRotorua/ Bay of Plenty Branch was confirmed as Vice President (Senior).

Mr I W Gribble, Councillor for Auckland Branch was elected as Vice President (Junior).

The following appointments to committees *were* made by Council, subject to acceptance by some appointees:

Executive: J Larmer- President
W A Cleghorn - Vice President, I W Gribble Vice President
Messrs.: J N B Wall, A J Stewart, R M Stone, A R Calderwood, E F Gordon
Professional Practices: J N B Wall - Chairman
Messrs. W A Cleghorn, E F Gordon
I W Gribble, G Kirkaldie
Editorial Board: WA Burgess - Chairman, Messrs. R L Jefferies, R V Hargreaves, S L Speedy, T Boyd, TJ Croot - Editor
Ms Vicki Jayne Production Editor
Promotions: A J Stewart Chairman
Messrs. A J Brady, S A Ford, W M Smith, J P Larmer
Services: R M Stone Chairman
Messrs. R V Hargreaves, A W Gowans, E T Fitzgerald
Standards: G J Horsley Chairman
Messrs. B Hilson, PG Heavey, G H Kelso, J Dunckley, I W Gribble, K Cooper, D Smith- IPMV Representative
Education Board: W A Cleghorn Chairman, Ms G Jansen, Messrs. J W Briscoe, A J Stewart, R P Young Valuers Registration Board Nominee
C Wills Landcorp, C Laird AMP Society (Representatives from Commerce)

Notices of Motion

Council approved Notices of Motion to the 1993 Annual General Meeting in respect of rule changes for retired status and for postal ballots on any matter.

Valuers Registration Board Visit

The Council meeting was visited by a full representation of the Valuers Registration Board - Messrs. H McDonald, Valuer General - Chairman; P Tierney; D Armstrong; A Stewart and E Gamby and there was discussion on a number of issues raised by the Board and by the Council.

(The Editor)

VALUERS' REGISTRATION BOARD

The Valuers' Registration Board's prizes for the 1992 academic year have been awarded to:

Auckland University: Thomas Lee of Auckland
Massey University: Andrew Selby of Auckland
Lincoln University: Peter Walkinshaw of Invercargill

The awards, currently $500.00 each, are made by the University Councils of the recommendation of the appropriate Faculty or Professorial Board to the students showing the greatest promise of being successful valuers.

Key factors of Business Valuation

by Shannon P Pratt

1. Income approach

A. Discounted future benefits method

In theory, a business or business interest is worth the sum of all the benefits it is expected to provide to its owner in the future, each discounted back to a present value at a discounted rate that reflects the risks and other characteristics of the subject investment. The formula for the discounted future benefits method is as follows:

A, "
PV= (1 +d) + (1+d)2 +... +(1 +d)"

where:

PV = Present value
A, = Value of future benefit expected at the end of period 1
A" = Value of future benefit expected at the end of the n'" (final) period
d = Discount rate (required rate of return in the marketplace for investments of comparable risks and other characteristics)

The amounts of expected benefits may be denominated in terms of expected dividends orpartnership withdrawals. net free cash flow, net income or any of a variety of other financial variables. *It is critical that the discount rate selected be appropriately matched to the financial variable being discounted.* The valuation work product should offer empirical evidence to support the discount rate being chosen as being appropriate for the financial variable being discounted.

B. Capitalized returns method

The capitalized returns method is, in effect, a shortcut version of the discounted future benefits method. In this method an indication of value is derived by dividing a single benefit (return) flow number by a capitalization rate. The formula for the capitalized returns method is as follows:

$$PV = \frac{Al}{r}$$

where:

PV = Present value
A, = Value of the return (benefit) expected at the end of period 1
r = Capitalization rate

As with the discounted future benefits method, the amount of the expected return being capitalized may be denominated in terms of expected dividends or partnership withdrawals, net free cash flow, net income, or any of a variety of other financial variables. Also, as with the discounted future benefits method, *it is critical that the capitalization rate selected be appropriately matched to the financial variable being capitalized.* The valuation work product should offer empirical evidence to support the capitalisation rate being chosen as being appropriate for the financial variable being capitalized.

C. Relationship between discount and capitalization rate

As noted above, a discount rate is applied to all the future expected benefits, explicitly forecasted for each period (usually by year). A capitalization rate, on the other hand, is applied to the expected benefit for only a single period, often the expected benefit for the 12 months immediately following the valuation date.

The numerators (amounts being discounted) in the discounted future benefits model specifically reflect all the future changes (usually growth) in the benefit stream, while the numerator being capitalized in the capitalized returns model does not.

This difference must be reflected in the difference between the discount rate and the capitalization rate. Because the discounted future benefits model usually reflects growth in the expected benefit stream, capitalization . rates usually are lower than discount rates. *The discount rate and the capitalization rate are equal in only one unique circumstance: where the expected benefit stream is a constant amount in perpetuity* (such as the dividend for a noncallable preferred stock). If one could assume that a benefit stream being capitalized would be expected to grow at some constant rate in perpetuity, then a discount rate could be converted to a capitalization rate by the following formula:

$$r = d-g$$

where:

r = Capitalization-rate for the financial benefit forecasted for the coming 12-month period
d = Discount rate (applied to all future benefits forecasted in perpetuity)
9= Annually compounded growth rate in perpetuity for the financial benefit being capitalized

The most widely used procedure in applying the discounted future benefits model is to use net free cash flow as the variable being discounted, building up a discount rate using equity risk premium data from Ibbotson Associates. *Net free cash flow* is defined as follows:

Net income (after taxes) +
Noncash charges
Capital expenditures (the net changes in fixed and other noncurrent assets)*
- Changes in working capital* +
Net changes in long-term debt* =
Net free cash flow

This paper was presented at the NZIV Seminar held at Dunedin on 19 April 1993

*Assumes amounts are those necessary to support projected operations.

The discount rate may be built up as follows

20-year U.S. Treasury bond yield to maturity or STRIP rate*
+ Long horizon equity risk premium**
+ Small stock premium (if applicable-applies to companies the size of the smallest 20% of the NYSE)**
+ Specific size or additional risk premium, if applicable Discount rate * From daily newspapers.

** From Ibbotson Associates *Stocks, Bonds. Bills & Inflation (see 'exhibit 1)*

Alternatively the discount rate applicable to net free cash flow can be developed using the Capital Asset Pricing Mode12. Finally, the Arbitrage Pricing Theory is used occasionally for the development of discount rates, but this procedure has not yet come into wide usage.

In valuing minority interests, the expected dividend stream frequently is the variable discounted, using the same procedures for developing a discount rate.

11. Comparative Company Approach

A. The premise of this method is that prices atwhich comparable companies have sold in the market provide empirical evidence as to the value of the subject company

B. Need for each comparable company
1. Transaction price
2. Value parameter to which to relate transaction price (to derive a multiple which may be applied to the same valuation parameter for the subject company)

C. Traditional valuation parameters
1. Some measure of earnings or cash lfow
2. Gross or net revenues
3. Dividends or other form of payout
4. Some measure of underlying asset value

D. Types of transaction data
1. Publicly traded shares (if valuing a total enterprise, some premium normally is added for "control." There are several sources of data to quantify such a premium)
2. Merger and acquisition data

E. It is essential to measure the valuation parameters in the same manner for the subject company and the comparable companies

F. Financial analysis mustbe undertaken to make appropriate adjustments to valuation and also to reflect differences between the comparable companies and the subject company

G. Finally a correlation must be made among the values indicated by the various valuation parameters, and a final value determined.

EXHIBIT 1

IBBOTSON ASSOCIATES
Stocks, Bonds, Bills and Inflation 1992 Yearbook

Series Difference	Difference of means
STOCKS MINUS BONDS AND BILLS	
Long-horizon expected equity risk premium: Common stock total returns minus long-term government bond income returns	7.4%
Common stock total returns minus long-term government bond total returns	7.3%
Intermediate-horizon expected equity risk premium: Common stock total returns minus intermediate-term government bond income returns	7.7%
Common stock total returns minus intermediate-term government total returns	7.1%
Short-horizon expected equity risk premium: Common stock total returns minus U.S. Treasury bill total returns	8.6%
SMALL STOCKS	
Expected small stock premium: Small stock total returns minus common stock total returns	5.1%
BONDS AND BILLS	
Expected default premium: Long-term corporate bond total returns minus long-term government bond total returns	0.6%
Expected horizon premium: Long-term government bond total returns minus U.S. Treasury bill total returns	1.3%
Long-term government bond total returns minus intermediate-term govern- ment bond total returns	0.2%
Long-term government bond income returns minus intermediate-term government bond income returns	0.3%
Intermediate-term government bond total returns minus U.S. Treasury bill total returns	1.5%
Intermediate-term government bond income returns minus U.S. Treasury bill total returns	0.9%

Source: ®*Stocks, Bonds, Bills, and Inflation 1992 Yearbook*- Ibbotson Associates, .Chicago, Illinois (annual update work by Roger G. Ibbotson and Rex A. Sinquefield).

III. Gathering Data

A. The search for comparative publicly traded companies

The purpose of gathering data on comparative publicly traded companies is to derive some benchmarks by which to value the subject company. For example, public companies in the industry selling atprice/earnings orprice/ cash flow ratios higher than the overall market average indicate that the public market is optimistic about the industry's future, and this optimism should also be reflected in the subject company's P/E ratios. Similarly, the public market can provide benchmarks concerning the relation of stock prices to such variables as book values, adjusted underlying net asset values, dividends, and gross revenues. Any or all of these parameters can be relevant to a specific valuation situation.

B. Sources of comparative public company data

** Footnote From Shannon P. Pratt, *Valuing a Business: The Analysis andAppraisal of Closely Held Companies*, 2nd ad. (Homewood. Ill.: Business One Irwin, 1989), p. 83.

2 For a detailed discussion see Shannon P. Pratt, *Valuing a Business,* 2nd ed., pp. 45-51.

1. SEC Directory

Directory of Companies Required to File Reports with the Securities and Exchange Commission. Securities and Exchange Commission. Washington, D.C.: U.S. Government Printing Office. Listing of companies required to file with the SEC under the Securities Exchange Act of 1934. Arranged alphabetically and by industry group. Annual.

2. Standard & Poor's *Corporation Records*

Standard & Poor's Corporation Records. Standard & Poor's Corporation, Inc., 25 Broadway, New York, NY 10004. Provides company descriptions and supplementary news items, plus an index. Comparable to Moody's manuals. Covers companies having both listed and unlisted securities. Company information includes history, list of subsidiaries, principal plants and properties, business and products, officers and directors, comparative income statements, balance sheet statistics, selected financial ratios, and description of outstanding securities. Daily News Section provides updates. Annual with bimonthly updates.

3. Standard & Poor's *Register*

Standard & Poor'sRegister of Corporations, Directors, and Executives. Standard & Poor's Corporation, Inc., 25 Broadway, New York, NY 10004. Vol. 1: Corporations; alphabetically lists over 4 5,000 companies, gives brief summary description with addresses, telephone numbers, corporate officers and directors. Vol. 2: Individual listings, directors, and executives section; lists alphabetically the individuals serving as officers, directors, trustees, partners, and so on. Vol. 3: Indexes; gives SIC classification, geographic index, and new additions. Annual.

4. Moody's Manuals

Moody's Bank & Financial Manual. Moody's Investors Service, 99 Church Street, New York, NY 10007. Covers insurance, finance, real estate, and investment companies. Includes five- to seven-year presentation of income accounts, balance sheets, financial and operating ratios, a detailed description of the company's business, including a complete list of subsidiaries, and a capital structure section with details on capital stock and long-term debt and bond and preferred stock ratings. Semiweekly with annual cumulation.

Moody'slndustrial Manual. Moody's Investors Service, 99 Church Street, New York, NY 10007. Covers companies listed on the New York and American stock exchanges and those listed on regional American exchanges. Includes five to seven years of financial information on income accounts, balance sheets, financial and operating ratios, a detailed description of the company's business, including a complete list of subsidiaries and a capital structure section with details on capital stock and long-term debt. Semiweekly with annual cumulation.

Moody's OTC Industrial Manual. Moody's Investors Service, 99 Church Street, New York, NY 10007. Covers over-the-counter industrial corporations, with history, background, mergers and acquisitions, subsidiaries, business and products, principal plants and properties, names and titles of officers and directors. Includes financial statements and a description of capitalization with financial and operating ratios. Weekly with annual cumulation.

Moody's Public Utility Manual. Moody's Investors Service, 99 Church Street, New York, NY 10007. Includes electric and gas utilities, gas transmission companies, and telephone and water companies. Covers financial statements and operating and financial ratios, with history, background, mergers and acquisitions, subsidiaries, business, construction programs, principal plants and properties, and data relating to rates, franchises, and contracts. Semiweekly with annual cumulation.

Moody's Transportation Manual. Moody's Investors Service, 99 Church Street, New York, NY 10007. Covers railroads, airlines, shipping, bus, and truck lines. Also covers oil pipelines, bridge companies, and auto and truck leasing and rental companies. Includes maps of many of the larger railroad systems, plus route maps of some large airlines. Presents statistics showing financial and operating results, with historical data, location and mileage, and management and security descriptions. Semiweekly with annual cumulation.

5. Value Line Investment Survey

Value Line-Investment Survey. A. Bernhard & Company, New York,NY. Analyzes and reports on 1,700 companies in about 95 industries. The statistics, charts, and brief explanatory text are reviewed and updated, industry by industry, on a rotating basis so that the information on each company in every industry is revised quarterly.

6. Computer Databases

There are a growing number of online databases thatprovide comprehensive and timely information accessible through many widely used online information vendors. Some of these are:

a. BRS Information Technologies, 1200 Route 7, Latham, NY 12110 (800) 3454277 or (518) 783-1161.
b. DIALOG Information Services, Inc., 3460 Hillview Avenue, Palo Alto, CA 94304 (800) 334-2564 or (415) 858-2700.
c. Mead Data Central Inc., P.O. Box 933, Dayton, OH 45401 (800) 2274908 or (513) 865-6800.
d. Pergamon ORBIT InfoLine Inc., 8000 Westpark Drive, McLean, VA 22102 (800) 421-7229 or (703) 442-0900.
e. I.P. Sharp Associates Ltd., Two First Canadian Place, Suite 1900, Toronto, ON, Canada M5X 1E3 (800)387-1588or(416)364-5361.

C. The search for merger and acquisition data

The search for comparative companies deals primarily with data on daytoday trading prices of stocks. However, one can also derive indications of value from data on the prices at which entire companies or operating units of companies have been sold or the prices at which significant interests in companies changed hands. Such data are harder to find than daily stock trading data, since there are far fewer such transactions and there is no centrally organized mechanism for collecting and making such price information available.

D. Sources of merger and acquisition data

1. *Acquisition/Divestiture Weekly Report.* Quality Services Company, 5290 Overpass Road, Santa Barbara, CA 93111. Reports weekly activity on acquisitions, mergers, offers, rumors to buy or sell and terminations. Includes financial data on buyer and seller, plus purchase details. Weekly update on companies in negotiations.
2. *Announcements of Mergers and Acquisitions.* Conference Board, Inc., •

845 Third Avenue, New York, NY 10022. List of completed mergers and acquisitions reported in the month indicated. Covers independent corporate and noncorporate units, subsidiaries, affiliates, divisions, and stock acquisitions that bring the acquiring company's ownership to at least 50 percent of the voting stock of the acquired unit. Covers firms engaged in manufacturing, mining, wholesale and retail trade, services, agriculture, forestry and fisheries, and contract construction. Shows total assets (where available), business, and location. Monthly.

3. *Merger and Acquisition Sourcebook.* Quality Services Company, 5290 Overpass Road, Santa Barbara. CA 93111. Covers purchase details on 3,000 major transactions, 92,000 merger and acquisition facts, the previous year's deals that fell through, prices paid by type of industry, merger terminology, premium paid for stocks on month before acquisition announcement, troubles in leveraged buyouts, takeover law revisions, tax benefits in ESOP acquisitions, industry surveys on acquisitions. Lists 125 takeover targets, premerger questions, and companies selling below book value. Annual.
4. *The Merger Yearbook.* Cambridge Corporation Publishers, P.O. Box 670, Ipswich, MA 01938-9989. Summarizes selected information on merger activity for the year by general SIC code. Besides small minority investments of one percent or more, it includes the purchase or sale of product lines and companies with sales as low as $1 million per year. Cambridge Corporation also publishes biweekly supplements in a newsletter entitled *Mergers and Corporate Policy.* Annual.
5. *Mergers & Acquisitions.* Information for Industry (Member of the Hay Group), 229 South 18th Street, Philadelphia, PA 19103. Covers the merger/acquisition/divestiture field with articles on techniques and merger methodology; case studies of recent noteworthy deals; detailed records and evaluation of business deals for each quarter accompanied by tables analyzing merger activities in the past quarter; interviews with key people in the field; news of current legislation and regulations affecting the industry.
6. *Mergerstat Review.* Merrill Lynch Business Brokerage & Valuation, Inc., W.T. Grimm & Company, 854 E. Algonquin Road, Schaumburg, IL 60173-3808. Contains statistics on merger announcements, total dollar value paid, medium of payment, foreign buyers, divestitures, tender offers, and so forth. Provides historical statistics in each category. Each edition also contains analyses of the current year's transactions under a variety of categories. Annual.
7. *National Review of Corporate Acquisitions.* Tweed Publishing Company, 49 Main Street, Tiburon. CA 94920. While this source provides timely and interesting thoughts on current merger activity, it organizes brief summaries of transactions in very broad industry groups and does not include SIC codes. Weekly.
8. *Predicasts F&S Index of Corporate Change.* Predicasts, Inc, 200 University Circle Research Center, 1101 Cedar Avenue, Cleveland, OH 44106. Provides abstracts of articles on U.S. business information including mergers, investments, legislation, and new products. Weekly report, with monthly and quarterly cumulatives.

9. Computer Databases
   a. DIALOG Information Services, Inc., 3460 Hillview Avenue, Palo Alto, CA 94304 (800) 334-2564 or (415) 858-2700.
   b. M & A Data Base, ADP Network Services, Inc., 175 Jackson Plaza, Ann Arbor, MI 48106 (313) 769-6800.
   c. Mergers & Acquisitions DataBase, Securities Data Company, 118, Raymond Boulevard, Newark, NJ 07102 (201) 622-3100.

IV. Difficulties with Gathering Data

A. Finding comparative companies
1. For industries with few comparative companies, may have to broaden selection criteria creatively
2. The smaller the company, the more important to extend the search to some of the less known and less convenient data sources in order to find other companies comparable in size as well as other respects.
3. In general the relevant factors to consider in choosing a comparative company are:
   a. Products
   b. Markets
   c. Management
   d. Earnings
   e. Dividend-paying capacity
   f. Book value
   g. Position of company in industry

B. Getting comparable time periods for financial data
Companies have different fiscal years and report at different times: it is important to collect or adjust comparative data to the same or nearly the same time periods as for the subject company

C. Adjusting for nonrecurring or other special items
It is important to adjust comparative company data as well as the subject company data for nonrecurring events or other factors which could distort financial results

D. Adjusting data to comparable definitions and accounting practices
Within the scope of U.S. Generally Accepted Accounting Principles (GAAP), many options are available for defining and reporting data. Many adjustments may be required to place the subject and comparative companies on a comparable basis.

V. Asset-based approach

A. Adjusted book value method (asset accumulation method)
   1. Adjust all assets and liabilities on the balance sheet from historical cost to current value (usually fair market value on a going concern basis).
   2. Identify, value, and bring onto the balance sheet all off-balance sheet assets and liabilities (frequently intangible assets which never were recorded on the balance sheet, and contingent liabilities).
   3. Subtract the re-cast liabilities from the re-cast assets.

B. Liquidation value method
   1. Determine value in exchange of assets on either orderly liquidation or forced liquidation basis.
   2. Subtract liquidation value of liabilities.
   3. Subtract all costs of liquidation.
   4. Discount estimated net proceeds to a present value at a rate reflecting the risk of attaining the expected proceeds at the expected time.

Added Value manage or sell

by T D Scott

Trevor Scott is a chartered accountant in public practice in Dunedin. He has recently been appointed Chair of the Institute of Geological and Nuclear Science and he is the Chair of the Board of Directors of Zenith Technology Corporation Ltd.

Trevor Scott is also on the directorate of, or is an advisor to a number of other public and private companies and is a member of the Council of the University of Otago.

My paper comments on Added Value and reviews the question of whether to manage or sell. I have found the statement "Added Value" to be somewhat confusing so consulted the McMillian Dictionary of Modern Economics for its definition. I found that "Added Value" meant "the value of the firm's output minus the value of the input purchases from other firms. Essentially it is the sum of the FACTOR income, the wages and profits of the firm."

This further confused me so I needed some guidance in relation to "FACTOR Income" and again I consulted the McMillian Dictionary of Modern Economics and found that "FACTOR income' meant "income derived directly from the current production of goods and services; the reward to the factors of production for services to current production of goods and services. It is usual to distinguish four main categories, rent, wages and salaries, interest, and profits."

It also went on to mention both national income and transfer income and in fear that I would spend the rest of my time referring to the dictionary I decided that my view of "Added Value" as it has always been, was to improve the value of a business through increased asset values and/or increased returns by way of profits on assets employed in a business.

This, of course, leads me to realise that there is always an element of risk in adding value to a business or its assets or endeavouring to improve a business's return on assets. I, therefore, had to consider the risk factor and in particular the measurement of that risk in decision making.

This was fine until I recently reviewed a copy of the English Economist and read an editorial entitled "Beating the Market". It said "for nearly forty years Economists have preached that investors can earn above average returns and add value only by taking extra risks or by striking it lucky. Recent evidence suggests that clever investors can outwit the market after all." It then went on to say "the death, when it was announced this year sent shock waves along Wall Street. Life would never be the same again, wailed the obituaries. Had some star analyst passed away, or was it the head of a top investment bank? Or maybe another crooked company boss had slipped from his yacht? In fact, the deceased was not a he or a she, but an it. "Beta" screamed the papers, was dead.

Beta? Why would the average Wall Streeter mourn the second letter of the Greek alphabet? Beta is one of the best known measures of risk used by investors. It plays a key role in lots of tricky financial activities, from portfolio management to pricing derivatives, working out the cost of capital and deciding if a firm should go ahead with its investment plans (thus adding value), and calculating or even setting top executives salaries. Without Beta these tasks are hard indeed.

> "Added Value (is) to improve the value of a business through increased asset value and/or increased returns by way of profits on assets employed in a business."

Having thought about these statements I suddenly realised that at last it would seem that economists, valuers and others involved in the assessment of business worth were suddenly being introduced to the "real world". In the past inefficient markets and the inefficient management of assets have been a plain fact to them. However, how can it be suggested that we have been in a normal and manageable economy and environment with crashing stock markets, lurching exchange rates and wildly fluctuating asset values? The efficient market theory was one that provided for inefficient markets within. This to me is a nonsense. If prices aren't efficient it means the market is ignoring price sensitive information. Once overlooked information is incorporated in a price or value, then this makes it efficient.

What has worked in the past in relation to value or risk may not work in the future. Too much emphasis is placed on past performance being an indication of future performance. Added value is, therefore, not as simple as one may think. Decision makers should not imagine that making the right decision in relation to risk, profits and added value will get any easier regardless of whether Beta has been buried or is alive and well, or through the existence of any other theory that may be developed as a model for the use of decision makers.

An efficient economy develops from individuals who clearly understand the current position and have a vision of the future separated from risk taking or as the Economist article suggests "striking it lucky."

I would now like to discuss the question of added value in relation to economic efficiency. Economic efficiency must always be the principal economic objective in deciding whether an asset is capable of having value added to it. This suggests that in determining whether it is possible to add value a broad range of expertise should be part of the decision making process to determine the economic efficiency of the decision.

In reviewing added value it is necessary to assess the potential gains. The 0

This paper was presented at the NZIV Seminar held at Dunedin on 19 April 1993

gains may be more valuable through, for example:

- More efficiently producing greater quantities of existing products.
- Increasing the efficiency and effectiveness of the assets concerned
- Through reducing non labour input costs.

Added value in itself is not a primary economic objective. The overriding economic objective is to improve economic efficiency, in other words to increase the value of output per unit of input. This takes into account the marketability of increased production which may entail added value but only if the extra added value is greater than the additional cost of all inputs. At the present time, for example, in the wake of the electricity supply crisis which the country experienced last year, any research which improves energy use efficiency will have a considerable bearing on the ability of industry to add value.

Added value may come from reduced costs as well as with improved revenues. With floating exchange rates there is no reason why a dollars worth of export income is any different from a dollars worth of import substitution or a dollar saved by reducing costs. They all contribute toward economic efficiency.

There hasbeen considerable discussion relating to further processing of forest products. As with other primary processing sectors, this is an area holding out for major potential economic gains from research that will lead to further added value. At the present time the sector faces very high comparative new plant construction costs, energy costs, and unit labour costs. It cannot, therefore, in my view, be said to necessarily have a competitive advantage with the rest of the world.

There is the current debate that we have sold out our forests to overseas interests. It has been established that we are as efficient if not more efficient than other countries at growing certain tree stocks. The question however, that has to be asked is are we as efficient at constructing and managing pulp mills or other downstream activities. If we are not we may find that where we, as a country, have had endless markets for raw logs, through adding value in an inefficient form may not have a market for the end product. In these circumstances by adding value to the raw materials that we can grow and develop in an efficient and competitive way, our advantage is lost through the inefficiencies of having added value. This could leave an infra-structure that had been developed to provide that added value idle and we could lose our timber trade.

When I was asked to deliver this paper I received a letter from the Convention Committee with some ideas on the subject data required. Included was a chart setting out a number of options associated with a marginal business. The question was should the business be managed or should it be sold. The chart clearly showed that management could restructure, improve revenues and, therefore, there could be a value recovery. Alternatively, if this was not possible the business could be sold. I now propose to discuss added value in specific terms and not in broad economic terms to show that improved revenues, unless it was meant to say "improved net revenues" is by no means the only way of adding value to a business.

Adding value to a business can be achieved either through improved profitability or through strategically developing the assets within the business to make them more valuable. On a "going concern" basis the market value of the assets must be influenced by the efficient use of them.

Added value can also come through increased revenues or reduced costs and this, therefore, must be related to theproduct that is produced or the goods and services which are offered by a business. Adding value becomes the task of creating value including, the making of the product, the potential selling of the product, choosing the value, providing the value and then communicating the value.

Making a product includes design, procurement of raw materials and the manufacture of the product. Selling the product includes the pricing, advertising and promoting, the distribution and the servicing of the product. In doing this market selection or focus must be addressed, value positioning determined. In providing value there must be product development, service development, pricing strategy, and development of distribution and servicing. To communicate the value there must be a sales force, sales promotion and advertising. It can be seen, therefore, that to add value to a business through its products is a complex and detailed process.

Value may also be added or value created through the merging of assets of two businesses or through the elimination of competing assets and again this is a complex and detailed exercise requiring input from many skilled disciplines.

Information technology is changing the way businesses operate. It is affecting the entire process by which companies create their products. The value a company creates is measured by the amount thatbuyers are willing to pay for a product or service. A business is profitable if the Value created exceeds the cost of performing the value activities. To gain competitive advantage over its rivals and thus add value to its own business, a business must either perform these activities at a lower cost or perform them in a way that leads to a differentiation and a premium price.

The information revolution is transforming the nature of competition and it is hard to underestimate the strategic significance of new information technology. This technology is transforming the nature of products, processes, companies, industries, and even competition itself. Companies or businesses must understand the broad effects and implications of new technology and how it can create substantial and sustainable competitive advantages. It alters industry structures, it supports costs and differentiation strategies and it spurns entirely new businesses. In my view the information revolution is a critical factor in the value chain which will ultimately assist in achieving "added value".

To add value to assets is complex and involves economic efficiencies, production, pricing, marketing decisions and ...utilisation of information technology.

Management decision can substantially effect base asset values. I hope that I have adequately demonstrated that to add value to assets is complex and involves economic efficiencies, production, pricing and marketing decisions, and most importantly the input of a number of different skills which are identified through the utilisation of information technology now available to business.

Finally, I have been asked to comment on instructions given to and to communications with Valuers in a positive prospective of "management or sell". I think that my advice would be to become aware of the information technology available within the business, to assess the economic efficiency of products manufactured or the utilisation of assets involved and to establish on a broad basis the position that either the assets or the product will ultimately have in the marketplace should time be allowed to manage and to add value.

Added Value for business assets

by GI Horsley

Added value as a concept is concerned with what value can be achieved by using assets in a productive process. In other words the value of the process or organisation achievable through combining assets in the optimal way to produce an item or service for which there is a demand. This idea of the value of the business being greater than the value of the assets is not new but there is an increasing emphasis on optimal organisation or choice of assets to add the most value.

Performance improvement as it relates to asset utilisation incorporates many skills of management, technology, finance and others. The basic procedure is shown in Figure 1 (over page). However, it is essential to keep in mind that the assets which we value are key inputs into this drive for added value.

Within commercial valuation "going concern" and "continuing profitability" are two cornerstone expressions. While they are foundational for much of modem valuation methodology they seem now to be no longer well understood. It is essential we rediscover these concepts in the context of added value or the numbers we attribute will be nonsense. Unfortunately, the trend to develop and introduce new techniques has moved us further away from, rather than closer to, embracing the economic foundations of our discipline.

Recent activity in the corporatisation/ privatisation arena relating to Crown activities serves to redirect attention back to these concepts of' going concern" and "continuing profitability". What I propose to do in this paper is use some examples relating to recent valuation assignments to illustrate the need to look at what is the going concern and what drives the profitability.

From these case studies we can extrapolate or generalise to most com-0

vraemengr$teyt Narc9nawirectaro vutuatwt+,s. in the corporateadvrsvrdlvi$ion of Ernsf&ottttg at Wellington He.Is a FeXlaw and is pr �i president. of the NZCV and is the imtredi'ate past Chap of tote: International Asset Valuation Standards Ccit mti? tee (TIAVSC). He is al an Associate member of the Chartered Institution of Arbitrators and a member of the Institute of Directors.

Graeme Horsley has been involved in public valuation practice for more than 25 years and has undertaken valuation and property consultancy as signmentsforhighlycpecialtsedassets, central dstrict portfolios and t<vurism properties throughout New ealand, the Tacif ie I.slandsand in Australia

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An example of this and I must say to my own condemnation, is my involvement with a major retailer in the South Island. The company was offered nineteen additional retail stores in the North Island and the transaction was structured in such a way that based on book values the purchaser received assets to the value of approximately $30m for the outlay of less than $10m. Included in the assets acquired were cash deposits approximately equating the price paid by the purchaser.

This seemed a marvellous deal where the purchaser basically acquired outlets which would more than double its turnover at no net cost to it. The company became so excited with theprospectof the acquisition that the question of the North Island stores position within the marketplace and the efficiency of operating these stores was completely overlooked. Initial net added value to the acquirer was approximately $20m.

As it unfortunately turned out not only could the North Island stores not operate efficiently but with the onset of the recession in the late 1980s it was impossible to achieve positive cashflow and ultimately the majority of the added value in the purchase was lost in trading deficits. That did not take into account the endless list of contingent liabilities associated with leases and other commitments that were of a longer term nature.

After many years of hard work and heartache and direct losses of in excess of $10m (after losing the $20m of added value gained at the time of purchase) the company has quit its investment. I have learnt that in certain circumstances businesses can have no value although individual components of the business can give the appearance of having value and collectively the prospect of adding value. In this particular circumstance individual valuers would have had little difficulty in placing reasonable values on land and buildings, inventories and accounts receivable and collectively a business valuation without a detailed review of the long term direction of the New Zealand retail trade. To have truly ascertained a value for this particular acquisition (and in hindsight it would have, in my view, had to have been a negative value) it would have required the collective skills of individuals well beyond those who traditionally value businesses.

To manage or to sell, therefore, in my view is a decision that must be made collectively between valuers, management, marketing consultants, product consultations, accountants, economists and others. As previously illustrated the present discussions taking place in relation to the forestry industry have involved a broad base of people from many disciplines and it would seem that no one of them is capable of making the appropriate decision without the input of the others. Their discussions revolve entirely around added value.

Added value it is not a simple subject with clearly defined answers but the sum of a number of aspects of a business or an industry that could just as easily result in the reduction of value. The ultimate economic efficiency of adding value must be recognised before a decision to manage or sell can be made.

Perhaps in the future the valuation profession can play a major role in coordinating the many individual skills that are required in determing whether to manage and add value or to sell. A mercial valuation work. It is then readily apparent why the basic tenets of "going concern" and "continuing profitability" do serve as the foundation blocks for modem valuation practice.

Crown Enterprises

Since 1984 there has been a steady process of reform in the Public Sector which has been noticeable through the Government's policy of corporatisation and privatisation. This movement precipitated the need to value government trading activities for the purpose of the opening balance sheets of the enterprises.

The creation process can generally be characterised as involving Establishment Boards which are responsible for setting up the new trading organisations, including determination of the value of the assets. They negotiate the value of the business with the Crown or Local Authority, as appropriate, within some predetermined guidelines. The process has been accepted as arm's length and the IRD has agreed to these opening values.

Value

Value has been determined by reference to the earnings potential of the organisation. The valuation report for the Crown Research Institutes states:

- As a general principle, the value of business is represented by its future cash flows discounted at a rate which reflects the risk inherent in those cash lfows.

This approach is forward looking and it is essential to appreciate, as a recent report to the Economic Intelligence Unit (EIU) in the UK notes, that:

- There is no direct correlation between expenditure on an asset and its value.

The process has now been refined further to what is known asthe Optimised Deprival Value (ODV) approach. In summary this involves establishing value as the lesser of:

- Optimised depreciated replacement cost (ODRC) and economic value (EV).

EV is defined in this context as the maximum of earnings based value and net realisable value (NRV). ODRC is the modern equivalent asset base for providing the service capability of the current system depreciated for the age proportion of the existing asset to that asset's total useful life. This means in effect replacing the asset configuration in the most efficient way possible, from an engineering perspective.

Going Concerns

EV based on future earnings potential is commonly calculated using a form of discounted cash flow analysis called discounted free cash flow (DFCF). As mentioned above this is forward looking and is concerned with where the organisation is going, not with where it has been. Of course past performance is often a useful guide to future maintainable earnings, however, where restructuring etc is involved the past may be of limited guidance in extrapolating forward.

Managements' Plans

The strategic and operational plans which management implement will shape the value of the business. This value is represented by two components. First, the tangible assets of the organisation contribute to the future earnings. Second, the intangible assets such as management expertise, monopoly circumstances, patents etc, which are often grouped together as goodwill.

The valuer must determine the asset values. Where there is an efficiently operating market for such assets reference to comparable sales will provide useful information. However, for the majority of the asset values this will not be the case. What is required is a means of calculating the asset values, in the" going concern", so that they show a rate of return commensurate with their risk characteristic. The fundamental principle is that there are no free lunches and the assets shall earn a normal rate of return in the long-term.

In the context of capital asset pricing model (CAPM), now widely used in the New Zealand public sector for setting capital charges on Government Departments by Treasury and calculating the cost of capital for valuation, assets lie on the security market line (SML). In an efficient market assets are valued so that the return they receive is commensurate with their market risk. In Figure 2 (opposite) asset A is shown as lying below the SML in which case its value will fall until the return generated is appropriate for the asset's risk level.

Where the asset markets are less competitive and the assets are more specialised the lack of recent sales transactions cause a problem. This is where dangers develop with reliance on engineering construction costs adjusted arbitrarily to compensate for assumed depreciation throwing up ludicrous answers. The risk considerations must be addressed to cal-

Figure 1

Five Phases of Business
Performance Improvement

Organising for improvement

4

Understanding the process

Streamlining

Figure 2

Expected
Return

Security
Market Line

Risk Free
Rate

0

Market Rate

culate the value which equates with the required rate of return.

Adoption of this modem portfolio approach allows for performance assessment using performance indices. Various measures such as those developed by Sharpe, Treynor and Jensen can be used to assess the performance of the assets within the going concern construct of the organisation.

Valuation Process

The process may be thought of as consisting of three issues. First, what are the assets? Second, for what are the assets to be used? Third, what are the assets worth in this context. In Figure 3 a flow chart presentation of the process of determining value is presented. Specifically it involves each of the three stages.

Asset Register

While having an asset register may seem fundamentally obvious it is seldom the case. With the CRI valuations conducted subsequentially to the initial process, which it is appreciated was rushed and subject to a budget constraint, major omissions have been detected on some asset registers. Crown Health Enterprises are likely to be in the same position as the asset registers are not being subject to a comprehensive update.

We are working closely with several CHEs and have completely re-done the asset registers. This exercise has taken several months of work and means that the CHE is holding far superior records to those which the Crown is basing its broadbrush valuations upon.

Strategic Property Plan

A strategic asset plan is necessary for all organisations. This must flow from the strategic plan of the organisation as it strives to pursue its mission and objectives. From the organisation's strategic and operational plan with the asset register a strategic asset plan can be developed. In particular the property component of this plan is likely to be of considerable value.

Classification

Classification of assets is important. Consideration must be given to whether the assets are core, ie inextricably linked to the primary activity of the organisation, or surplus. The latter need to be repositioned. Our experience in this area indicates that it is not purely a matter of disposal but rather working through a number of repositioning scenarios. In Figure 4 (over page) an approach to this form of analysis is shown. In practice of course it is a little more difficult and must be linked with management's strategic and operational planning.

Investment assets, current assets, core assets, surplus assets, specialised assets and non specialised assets are some of the likely categories. Failure to encode the appropriate classification flags on the register means that the valuation process will not distinguish between "going concern" and "alternative use" valuations

When the assets are known and

Figure 3

Flow Chart for Determining Valuation Methodology

Asset Registers
I
Strategic Property Plan

Property held as investment

I

Property being developed

Property held for development in future

f

Property held for disposal

Property occup primarily by the company

GN3 value to market value highest and best use

Property surplus to requirements

Property held for development and occupation by the company in future

Property being developed for occupation by thecompany

I

SSAP 17 Accounting for investment properties and properties intended for sale

SSAP 28 Accounting for fixed assets

GN3 value to market value-existing use or in the case of specialised properties where a market value cannot be assessed adopt depreciated replacement cost

MV Market VAlue
EU -Existing Use
P&M-Plant & Machinery
DRC-Depreciated replacement cost
NRV-Net realisable value
DCF-Discounted cash flow
MEA-Modern equivalent asset

Specialised

Value buildings basis of MV EU

Value buildings at DRC and land at MV EU

Value P & M at DRC

Value surplus P&M to NRV

Value P&M all DRC

Assess DCF value all assets

Adopt the DCF value and allocate to fixed assets

s the DCF value 5 DRC of the MEA2

Allocate DCF value to intangible and tangible assets, otherwise adopt DRC

Value is never less than NRV

the intended use of the assets is known the valuation process can proceed. Of particular importance is adherence to the asset valuation requirements of the Institute and conforming with the standards of the Society of Accountants.

By working through the methodology we do not end up with some of the ridiculous figures which were assigned in some of the Crown restructuring. In particular depreciated replacement cost must be subject to "continuing profitability". The number of occasions which valuers go through the technical process of calculating DRC and report it along side an income based valuation with a discrepancy between the two of sometimes more than 100% is frightening. Some recent public sector valuations we have seen do exactly this.

Recent work with several port authorities has shown the importance of understanding the business. Several valuers had been requested to value the harbour facilities including land, buildings and plant and machinery. The degree of divergence in the figures was as they say on the Saturday morning Yahoo show - truly amazing.

Our approach was to undertake a comprehensive business valuation appreciating the current and future market forces. Land and buildings and plant and machinery were valued in the context of the going concern. It was readily obvious that this was a competitive business and that technology had changed over the last quarter of a century. Straight depreciated replacement cost valuations did not make sense in this context.

Understanding the nature of the service provided allowed for the use of optimal deprival value methodology with the sum of the component assets earning a normal return, given the market risk of the sea transport industry, coming very close to the value of the discounted free cash flows.

The Asset Repositioning Process

7 Site capacity Analysis

- Site Capacity
- Resource Mangement/Zoning constraints
- Site Utility Infrastructure
- Deferred Maintenance

2 Local Market Support

- Demographics & Employment
- Comparables/ Competition
- Market Voids
- Lease-Up/ Absorption

DCurrent Property Operations

- Building structure & Systems
- Current Revenues
- Operating costs/ Constraints
- CAM Performance Review

4 Alternative Concept Scenarios

- Image/Theme & Concept
- Mixed-Use Synergy
- Targeted User Preferences
- Configuration charges

- Building Systems Impact
- CAM/Operating Costs
- Building Act Constraints
- Construction Unit Costs

- Revenue Projections
- Absorption/ Vacancy Factors
- Capitalisation
- Discount Rates
- CAM/Operating Costs

8 Management Decision Matrix

- Master Schedule & Planning
- Tenant Retention Programme
- Site & Architectural Improvements

- Investment Objectives
- Outside Joint Venture Options
- Capital Cost Requirements
- Target Tenant Preference

Implementation Schedule

- Marketing/ Strategy/PR
- Pre-leasing or Sale Targets
- Approvals
- Financing Benchmarks

Careful modelling using computer simulated greenfield alternatives allows for a reconciliation of the assets and the business valuation. This trend will increase. The recent report by the Task Force into Capital Charging for the Tertiary Education Sector recommends that the valuation of assets be based on an optimisation methodology. They discuss the spectrum of optimisation from status quo through to new greenfield campus developments.

Summary

The valuation of business assets except in a very efficient competitive market cannot be undertaken in isolation from the strategic and operational decision making of management. Their decisions impact directly upon the value of assets as "going concern" through not only the "continuing profitability" but also through the asset classification.

It is no longer sufficient to be all wise and provide a professional opinion which may be totally incompatible with the organisations strategy and thus not in keeping with the necessary classification categories which in turn relate to both NZSA and NZIV standards.

It is perhaps a sad commentary on our times that the greater number of queries received from clients concern the hold or sell debate rather than whether they should buy.

They are making these decisions in a valuation void and we are not doing enough to construct the framework in which positive investment decisions can be made. Of course, holding an asset is in effect a continuing investment decision but this is making a virtue out of a necessity. There may be signs of hope with at least a few willing buyers appearing over the last 12 to 18 months.

The very real difficulty we face is that if management is uncertain where the organisation is or should be going, then how can valuers or accountants be expected to divine that hidden path? To obtain the Economic Value we need to know:

- the market structure in which the asset operates;
- the organisation's pricing strategy;
- the organisation's cost structures; and
- the organisation's financial structure.

It is absolutely essential to understand the source of value for the organisation for value added in management or sale. How can we value if we don't know what value is?

City Utility Valuations

by A Thomson

The theme of this conference is "The impact of cashflow on value". However for quasi monopoly-type infrastructural assets such as city utilities the theme could perhaps be better expressed as "The impact of value on cashflow" because for this type of asset there is a circularity between cashflow and value.

Alistair Thomson is D. treeror of Valuations at Beca Carter HHollings & Ferner Ltd in Auckland. He holds . Bachelor of Engiveering degree from Canterbury University and a Master of Applied Science from Melbourne University in Australia. He is registered as an engineer in New Zealand and chartered as an engineer in England.

Alistair, homson has been employed with Beca Carter Hollings & Ferrier Ltd since 1984 and has been a director since 1986.

The cost of replicating infrastructural assets is such that suppliers (city & district councils) retain significant discretion in setting prices without reference to "a market" and customers (ratepayers & residents) really have little alternative but to pay the asking price eg, charges for water supplies.

The 1989 amendment to the Local Government Act required local government to follow "Generally Accepted Accounting Principles" (GAAP), which effectively meant adopting accrual accounting in place of the old cash accounting techniques. The old system mixed capital and operating transactions, making it impossible to differentiate them in the accounts.

Under accrual accounting capital expenditure (capex) is treated separately from operating expenditure (opex) and depreciation is charged as a cost, thus enabling better management of both assets and expenditures.

The move to accrual accounting has resulted in significant effort to identify and value local government balance sheet items and this in turn has resulted in the need for local government, accountants and valuers to arrive at appropriate valuation techniques for local government assets.

This paper backgrounds the peculiar features of local government infrastructural assets and the difficulties in applying traditional valuation techniques to them. It then shows how the Optimised Depreciated Replacement Cost and Optimised Deprival Value methodologies deal with such assets and addresses the limitations of traditional techniques.

What are City Utilities?

City utilities are infrastructural assets, that is physical assets that form a network for delivery of goods and services. Such assets are not expected to have any alternative use and are expected to need to be maintained indefinitely. Examples are roads, bridges & water reticulation systems.

Why Value City Utilities?

The "Local Government Amendment Act (No 21 1989" called for local bodies to work to Generally Accepted Accounting Principles (GAAP) which in turn resulted in a move to accrual accounting with its requirement that assets and liabilities be itemised and accounted for.

Coupled with this move has been the recent reform of local government and increasing moves in the public sector as a whole towards corporatisation/privatisation.

Reasons to value city utilities therefore include:

- Meeting the needs of accrual accounting
- Providing a consistent basis for possible mergers and acquisitions
- Providing input to the pricing of services and the setting of council rates
- Ensuring that depreciation allowances adequately reflect asset consumption

Valuation Methodologies for City Utilities

The three traditional approaches to determining value are based on:

- Comparable sales of similar facilities
- Net income or earnings
- Asset costs

1. Comparable Sales

City utilities are rarely traded in New Zealand so there is little market evidence on which to base values. Even if evidence were available, New Zealand's small size makes it unlikely that the prices recorded could be compared sensibly due to differences in size (economy of scale) and geography (building roads and laying sewers in Wellington costs more than it does in Christchurch on a per kilometre basis).

This approach therefore has little scope for application in New Zealand at present, although it is becoming increasingly applicable overseas due to the worldwide push towards corporatisation and privatisation in the public sector.

2. Earnings-based Methodologies

Typical cash-flow based valuation methodologies include:

- Discounted cash flow
- Capitalization of future earnings
- Dividend yield

Earnings-based methods derive from the fundamental principle that the value of a business can be represented by the future cash flows of the business, discounted to present value at a rate which reflects the risk inherent in those cash flows.

These methodologies are appropriate for businesses in contestable markets where external forces determine prices. However they are not necessarily appropriate for monopolistic businesses such as city utilities where the cost of duplicating services is such that prices can be set without regard to "a market" and users have little choice but to pay the asking prices.

Furthermore, local bodies earn the

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majority of their revenue through the power to levy rates rather than through trading, making it difficult to establish a direct link between revenues (earnings) and costs (expenditures) for individual activities/utilities.

3 Asset-based Methodologies

Asset-based valuation approaches include:

- Historic cost
- Net Realisable Value (NRV)
- Depreciated replacement cost (DRC)
- Optimised depreciated replacement cost (ODRC)

A. Historic Cost

Historic Cost has three disadvantages as a valuation methodology for public sector assets:

i) Infrastructure assets tend to be old eg up to 100 years and few cost records exist. For assets over about 20 years of age historic costs are largely irrelevant for current asset management and financial reporting. Comparisons should not be made between the costs of pumping stations built in the 1950s and those built in 1990s without making due allowance for 40 year's worth of inflation.

ii) Prior to the introduction of accrual accounting in the public sector many items were expensed in the year of purchase and no record kept of cost. This means that capital cost records prior to this period are often incomplete particularly where local bodies have amalgamated as part of the local government reform process.

iii) The materials and technology on which historic costs are based may have been superseded eg, cast iron for water mains and gas mains.

Notwithstanding the above, it should be noted that accountants like to use historic cost because it is "real" and the Audit Office likes to use it as a check on public sector asset transfers.

Historic Costs can if necessary be estimated by depreciating estimates of current replacement cost back to original purchase dates. This technique was applied for the CRI plant & equipment valuation, for example, so as to provide an estimate of original cost for reconciling with parent department asset registers eg, the DSIR.

B. Net Realisable Value (NRV)

Net Realisable Value is an estimate of the disposal value net of disposal costs and as such is market-based rather then cost-based.

For specialised assets such as city utilities NRVs tend to be low unless the assets are taken over/sold as a going concern. Nevertheless NRV is a useful valuation concept as it forms the lower bound value for applications of the Deprival Value Approach and provides a measure of the break up or disposal value of a business.

C. Depreciated Replacement Cost (DRC)

The "Guidelines for Good Accounting Practice in Local Government" produced by the Society ofLocalGovernmentManagers (SOLGM) advocate use of Depreciated Replacement Cost for local body assets because:

- Few local bodies could identify actual historic cost
- Age distorts current values

Assessment of Depreciated Replacement Cost involves calculating the cost of replacing existing assets with substantially identical assets and then deducting an allowance for depreciation to reflect the remaining life. It suffers from the following disadvantages:

- Technological change may allow replacement with lower cost assets
- Redundant assets are included at full value
- Over designed assets are included at full value

Notwithstanding these disadvantages, DRC is an oft used technique for valuing specialised properties (such as infrastructural assets) which are infrequently traded and for which there is a limited market in terms of their current use.

D. Optimised Depreciated Replacement Cost (ODRC)

A limitation of the basic Depreciated Replacement Cost approach is that it assumes replacement with assets substantially identical to those existing. The process of "Optimisation" is an enhancement of the traditional like-with-like replacement approach that arrives at replacement costs using "modem equivalent assets" performing the same function as the existing assets. It results in an estimate of the lowest possible cost of replicating existing services using modem materials and modem technologies in the most efficient asset configuration.

Using this approach account can be taken of technological and functional obsolescence. For example, replacement of cast iron gas mains with polythene.

Its use also means that current asset owners/managers/users need not be saddled with the consequences of historic decisions made by previous owners/managers. For example, over optimistic predictions of population growthand demand may have resulted in over investment in certain city utilities (eg water mains) with the result that there is now considerable under utilised capacity in the system. Optimisation allows the system value to be based on an asset configuration that meets but does not unduly exceed current needs.

To apply this approach the valuer needs to determine just what form functional replacement of the assets would take. It is in this area that valuers associated with city utility users and designers (typically consulting engineers) have an advantage. The technique has been applied to natural gas utilities, electricity supply authorities and to major industries. Optimised Depreciated Replacement Cost is presently seen as the most satisfactory of the purely cost-based valuation approaches for valuing specialised/public sector assets, particularly those for which there is little earning potential eg roads.

Deprival Value Valuation Methodology

Because city and district councils typically dictate the charges made for utility services such as water supply without threat of competition, there is some circularity between earnings and value (the higher the charges the greater the revenue and in theory the higher the Discounted Cash Flow value).

For infrastruc tural assets with earnings potential eg water supplies the "Deprival Value" concept addresses this limitation by setting asset values at:

- No greater than Depreciated Replacement Cost (DRC), if DCF > DRC
- No less than Net Realisable Value (NRV), if DCF < NRV
- Discounted Cash Flow (DCF) value, if NRV < DCF < DRC

In order to overcome the limitations of the pure DRC approach referred to previously, Optimised Depreciated Replacement Costs (ODRC)can be used, in which case the deprival value technique is known as Optimised Deprival Value (ODV).

Deprival Value Rules provide a mechanism to arrive at "market values" for assets which are highly specialised, infrequently traded or which display monopoly characteristics. However the technique is not applicable for non-earning assets such as roads.

To Depreciate or Not Depreciate Infrastructure Assets?

Depreciation is the amortising of the cost of a fixed asset over its useful life.

Proper provision for depreciation recognises the use of assets as a finite resource whereas previously the value of assets utilised by the public sector tended to be ignored until replacement was needed.

It has been suggested that many infrastructural assets have no determinable life because with proper maintenance they should last almost indefinitely and that no depreciation should be charged because the cost of using such assets is covered by the cost of the maintenance.

Two aspects that tend to counter this view are:

1. For various reasons full and proper maintenance is not always carried out, resulting in decidedly finite and often reduced useful lives for the affected assets. If the surface of a road is not kept sealed, water ingress and pot holing soon lead to degradation of the road subgrade and shortened pavement life.
2. Capital improvements are often incorrectly charged as maintenanceeg, when a road is not just resurfaced but is dug up and realigned/relaid. This type of improvement (betterment) in some cases goes so far as to amount to full replacement and certainly adds to the value of the asset. (An analogy is the "replacement" of an axe under a "maintenance" budgetby first fitting a new head and then fitting a new handle).

Nature of Asset and Effect on Valuation Methodologies

AttheNZ Society of Accountant's (NZSA) Public Sector Convention in November 1992 the keynote speaker saw as a fundamental issue the question of whether or not the "public good" characteristic of infrastructure assets should have any bearing on valuation methodologies. The concept of "public good" (as distinct from a "private good)" arises where the use of an asset and the benefit from the asset are not restricted to the organisation owning and administering it.

The speaker believed that the public good aspect makes infrastructural assets quite different in nature from those on which accountants and valuers have traditionally focused their attention and standards. However it is doubtful that the public good aspect has a meaningful effect on asset value, provided it is accepted that by value we mean what an asset is worth to the community.

In the final analysis it is the community that owns and uses infrastructural assets - local government is just the mechanism whereby the community organises the provision and maintenance of these assets.

Examples of Infrastructural Asset Valuations

1 Manukau City

Infrastructural assets equate 68% of the total assets of Manukau City. These assets were included in the City's accounts because the City has an obligation to maintain them andprotectthepublic investment in them.

The assets were valued at Depreciated Replacement Cost after establishing remaining lives, except for roading where land was valued at the price of undeveloped land.

The "opportunity cost" concept of arriving at a suitable return on capital was used except for infrastructure assets where Manukau argue that there is no opportunity cost because the assets cannot be sold.

2 Waitakere City

Infrastructure assets are defined as the fixed utility systems Waitakere City provides and maintains as services to the community.

Land was valued at the Government Value (GV) average in the area. Other infrastructural assets were valued at a percentage of replacement cost eg, 67% for sewers.

Only bridges were depreciated (100 year straight line). The rest of Waitakere's infrastructural assets were not depreciated but treated as maintained in perpetuity.

3 Wellington City

Wellington's infrastructural assets were valued at 50% of replacement cost, the write down being to reflect the steady-state used condition of the assets.

• Total Assets = $1,700 million of which
• Fixed assets = $1,030 million of which • Infrastructure = $735 million
Theinfraswctureassetvaluewasmadeupof • Roading base = S 140 million
• Other wading = $115 million
• Water reticulation = $190 million
• Drainage = $290 million

Case Study: ARC Water Supply Valuation

1 Background

The Auckland Regional Council (ARC) supplies water to metropolitan Auckland. Assets include dams, reservoirs, headworks, filter stations, transmission mains, feeder mains, pumping stations.

In 1988 terms, Historic Cost was estimated at $170 million and Replacement Cost at $1000 million, the wide difference being indicative of the age of the assets.

2 Asset Management

At the time of the valuation the ARC's records for the system were fragmented, making for difficult asset management so a requirement of the valuation exercise was that it create and incorporate a new asset management information system.

3 Objective of Valuation

The objective of the valuation was to identify, list and value ARC bulk water assets in such a way as to provide a data base for a computerised asset management accounting system. Each asset was to be valued in terms of historic cost and current replacement cost.

In order of priority the objectives were:

1st priority:
- Improve asset management
- Allocate responsibilities for specific assets
- Calculate bulk water price based on current asset value
- Set aside appropriate funds for replacement

2nd priority:
- Insurance
- Tax depreciation

4 Scope of Valuation

a. Produce a fixed asset register (FAR) of fixed assets over $2,000 replacement cost
b. Calculate historic costs by working back from current replacement costs without recourse to historic cost records
c. Provide opening book values for tax and corporate purposes.

5 Asset Details

The fixed asset register provided:

- Asset number
- Asset description
- Quantity
- Acquisition date
- Remaining life
- Historic cost
- Tax depreciation rates
- Book value
- Insurance indemnity value
- Replacement cost estimate
- Cost centre
- Material
- Asset type code 0

City Utilities:
Public Good vs Sustainable Value
by M Douglas

T his subject of accounting for city utilities is currently taxing the minds of my accountants and causing anguish in the Finance Department.

It may be best to first briefly recap on the development of accounting for assets in the public sector over this last decade. It started with great debate a few years ago, over the concept of community assets.

These were to be major public buildings, parks and reserves, roading, water and drainage systems, etc. The criterion for classification as such was could the asset be divided up? Could the asset be sold off in bits or as a whole? Assets that fell into this category were not to be valued in the books, but instead just listed in the Annual Report.

The concept of community assets got widespread support, to the extent that an exposure draft was published by the New Zealand Society of Accountants (NZSA), a preliminary to becoming a professional standard.

But times change. It is no longer unthinkable that we might sell off the Moana Pool or the water utility. And why should we not value the underground drainage pipes, or our roads?

A subsequent development has been the issuing of Financial Reporting Standards by the NZSA. These take a very different stance. A common financial framework has been devised for reporting for both the public and private sectors. This is how things stand at present, with no professional accounting standards relating specifically to assets in the public sector.

In an attempt to bridge this gap, the Society of Local Government Managers (SOLGM) has issued guidelines. These introduce the concepts of infrastructural, operational and restricted assets.

lax i Chief xecutive Officer of the`..: Council. a position he has held since`'

Infrastructural assets are fixed utility systems including roads and bridges, water and sewerage services and stormwater systems.

Restricted assets are those that cannot be disposed of (usually for legal constraints) and which provide a benefit or service to the community.

In practise, many local authorities are using a further category, heritage assets. Here we place assets important to the community because of their heritage or historical significance. Many of our recreational and cultural assets will fall into these restricted or heritage groups.

This is the background paper to an address presented at the NZIV Seminar held at Dunedin on 19 April 1993

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- Accounts code
- Location
- Manufacturer
- Model number, serial number, registration number
- New/Used
- Country of origin
- Status (in use/surplus/redundant/obsolete)
- Risk of failure (hi/med/lo)
- Consequences of failure

6 Exclusions
- Easements
- Farms & farm improvements
- Forests
- Water
- Consumables
- Patents etc
- Goodwill
- Financial assets
- Intellectual property
- Work in progress

Conclusion

Local bodies moving towards accrual accounting will usually be unable to establish opening book values for infrastructural assets based on historic costbecause the records no longer exist or are no longer of relevance.

In New Zealand there is little market for infrastructural assets so comparable sales evidence does not exist and cannot be used to establish value.

In the absence of a cash flow directly attributable to the assets, earnings-based valuation techniques such as Discounted Cash Flow (DCF) cannot be applied.

A typical solution is to value at Depreciated Replacement Cost (DRC) but this has its limitations in that it envisages "replacement" of the assets in theirpresent form and so does not allow for technological advances, redundant assets or under utilised assets.

Optimised Depreciated Replacement Cost (ODRC) is a more refined approach that overcomes the limitations of the straight DRC approach by basing replacement costs on modem equivalent assets that replicate existing services in the most efficient manner.

For this reason, ODRC is considered the most appropriate of the purely costbased valuation methodologies for infrastructural assets, particularly those with no earning potential such as roads.

For infrastructural assets with earning-potential, such as water supplies, Deprival Value Rules and the Optimised Deprival Value (ODV) approach provide a mechanism to arrive at an appropriate value that takes account of the monopoly nature of such assets. A

But whatever the class of asset, under the SOLGM guidelines, they will still be valued similarly to operational assets.

Before discussing the valuation methods used, I will give some background to the reasons for the accounting changes that we're currently working through. Whilst it was formalised by the Local Government Act of 1989, which followed closely on amalgamation, there was, prior to that, a growing awareness of the shortcomings of our previous practices.

The way it was done, is that when capital money was spent, the cash flow was all recognised in the year that the purchase was made. The expenditure on capital items was not related back to the operating statement.

This is quite different from amanufacturer, say, who looks at his costs as being made up of not only the costs of labour and materials, but must also add in something extra to cover a proportion of the capital equipment cost used up in creating the product. This is done through the depreciation charge.

Following on from this, we should realise that the purpose of collecting the cost information is for setting proper prices. If the manufacturer does not cover capital costs as well as operating costs, the firm will go out of business and it will no longer be able to provide its service. There is no reason why the provision of services by local government is any different.

In the past, Council has been able to see the operating and capital budgets as quite independent. They could focus on the operating budget first and say well, of course we must set the rate to cover these costs. Further, the water and drainage rates were then considered in the context of the general and other rates. Amendments might be made to the renewals and extensions items in water and drainage in the context of considering the overall rates bill to Mr and Mrs Average Ratepayer.

A bit later in the piece, Council would consider the capital budgets, again in the context of all the other capital projects. What can we afford to do this year?

Of course the engineers would be continually giving advice to Council about work needing to be done, and giving them reports about the physical state of the assets. But nowhere in the process did the financial accounting highlight whether the amount being budgeted for renewals was adequate.

Nor did the accounting indicate whether the amount of income from customers and/or rates was adequate to sustain the asset in the long term, in such condition as is necessary to provide adequate service. Using full accrual accounting, valuing and depreciating our assets will change this.

I will not go into great detail about methods of valuation. Suffice to say that we have taken a fairly pragmatic approach in most areas. Where Government valuations exist (for land and buildings) these are accepted with some variations for leaseholders and similar interests. This was done on the grounds of economy, and to take advantage of an existing data base of Council property. Some professional advice was received in the course of this process.

In large part we have tried to assess depreciated replacement value for roads, water and drainage reticulation, etc, and for fixed plant. The major work was done inhouse, but engineering consultants reviewed the valuations.

The art collection is valued at estimated market value. Again a combination of consultants and staff expertise was used in the valuation. When a touring exhibition was recently put together of the Treasures of the Gallery, the 30 or so most valuable items were valued for insurance purposes by Sotheby's. This information was used by staff as a benchmark to assess the rest of the collection.

The choice of method is not related to the classification of the asset, so that whether for instance a building was a pumping station for drainage, or a heritage asset like the Municipal Chambers, it would still be a building. Likewise reserves which are restricted assets are still valued as land at GV.

Whilst we have taken our pragmatic approach to the valuation of core Council assets, on the grounds of cost-benefit to the ratepayer, of course in the event that an activity is transferred to a LATE, then we do use specialist expertise in valuing the new company.

Let me make quite clear however, this is the Dunedin City Council approach. There are councils in the North Island that have brought in professional expertise on a wide scale. Further, a variety of practises are involved. I was curious to note that in the Wellington City Council 1991/92 Annual Report (and under infrastructural assets, too) they note "that zoo animals are estimated at their replacement cost and not depreciated, while monuments are reflected at a nominal value".

We do calculate depreciation for all our operational assets but as yet we don't include this as a cost when calculating the rates requirement, in most core Council areas (that is rates funded areas). In our business units, of course, we account for it just as any commercial operation would, and build it into the charge out rates to other Council departments.

The problem area we are currently grappling with is how to deal with depreciation for our major and infrastructural assets. We are examining the maintenance or renewals method with the possibility of its use in roading. Using this approach, a long term maintenance plan is drawn up and costed. Instead of putting a depreciation expense through the operating statement, the maintenance expense (at the value calculated in the plan) shows there.

At present there is no New Zealand standard relating to the use of renewals accounting, but it is nonetheless in widespread use by local authorities. In the 1991/92 Annual Reports, Auckland and Manukau cities, and Rodney County all applied it to their roading, water and drainage assets, as did Queenstown Lakes and Waikato District. Clutha District used renewals for roading only. This was out of a sample of 11 reports we checked.

The effectof using either conventional depreciation or renewals accounting is that a sufficient expense is shown through the operating statement to indicate the cost of keeping the major systems up to standard.

Of course, this doesn't mean we have to raise and spend this much money. But if we don't, if we keep the rates and customer charges below the level required, and spend less on capital work than required, then it will show as a deficit in the operating statement. This flows through to the reserves or owners equity in the business, and shows in the accounts that the asset is being run down.

And this is really the crunch of this exercise. For many years the engineers have been advising us that we need to spend more in the areas of water and drainage. Analysis shows that the amounts spent in recent years have been insufficient, and that the assets have been running down.

But in local government we are in the business not just of providing basic services. We provide recreational and cultural facilities, look after the needs of various community groups, promote the economic development of the City, making it an attractive place for people to live and visit. We are continually making allocations of the ratepayer dollar between all these competing demands.

And not only is it a question of the ▶

Market Valuation With No Market

Valuing properties with little evidence

by R P Young

n examination of accounting and A valuation journals from many parts of the world leaves one with little doubt that one of the "International Valuation Problems" receiving considerable attention currently and in recent years is the valuation of "Public Sector Assets". Many New Zealand valuers will not dispute the "National Setting" of this problem.

To give my paper and your minds a focus let us consider why and how we would go about valuing the following "Public Sector Assets":

Peter Young is the Chairman of Directors O, Robertson Yatang elfer Ltd and he special ises MOM" ercial ai industrial properej valuation ttt Auckland. ffe is a ello of the NZlnsiiruteofig'aJtter$anda.L1fe. ettfber the Institute'PP Education i oc member of the is Regzstrcxtirn lac for a term exte over a eoutlrtrraus riod of 13 year

1. Albert Park:
A relatively large and attractive area of park land located in the Auckland Central Business District slightly more than 200 metres to the west of the venue for this conference.

2. "Infrastructural" Assets:
The Roads, Foul Water and Stormwater Pipelines and Water Supply Services vested in or "owned" by the Mayor, Counsellors and Citizens of the City of Auckland, and servicing both the private and "public" property which we see surrounding us in Downtown Auckland.

As to why we should contemplate valuing these public sector assets: Such a suggestion would have been greeted with some degree of ridicule a few years ago, but in 1989 our Government passed an amendment to the Local Government Act which specifies that every Local Authority shall prepare in each financial year a report which incorporates, for each significant activity of the Local Authority, the indicative costs including an allowance for depreciation and a returnon capital employed, for the financial year in which the report is adopted and (in general terms) for each of the following two financial years. This legislation also requires the Local Authority to adopt financial systems and reporting that are consistent with generally accepted accounting practices recognised by the New Zealand accounting profession. These systems and procedures shall identify the costs, revenues and financial performance of various activities of the local authority and of each of its significant activities including, for each significant activity, a separate allowance for depreciation and provision for a return on the capital involved.

Accordingly, in order to comply with this legislation, the Auckland City Council Parks and Reserves Department must ascertain the costs involved in providing Albert Park (and that of every other similar utility in the entire City) to the citizens of Auckland including an allowance for depreciation and a provision for a return on the capital involved.

Most local authorities in New Zealand have decided that compliance with this requirement means that Albert Park (and similar facilities) must be "valued" each year so that depreciation (on depreciable components) can be calculated and so that a provision can be made for "a return on the capital involved".

This legislation has come into force over the past five years as part of ageneral clamour for "accountability" in the public sector, ie within central government de-

This is an elaboration of a paper presented at the 5th World Valuation Congress held at Auckland on 1 February 1993

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diversity of the activities that are carried out, but we have to be always mindful of the diversity of our population and their needs and circumstances. There is the business community, the pensioners, the students, the employed, and the growing unemployed.

Moreover, when it comes to the major infrastructural assets we are mindful of our responsibilities not only to the present generation but also the future. Indeed it could be argued that we have a responsibility to past generations with respect to heritage assets. In some cases, heritage assets are a significant liability and should be calculated accordingly. One of the central effects of the valuation regime has been to focus the business on what is `cone' and what is commercial or other in the provision of goods and services.

Dunedin City has attempted to extract the commercially competitive components and provide those goods and services through company structures. Such structures value assets in appropriate commercial ways. Currently work is underway to view water, drainage and property assets in the same way with the possibility that they are handled in a similarly competitive environment.

The balance of what are `public goods' would be therefore much more limited than at present. One thing that always has to be recalled is that the customers of local government are also citizens. Irrespective of the arcane machinations of accountants and valuers, the ownership of the local authority is still the locals, and every politician knows this.

Thus we can go so far, but at the end of the day, local authorities are about services to people, who will determine the use, functionality and expense of service. We should not always expect that view to be rational. A partments, agencies and enterprises plus local government authorities, public utility boards and the like. It has apparently been decided that if the accounting procedures for the public sector follow the accounting procedures used in the private sector then there will be better "accountability" and more efficient management. Any inefficiencies in "significant activities" undertaken by local government will be more easily identifiable and therefore more easily rectified. The use of "assets" will be more efficient if they are valued and if the costs associated with these assets is accounted for in the annual accounts for the Local Authority concerned.

Several questions arise out of this rather dramatic change in philosophy and these questions have been the subject of considerable debate in recent years, particularly in the accountancy discipline. The questions may be simply summarised as follows:

Is the quite understandable demand for more efficiency in local and central Government ultimately going to be met by imposing upon these organisations the accounting systems used for many years in the private sector? If so does this necessitate the valuation of all assets or utilities involved"? If not, what system of accounting is appropriate and what treatment of assets is involved"?

> By any commonly accepted definition of "value" do these assets have a value ...?

Is Albert Park (and the roads, sewers and water reticulation generally described as "infrastructural assets") really an "asset" or is it not in fact a liability from the point of the view of the Auckland City Council, which earns no driect income, but indeed expends considerable rate payers money in its annual maintenance? Alternatively are not these utilities more appropriately classifiable as "outputs" in their own right and in the context of "inputs", "outputs" and "outcomes".

By any commonly accepted definition of "value" do these assets have a value in any event? Alternatively, what is the "capital involved" in providing these significant activities (Local Government Act)?

In other words, are the accountants, economists, treasury officials and politicians asking the right questions or passing appropriate legislation in their understandable requirement for better accountability and efficiency in the public sector? Personally, I do not think that they are and there are obviously others who share this view.

The nature of common property

If confronted with an instruction to value Albert Park or the "Infrastructural" assets in the Auckland City (comprising public roads, bridges, sewer and storm water pipes), I suspect that most valuers would instinctively and fairly quickly experience some uneasiness and apprehension. Most would question the logic and philosophy behind the request; the possible meaninglessness of the "valuation" figures which may be arrived at; and the methods which might be adopted in arriving at the valuation.

Many of us would not, without a good deal of thought and research, be able to clearly articulate the reasons for our apprehension, but that would not lessen its existence. Indeed, it would probably only add to our confusion.

Some of the reasons for our suspicions in this regard are examined and explained in a very interesting paper written by Dr June Pallot (Victoria University of Wellington, New Zealand) entitled: *Elements of a Theoretical Framework for Public SectorAccounting* appearing in the (Australian) Accounting, Auditing and Accountability Journal Volume 5 No. 11992.

In this paper Dr Pallot examines the upsurge of interest in public sector accounting and attempts to develop its theoretical framework.

Of particular interest to valuers, she examines a concept of community assets (used to describe Government-Managed assets of an infrastructural, cultural or environmental nature).

The recent upsurge of interest in public sector accounting has, I suspect, developed out of the "more market" emphasis which now permeates much economic and political theory and practice. It is designed to produce greater efficiency and accountability in the public sector. There appears to be a strong body of thought which supports the view that if public sector organisations (and the assets they use) are treated from an accounting and managerial point of view in the same way as are successful private enterprise organisations, then the aims of greater efficiency and accountability will almost automatically result.

Dr Pallot makes the point that "concern with accountability and constitutional constraints on executive power stems from a view that accounting is a social, not merely a technical, activity ." I suggest that the same can be said for the process of valuing the assets involved. Given that assets are arguably the most basic concept in accounting generally, that the sale of Government assets under "privatisation" has brought assets to the forefront of public policy discussion, that there has been considerable debate over depreciation and the maintenance of infrastructure capital; Pallot makes a plea for a clearer understanding of what is being talked about. This plea strikes a very sympathetic note in the mind of the valuer instructed to value AlbertPark or infrastructural assets.

When dealing with the asset commonly called "real estate" the valuer is familiar with the "bundle of rights" theory. This is noted in several New Zealand and overseas text books dealing with valuation theory and practice, including the NZIV published Mahoney's Land Valuation Economics recently updated by W K S Christiansen. The theory holds that ownership of real property has value because the real estate market deals in rights which arise from that ownership. In the case of property owned by private individuals or by nonGovernment organisations, these rights include the right to sell; to grant a lease or other partial interests to another party; the right to build new buildings or demolish existing ones; the right to grant access to certain persons and to deny access to others; the right to use the property in any way permitted under the law; and finally the right to refuse to exercise any of these rights.

When dealing with private property, these rights mean that the real estate is an economic resource capable of generating positive cash flows. However, in the hands of many central or local Government organisations (the non-profit sector) real estate may, to that specific owner, be more of a liability in that its ownership inevitably involves that organisation in incurring a negative cash flow. Pallot points out that "depending on what end is envisaged, assets may have different forms of value; for example, value in use/production or value in exchange, or, in the case of assets of an environment or cultural nature, a non-financial value."

Getting back to the valuer instructed to value Albert Park, that person is confronted with a large and attractive piece of land in a highly desirable location, but the bundle of rights owned by the Mayor, councillors and citizens of the city of Auckland is highly restricted. The city administrators and politicians would be faced with an insurmountable level of opposition if they attempted to sell all or part of the land; to deny access to the public; to lease all or part of the site; to build new buildings on it or to demolish existing buildings. All the owner can do with this piece of real estate is to maintain it as an attractive central city park at some cost to the Auckland city ratepayers.

Consideration of these issues should lead those concerned with the efficient and accountable use of Albert Park beyond the question confronting our valuer - how do I value Albert Park? Assuming that the valuer can answer that question with any degree of confidence (in my view highly doubtful), the real questions are why do we value Albert Park? What does the figure ultimately mean or represent in the real world? And even if the figure is deemed to be accurate, how does it help in the more efficient and accountable use of that particular public facility.

96... the requirement to value such parks, reserves, scenic attractions, cultural facilities and roads, bridges, sewage systems etc is ultimately a pointless and rather an expensive exercise."

I cannot escape the conclusion that the requirement to value such parks, reserves, scenic attractions, cultural facilities and roads, bridges, sewage systems etc is ultimately a pointless and rather an expensive exercise. Yet many of our local and central Government organisations have commissioned valuations of such facilities. A review of the use to which these valuation figures have been put in some instances is commented on later in this paper.

In recent years many articles and papers have been written on the subject of public sector assets and accounting. Most of them appear to proceed on the basis that such accounting and treatment of assets should or must follow the treatment applied in the private or commercial sector where assets are owned specifically as economic resources with a view to assisting with the generation of positive cash lfow. Few of these articles consider the very severe constraints placed upon the owners of public sector assets with regard to their use, rights of disposal and other elements of the bundle of rights which are enjoyed.

Pallot is one of the few writers who draws our attention to the "several ways in which certain public sector assets, Qua resources, differ from the fixed assets ordinarily encountered in commercial accounting. For example, they may have no readily determinable economic life as they are part of our heritage to be preserved or essential services which have tobecontinuously maintained, they may contribute to cash outflows rather than cash inflows (Mautz, 1981), they are utilised by the public rather than by the entity itself, and their worth may not be able to be measured in monetary terms (exchange value)."

To proceed on the basis that all central and local Government controlled assets (including real estate) are held or owned in precisely the same way as are the assets of private persons or non-Government commercial organisations, is, I believe, not correct. Such an approach will, in many instances, lead to the production of meaningless figures which confuse rather than assist in the achievement of an efficient and accountable public sector.

The fact that Albert Park and other parks, reserves, roads, bridges etc, cannot have ascribed to them a value in monetary terms does not of course reduce the "value" of these facilities to society at large or to the private enterprise business community. Indeed, provided the tax payers money is properly spent and within the obvious limitations of reasonableness and logic, the more that is spent on recreational, cultural, environmental and infrastructural assets; the greater will be the benefit to the private and commercial sectors of the economy.

There seems to be a strong feeling abroad (e.g. among Treasury officials and some accountants) that it is essential to have regular "valuations" of all public assets in order to measure and control the efficiency of the puhlic sector. This I believe arises from a misconception about the nature of valuation. There is nothing mystical or magic about the valuation process and even it it were possible to "value" properties like Albert Park the valuation figures in themselves are not capable of answering questions or solving problems in the areas of efficiency and management. I believe that it is misleading of the valuation profession to suggest or imply that the valuation of public sector assets is going to contribute anything of meaning in all situations, and it is naive of accountants, economist, politicians and treasury officials to believe that it will.

A different situation obviously applied when the New Zealand Government privatised and sold its Telecommunications facility. That was clearly a commercial entity very capable of producing a positive cash lfow and attracting equity capital. The value of the enterprise was however not calculated by valuing all its individual land holdings, vehicles etc and adding them up. Its value must surely have been determined on the basis of its existing and potential netprofits. In the same way, the sale by Goodman Fielder Wattie of its New Zealand operations to the Heinz Group would have been at a price arrived at on the basis of future net income rather than by adding up the value of individual asset items.

Albert Park has been in use as a public recreational area for well over 100 years and its original cost to the citizens of Auckland is of historical significance only. It is interesting however to draw a comparison with therecentpurchaseby the North Shore City Council of an attractive block of land containing 1.5353 hectares which abuts Takapuna beach on its eastern boundary and the main North Shore commercial/administrative district on its western boundary.

"...it is misleading of the valuation profession to imply that the valuation of public sector assets is going to contribute anything of meaning in all situations"

Within the past 12 months this block of commercially zoned land has been purchased by the North Shore City Council for public reserve purposes at a cost of $9.4 million. When developed as a public domain this block will be at least as desirable and attractive to the people who live, work or play on the northern side of the Waitemata Harbour, as Albert Park is to that community on the southern side of the Harbour. Land values are roughly equivalent and one could therefore say that Albert Park, with an area of 6.4458 hectares, has a "value" of around $40,000,000 based on the price paid for the Takapuna beach front site.

While this may represent the price which the Auckland City may have had to expend to create Albert Park from scratch in 1992/93 dollar terms; can that be said to be the value of Albert Park (in monetary terms) now that its function is irreversibly devoted to public use?

The land purchased by the North Shore City was previously in private ownership - zoned for commercial use and in the normal course of events would ultimately have been developed for some type of commercial function. The owners would have retained the bundle of rights generally associated with privately owned commercial land. Once this block has been developed as public open or recreation space the bundle of rights owned by the North Shore City Council will almost disappear in terms of the ability of that bundle of rights to produce a positive long term cash flow. Once the citizens of that part of the Auckland Metropolitan area become accustomed to its attractiveness and use as public open space, it will be impossible for the City Council to sell it or to use it for any commercial function which interferes with the rights of the general public. Adopting any definition of value (see below) the property will cease to have a value which can be expressed in financial terms.

The North Shore City Council has made what most would consider to be an extremely wise decision to devote community funds for the establishment of what will undoubtedly be a very attractive community facility adjoining both Takapuna Beach and the Takapuna Commercial Centre. The general environment will benefit considerably and the value of property in close proximity to this new facility will undoubtedly increase as a result of its existence. The value of this new park land will therefore to some extent be reflected in the value of properties benefitting from its creation. Similarly, properties in Auckland City which are in close proximity to Albert Park undoubtedly attract a higher value because of that location. Other infrastructural assets such as road and sewers have asimilar"reflected value" but it is difficult to conceive of an intrinsic value because these assets cannot be sold, do not produce a direct positive cash flow and indeed are expensive to maintain.

Practical application of the Local Government Act

As is noted above, the 1989 amendment to the Local Government Act requires that every significant activity of a local body shall be the subject of accounting and reporting practices which provide "a separate allowance for depreciation and provision for a return on the capital involved".

An examination of the annual report for the North Shore City Council for the year ended 30 June 1992 reveals that:

"Infrastructural assets" comprising roads, bridges, sanitary sewage systems, water supply and stormwater system were valued by independent consultants as at 30 June 1992 on the basis of a "replacement value" of $809,841,000. The consultants noted "the valuation of land in connection with the services is specifically excluded from this valuation." This figure is obviously depreciated, to produce a current "value" of $394,058,000 in the "Statement of Financial Position".

Under its report on depreciation policy it is noted "Council has adopted a policy of not charging depreciation on infrastructural assets on the basis that the level of reconstruction expenditure over a period of years will be sufficient to maintain the assets in good working order."

When dealing with "Cost of capital" (referred to as "a return on capital involved" in the Local Government Act) Council notes that cost of capital is a nominal charge to each significant activity and is regarded as an "opportunity cost" of holding fixed assets.

Significantly howevertheNorth Shore City Council notes cost of capital "it is not charged on either infrastructural assets or restricted assets on the basis that such assets are not saleable and there is therefore no lost opportunity costs".

"Restricted assets" include parks, reserves and foreshore which due to zoning restrictions are not for sale. "They are retained for the use and enjoyment of the public."

Of total assets of $633,570,000, $509,313,000 or 80.4% is represented by infrastructural assets and restricted assets. Depreciation is charged on none of this latter amount except the building components in the restricted assets category and "a return on capital involved" is not charged on any of it.

Accordingly, it would appear that the North Shore City Council is not complying with the terms of the Local Government Act, yet the report of the Executive Officer notes: "It is pleasing to report that the Audit Office has given an unqualified opinion on both the financial statements and statement of service performance. It is understood that only a small percentage of Local Authorities have been able to achieve this."

The North Shore City Council is not alone in its treatment of depreciation and "a return on capital involved". In an article by Dr June Pallot in the August 1992 *Accountants Journal* the annual reports of some major New Zealand City Councils is summarised.

Manukau City Council (which controls the southern portion of the Auckland Metropolitan area) has included a valuation of infrastructural assets which makes up 68% of its total assets. It has also included a value for "restricted assets" (mainly land zoned for reserves) and distinguishes these assets in view of their restricted saleability.

When dealing with "a return on the capital involved" Manukau City Council applies a nil rate of return to restricted and infrastructural assets arguing that there is unlikely to be an opportunity to trade these assets and therefore there is no opportunity cost.

Waitakere City (which encompasses the western portion of the Auckland Metropolitan area) makes no provision for depreciation on infrastructural assets and makes a capital charge of zero, apparently on all assets including infrastructural and restricted (parks and reserves) assets.

The Wellington City Council valued infrastructural assets on a depreciated replacement cost basis, as did all of the other City Councils noted above. Interestingly however Wellington valued monuments and Zoo animals at a nominal $1.00. In providing for "a return on the capital involved" Wellington applied 0% as the cost of capital for all significant activities!

Following discussions I have held with senior executives of the Auckland City Council I am left in no doubt that it is their view that the value of infrastructural assets is irrelevant in terms of accounting, management or operational efficiency. Auckland City is planning for maintenance and renewal expenditure designed to provide an efficient service. Accordingly, depreciation and return on capital allowances are both unnecessary and confusing and the cost of the valuation exercise involved is believed to be a waste of rate payers resources. Auckland City executives believe that a valuation approximation obtained at little expense is all that is required for accounting and managerial purposes but that local authorities should be required to make a realistic annual maintenance/replacement provision. In making these comments the executives point out that most of the infrastructural assets are networks (roads and drainage systems) which require continuous maintenance/replacement expenditure over an indefinite life span. Their comments are not intended to apply to a single asset with a finite life, whose asset costs need to be allocated over future periods in order to measure profit.

Auckland City executives agree with those of other Councils noted above in the treatment of "A return on the capital involved". They believe that capital charges should be based on the benefit that could be gained by an alternative use of funds by Council, and be applied only to assets where there is a real operating discretion to sell or reorganise asset portfolios. They believe that efficiency measurement 0 can be accommodated by other, more direct, means.

It is apparent that if there ever was a proper theoretical basis for the requirements of the Local Government Act with regard to depreciation and the provision for a return on capital involved; then it is not proving acceptable in practice, at least with regard to "infrastructural" and "restricted" assets - i.e. roads, footpaths, culverts, bridges, sewage systems, water supply systems and storm water systems plus parks, reserves and foreshores. Perhaps the two main reasons are that the application of financial techniques developed for an open commercial market cannot be applied to all sectors of central or local Government; and because there is a fundamental difference between the bundle of rights endowed by private property used by commercial organisations and that possessed by most public property used by central and local Government organisations.

A further matter which appears to have been overlooked by commentators on the subject of infrastructural and restricted assets is the manner in which these assets originally came to be vested in Local Authorities.

Where land is subdivided to provide residential, commercial or industrial allotments the owner responsible for that development must provide all infrastructural services to a standard required by the Local Authority and on completion of the subdivision to vest the assets in the Local Authority concerned (in the case of roads, footpaths, sewer and stormwater reticulation and water supply.) The cost of providing these services is of course recovered from the sale of the building allotments created and the "value" of these services is of course reflected in the value of the allotments so developed. The owner of the land being developed may also be required to pay for the upgrading of existing services connected to the land being subdivided and used in the subdivision process. Existing roads already vested in the Local Authority may also have to be upgraded at the cost of the subdividing owner.

For the Local Government Act to require, in the Local Authorities accounts, "provision for return on capital of the involved" creates an added confusion. The capital involved in many instances was not provided by the Local Authority or by its rate payers but was provided by the owner subdividing the land and indirectly by whoever purchased the new building allotments so created. This situation has applied for many decades and a large percentage of the infrastructural assets now appearing in the balance sheets of Local Authorities were in fact not provided at a cost to that Local Authority.

A "reserve contribution" is also levied on subdivision of land. In the case of residential land this now stands at 7.5% of the value of the allotments created and in the case of commercial and industrial land at 10% of the value of each allotment created in the subdivision. These figures are maximums permitted under the Local Government Act but are normally levied. Alternatively, the Local Authority may accept land in lieu of the cash contribution.

Accordingly, large portions of the "restricted assets" now vested in Local Authorities was financed from the proceeds of these reserve contributions and the "capital involved" did not come from the Local Authority or its then existing ratepayers. It was paid by the owners of land being subdivided and indirectly by the persons purchasing the new allotments.

The requirements of the Local Government Act with regard to depreciation and a return on capital for these assets is therefore rendered more confusing when one considers the origin of the capital so represented. The confusion is compounded by the fact that the "value" of these assets is in fact represented or reflected in the value of the (mainly private) land holdings serviced by and benefitting from the roads, parks and reserves etc.

It is not surprising that the treatment of infrastructural and restricted assets, required by the Local Government Act, is a controversial issue. The valuation of these assets is, in my opinion, a rather pointless exercise and one which involves the Local Authorities in unnecessary costs. While many large Local Authorities have obtained valuations of these assets, none of those noted above have used them for the purposes stated in the legislation. The valuations do not appear to serve any other useful purpose.

Not surprisingly, valuers have been ready to encourage local and central Government Authorities to undertake regular valuations of all assets. It provides a secure fee base but does the exercise provide a basis for anything else? Infrastructural and restricted assets are almost always valued on the basis of depreciated replacement costs. However it should be noted that the Asset Valuation Standards and Guidance Notes issued by the New Zealand Institute of Valuers provide that "when the depreciated replacement cost basis is used, the valuation amount should be qualified by the valuer as "subject to adequate potential profitability"."This will draw the attention of the management of the undertaking to the fact that the asset should not be included in any financial statement at an amount greater than its recoverable amount. These Standards and Notes define recoverable amount as "the amount that can be recovered from the future use of the asset including its net realisable value on disposal. Recovery amount, where applicable, will normally be assessed by the management of the undertaking."

Valuation of infrastructural and restricted assets on a depreciated replacement cost basis (as is virtually always done) is therefore not strictly in accordance with the NZIV Asset Valuation Standards and Guidance Notes since ownership of these assets does not involve "adequate potential profitability" to the owning authority.

In a NZIV background paper which applies to the valuation of fixed assets for financial statements (Background Paper B revised June 1988) it is noted "there can be properties which do not constitute an asset but are a liability to an undertaking and these are said to have a negative value." Such negative values it is suggested could arise where the costs of meeting statutory or contractual obligations exceed the value of the property assuming compliance with such obligations. The background paper states that such properties should notbe given a"nil" value in the financial statements but a true negative value.

These background papers were written with a view to valuing the assets of non-central/local Government commercial organisations. If accounting procedures for these organisations are to be applied to central/local Government organisations then the same criteria should apply. Infrastructural and restricted assets which produce no positive cash flow and are expensive to maintain should, if this criteria is applied, be ascribed negative values. Such a practice would be just as meaningless as is the current practice of ascribing positive values to these facilities.

In a paper entitled "Valuing Public Sector Assets" presented to the New Zealand Society of Accountants in October 1989 by Kelvin Cooper (New Zealand's Deputy Valuer General) the author notes that the application of the depreciated replacement cost basis of valuation requires the qualification that the final figure is "subject to adequate potential profitability". Mr Cooper also notes that in methods of accounting, the public sector is moving closer to the private sector and that public sector managers and accountants are now involved with the preparation of accounts that will have to incorporate property and other fixed assets in a more commercial way than they have ever had to in the past.

As an example he notes that the Wellington Hospital Board statement of financial position as at 31 March 1989 showed buildings with a book value of $267,000,000. He elaborates that the successor to this Board (The Wellington Health Board) is now confronted with the prospect of closing all or parts of obsolete hospitals which will possibly necessitate a massive write down of millions of dollars in the value of these assets.

Mr Cooper is clearly indicating that the previous figure of $267,000,000 was rather meaningless but this begs the question as to whether any alternative figure will have any more meaning given that the hospitals run by this organisation can never be expected to run at a true profit in the sense that most non-Government commercial organisations can be expected to operate. This further begs the question as to whether central/local Government non-profit organisations need to have all assets revalued on a regular basis in order to assist with efficiency, accountability and proper accounting standards.

The confusion surrounding the valuation of public sector assets, the need for such valuations and the application or usefulness of the figures produced is demonstrated by an examination of a booklet published by the New Zealand Government Audit Office in August 1988 and entitled *Public Sector Accounting Concept. A Guideline to Assist in the Implementation of the New Reporting Standards.*

Extracts dealing with or applying to the valuation of assets are as follows:

1. *"For the great majority of activities conducted in the public sector, achievement cannot be measured in purely dollar terms. While the objectives of a commercial organisation can be assumed and success measured by profit, in a non-commercial organisation any surplus or deficit often tells the public very little."*
2. *"In order for the cost effectiveness of achievements to be assessed, reporting on the full and true cost of activity is necessary."* It should be noted that the booklet does not refer to a return on the capital involved in assessing the cost of an activity. I assume that such a return is envisaged in compiling "the full and true cost".
3. *"For a true cost to be shown all costs must be included. This means applying indirect as well as direct costs. Apportioning of indirect costs (e.g. administrative and operating costs, maintenance expenditures, financial charges, depreciation) will require the use of a cost allocation process."* The ascertaining of these costs will necessitate a value being ascribed to the assets involved.
4. *"In the public sector, resources are often used for purposes other than generating financial returns. The resources available to public sector organisations are therefore not adequately described solely byfinancial value."* "The word "resources" has much wider implications than" assets',.,,
5. *"Resources are reported in physical terms. To be meaningful both the amount of resources available and the value of these resources to the community should be* shown. In *this context, value is the service potential or the use the community can expect to get from the resource. Any value attributed should not be in dollar terms, as this is the purpose of the Statement of Financial Position".* Note that the above comments refer to resources as listed in a "Statement of Resources".
6. "A *Statement of Financial Position discloses all of the assets and liabilities of the organisation, appropriately classified, including contingencies, but excluding community assets."* - This is quoting the New Zealand Society of Accountants statement of Public Sector Accounting Concepts (PSAC).
7. When dealing with community assets:
   "This term is used to define those assets which should not be reflected in the Statement of Financial Position. Consequently, community assets are only reflected in non financial terms".
   PSAC suggests that a community asset can be characterised as being:
   Infrastructural;
   Non-depreciable or maintained;
   Unable to be sold;
   Having no readily determinable market value.

Note the confusion arising from this description. On the one hand the booklet, quoting PSAC, requires the determination of the full and true cost of all services and on the other hand it specifies that certain assets cannot be ascribed a financial value. It is therefore impossible to determine the true cost of providing Albert Park or the roads, sewers and footpaths servicing the Auckland Central Business District!

8. *In considering whether a financial value should be placed upon an asset, the overriding question is "Would a value have meaning?" Or, considered from the other viewpoint "Would placing a value on that asset influence decision making."*
9. *"Value will be relevant when:*
   An asset can have an alternative use, e.g. Land can be used for a park or for a building (a value is necessary to determine if the best use is occurring);
   Sufficientfinancial returns are generated by the asset (a value helps determine the adequacy of the return);
   An asset depletes or wears out over time (a value is necessary to establish the extent of depletion and the resulting charge).
   In practice therefore there are probably relatively few assets for which value is meaningless."

"...if significant financial returns are generated a value will not determine the adequacy of the return."

In my opinion the above series of statements compounds the confusion. In practical terms AlbertPark and most other parks could not be used for a building. Certain recreation land accommodates buildings also used for recreation purpose but it is quite ridiculous to state in those circumstances that "a value is necessary to determine if the best use is occurring".

Furthermore, if significant financial returns are generated a value will not determine the adequacy of the return. The value is a function of the return, the return is not a function of the value. This statement demonstrates very muddled thinking. The quantum of the return is determined by supply and demand forces for the service being offered.

Similarly, the requirement for a valuation in order to determine the "extent of depletion" has been touched on above and is equally erroneous.

In practice, there are a large number of public assets for which value is meaningless and for which value is not readily determinable.

10. The Statement should reflect the 0 *overall financial condition or solvency of your organisation. It should contain: Assets measured in financial terms;"*

When applied to central/local Government organisations this statement is highly questionable. It has often been quoted that, on the occasions when New York City has found itself in an insolvent position, it has never been suggested that Central Park or Fifth Avenue should be sold. The reasons are obvious.

11. *"In all cases, valuations should be relevant and verifiable."*
12. *"The principle assumption is that all assets can and should be valued. In this context, a value represents the discounted future benefits derived from the resource."*
13. *"In cases where the benefits derived from the use of an asset cannot be captured in the form of a fee or charge, the resource has no financial value in that particular use."*

The above statement can be compared with the following one which deals with an allowance for depletion in the value of an asset over time:

14. *"The same principle applies in the case of resources or assets used in a service related activity. Where the future benefits are being depleted, the extent and cost of that depletionshouldbereflected. The costshould, in the case ofthePSAC, be bought to charge in the Statement of Cost of Service and therefore requires a valuation in financial terms. Valuation of the asset in financial terms is therefore necessary."*

I believe we have conflicting statements - one noting that a resource has no financial value where its use cannot be captured in the form of a fee or charge; but that nevertheless the asset must be valued so that the costof the service can ascertained. Reverting to our Albert Park example - it is almost impossible to value the asset with any degree of confidence and thereforenotpossible to determine the cost of the services provided by Albert Park. As is noted above, many Local Authorities have decided not to determine the cost of providing services furnished by the ownership of infrastructural and restricted assets and have apparently come to the conclusion that this does not impact on their efficiency or accountability.

The apparent contradiction is perhaps explained by the following extract:

15. *"Where the resource or asset is not depleted (i.e. the objective is that its service capacity will be fully maintained), all costs will automatically be bought to charge through the direct maintenance and capital works programme. That is, to the extent that a capital works programme is designed to maintain the resource's service capacity, the cost of thatprogramme would equate to the depreciation cost had the work not been performed. In these circumstances a financial value serves no particular purpose and adds nothing to the quality of the report."*

The above statement covers the cost of providing the service insofar as depreciation or depletion is concerned but does not allow for cost insofar as a return on capital or"finance charges" are concerned. It would appear that the guideline does not envisage the cost incorporating a return on capital unless there are borrowings against that particular asset.

Albert Park therefore need not be valued in terms of this guideline, but must be valued in terms of the Local Government Act so that "provision for a return on the capital involved" can be accounted for!

Whether the same can be said for other non revenue producing public assets such as hospitals, schools, universities and the like raises other issues but the conclusions may well be similar.

Government owned and operated schools, hospitals, etc.

The first part of this paper dealt with the needorotherwisetovaluecomponents(utilities or "assets") involved in the provision of essential services, that provision being traditionally undertaken by thepublic sector. These components include roads, bridges, sewage systems, etc. plus parks, reserves, foreshores and the like, provided to maintain or improve the quality of the environment.

It was noted that ownership of these utilities or assets endows the public sector organisation responsible for them with a very limited "bundle of rights" and with significant obligations including (in almost all cases) the certainty of continuous negative cash flows. Using any recognised definition of value or any recognised valuation method, it is impossible to value these "assets". It is possible to arrive at a figure which approximates theirreplacementcosts (less depreciation), but this figure does not represent their value and it is difficult to see how the figure can assist in achieving efficiency, accountability and more effective management. Indeed, those New Zealand City Councils which have commissioned a "valuation" of these assets have made a conscious decision not to use the figures, at least in the manner envisaged in the Local Government Act. It is difficult to see how the figures assist the City Councils in any other respect.

I would now like to turn my attention to the valuation of other public sector assets such as hospitals, schools, universities, Crown research institutes and the like. In New Zealand there has, in recent years, been considerable activityin the"valuation" of these public sector assets.

Again the question must be asked; why are these assets to be valued "What is the ultimate purpose and usefulness of the ifgures produced? How are they to be valued? Can valuation figures be produced in which one has any degree of confidence?

The commonly accepted definitions of value are (briefly): the most probable selling price of the property; the best price at which the property might reasonably be accepted to be sold assuming a willing seller; and the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arms length transaction, after proper marketing, wherein the parties had each acted knowledgably, prudently and without compulsion.

All these definitions assume that the property can be sold and most of them create as many questions as they answer. It is interesting to note that the last quoted definition of market value is thatreported to have been adopted by TIAVSC at its most recent meeting in Canada. It includes for the first time (for that organisation) reference to the willing buyer, a reference which had hitherto been deliberately excluded on the grounds that any proposed or hypothetical transaction setting a selling price necessitated the existence of a willing seller, but that it was not by any means necessary to assume that there is a market for the asset at a particular moment in time either at the asking price or any other price.

To quote Graeme Horsley (President of TIAVSC) in an article he published in the *NewZealandValuersJournal* March 1990: "Indeed it is essential to the concept of market value that the market is an open forum out of which there may or may not come a purchaser. It is a matter of fact not of presumption and the vendor is faced with whatever market (or lack of it) exists for his asset. Accordingly, it is for the valuer to assess the reality of the market place at the time of the valuation when considering his opinion of the level of value he will attribute to the asset concerned. Indeed it is by no means unusual for nil or even negative values to be quite properly arrived at" and further "If an asset contributes nothing or less than nothing to the profits of such a business it is both correct and prudent to consider attributing a nil or negative value."

The inclusion of the willing buyer in the new TIAVSC definition does not, I suggest, alter the approach very much and it is still possible to conceive of an "asset" with a nil or negative value. The interesting point however is that if a utility or asset held by a commercial private enterprise organisation can have a nil or negative value then surely the same situation shouldapply toapublicly owned hospital or university which "contributes nothing or less than nothing to the profits of such a business".

The whole thrust of public sector accounting is to (apparently) apply the "more market" philosophy and this must equally apply to the valuation of its assets.

Turning now to valuation methods (as distinct from definitions) the three accepted methods are:

(a) A value which is based on an analysis of market transactions involving similar properties. This requires an analysis of sale prices and the terms of sales of comparable properties recently sold in the open market.

(b) The present value of estimated future net income. This obviously involved the selection of an appropriate discount rate and the ability to estimate the future net profits with some degree of confidence. Obviously, this method can be applied to the analysis of market sales, but it can also be applied to properties which are rarely if ever sold but where there is a ascertainable future cash flow.

(c) Depreciated replacement cost. It should be noted however that when applied to the valuation of fixed assets for financial statements, the NZIV Asset Valuation Standard requires that this method must beaccompanied by a qualif ication that the final valuation figure is "subject to adequate potential profitability". If the potential profitability could be confidentially predicted it would be preferable to value the property by discounting the future net cash flows.

None of the above definitions or methods can be applied to a Government owned and operated university or hospital because such properties are never sold on the open market, and they do not produce a positive cash flow but indeed involve the tax-payer in considerable annual expenditure. Accordingly, even the depreciated replacement cost approach (as that method is applied to the valuation of fixed assets for financial statements) is not appropriate because the assets have no potential profitability.

I note with interest arecent comprehensive study undertaken on the depreciated replacement cost method by research staff at Kingston University, Surrey. The authors are W Britton, O P Connellan and M K Crofts and the study is entitled *The Cost Approach to Valuation* completed in 1991. This research project was undertaken by the Kingston UniversityResearch Team on instructions from RICS and was funded by the RICS Education Trust with some support from Surrey County Council.

The research report completed by Kingston University is very comprehensive and it reinforces the weaknesses in the method of valuation commonly referred to as the contractors test or depreciated replacement cost method. The report notes that this method is itself almost completely hypothetical, requiring the valuer to enter" a world of make-believe". It emphasises the previous absence in the standard valuation literature of a description of the use of this method and other contbased methods which are complete, concise and unambiguous. The report further notes that the method requires that the valuer "will frequently be attempting to adjust adjusted adjustments of adjusted raw evidence" in applying the method.

Of interest to valuers outside the United Kingdom is its reference to Statements of Asset Valuation Practice which either require or recommend that where the method is applied to public sector properties the depreciated replacement cost valuation is expressed as being "subject to the prospect and viability of the continuance of the occupation and use". This is contrasted with the proviso given where the method is used in valuing non-public sector properties - thatproviso reading "subject to the adequate potential profitability of the business compared with the value of the total assets employed". The research report points out that "In the private sector it is the size of the DRC figure on which the Directors have to decide as to inclusion in the balance sheet. Inotherwords,thereisameasureofpotential profitability against size of capital asset which has to be judged in terms of an acceptable economic ratio. But in the public sector there is no corresponding ratio that is measurable between the size of the capital asset (i.e. the DRC figure) and the "prospect and viability of the continuance of the occupation and use".-

In valuing public sector assets we are accordingly required to use a method which is, where possible, strenuously avoided in completing valuations of non-public sector assets. There can be little doubt that extreme care and considerable time and research isrequired when valuing public sector assets such as hospitals, if the final figures are to attract any measure of confidence.

Recent efforts to reform the public sector in New Zealand are designed to:

Increase efficiency.

Ascertain the real cost of operations and outputs so thatbetter political and management decisions can be made.

Improve the accountability of public sector managers (Cooper 1990).

A "valuation" of hospitals, schools and universities is possibly (and arguably) necessary in order to ascertain the real cost of operations and outputs but such a "valuation" cannot be undertaken using definitions and methods now acceptable in the valuation of private sector assets.

A recent interesting development in New Zealand is an attempt to convert State owned hospitals into profit making organisations. It appears that this is to be achieved by requiring each "Crown Health Enterprise" (of which there are almost 30 nationwide) to tender for the provision of "outputs" or hospital services. Private hospitals will tender in competition with State hospitals.

Tender prices may be compiled on a "cost plus" basis, the cost including an allowance for depreciation of assets and an allowance forareturn on the capital tied up in these assets. This however is very much a "cart before the horse" method and the true value of the assets will not be ascertainable until each hospital has been operating under this system forafew years. The value of the assets will then be ascertainable as a function of the net profit shown to be achievable. To reverse this equation, as is so often done, is quite illogical for reasons which must be obvious.

If the costs of running a public (State owned) university or hospital must include a component for a return on the "value" of the facilities involved and an allowance for depreciation where appropriate, these figures can beascertained if land and buildings are valued on a replacement cost less depreciation basis.

To have any degree of accuracy, the compilation of such figures forauniversity or hospital would require the input of architects, engineers and quantity surveyors experienced in university/hospital work as well as some managerial and academic/ medical input in order to ascertain the degree of efficiency experienced from the use of each separate building. Clearly, the whole exercise could become extremely expensive and whether or not this expense is justified will depend upon the element of total cost of operation for the hospital or university represented by the costs ascertained from valuing the land and buildings. If other costs comprising all wages and salaries, heating, lighting and other 0

Role of the Advocate in the Valuation Profession

by N J Carter

The Many Roles of a Valuer

I have been able to identify the following roles that a valuer performs.

1 *AnalystandResearcher:* Hopefully not a person who in Oscar Wilde's words "knows the price of everything and the value of nothing".
2 *Author:* A person who exercises judgment, creativity and imagination. An arch-manipulator or a master craftsman?
3 *Adviser to an Interested Party: A* mercenary or a gun for hire.
4 *A Legal Expert in Contract Interpretation and Law*
5 *Negotiator*
6 *Advocate*
7 *Expert Witness* Independent or biased?
8 *An Expert* (Judge) i.e. BOMA leases
9 *Arbitrator* (Judge)

"Now, who shall arbitrate? Ten men love what I hate, Shun what I follow, Slight what I receive: Ten, who in years

...continued from previous page

energy costs etc etc etc constitute a very significantpart of the total costof operating the universityor hospital then thereis clearly little point in expending large amounts of time and money in ascertaining the cost represented by depreciation on buildings and return on capital involved in land and buildings.

Advice I have received on the costs of running private (charitable) hospitals reveals that between 60% and 70% of the annual costs are taken up in wages and salaries and that less than 10% of these annual costs would be represented by depreciation on assets and a return on the capital invested in land, buildings and other assets. I believe that a similar, if not more extreme, position exists with "Public" hospitals.

Quite clearly any hospital building the functioning of which increases labour costs by around 10%, as compared with labour costs in an efficient building, will have a zero or a negative value, unless efficiency can be improved at low capital cost. Without detailed information on a buildings operating efficiency, valuers are not going to be able to value hospitals with any degree of accuracy.

Also of significance in considering this matter is the fact that if a university or hospital were found to be inefficient (the real costs of operations and outputs being abnormally high) the matter could not be remedied by selling the land and buildings because they would almost certainly not realise the amount at which they were "valued" using a depreciation replacement cost approach. Faced with the evidence of a comparatively high cost in the performance of any hospital or university, the public sectorhas several alternatives available to it but one of them is not the sale of land and buildings, unless of course it closes the entire operation down. These comments do not of course apply to surplus assets which, in today's climate, would probably be sold in any event regardless of costs and efficiencies.

A further reason often given to justify valuing assets is to improve asset management and to encourage the better use of assets such as land and buildings, plant and equipment etc. It is difficult to see how or why the valuation of assets can achieve these desirable aims. -

Assets should beproperly managed and properly utilised regardless of whether they are valued and regardless of the value ascribed to them.

Writing in the (U.K.) Chartered Surveyor Weekly,2July 1992,RobertKynock and Christine Eade note a recommendation of the Chartered Institute of Public Finance and Accountancy (CIPFA) that all U.K local authorities have in place a comprehensive register of assets by 1 April 1993. Kynock quotes officials who express concern at "the carrying out of meaningless valuations for example, how do you value a school?"

Eade notes thatRlCS and CIPFA representatives are meeting to attempt agreement on how to value assets such asschools.

I believe that the first question we should all address is WHY?

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and eyes match me: We all surmise, they, this thing, and I, that: Whom shall my soul believe?"

Please forgive the poetry but it expresses beautifully the questions that run through the minds of clients, valuers and lawyers, when the critical choice has to be made of who is to arbitrate.

An Outline of the Law of Evidence

I believe that it is helpful when considering the many roles you have to adopt that you should have a grasp of the fundamental rules of evidence which affect an expert witness.

1 The general principle is that all relevant evidence is admitted.

2 There are five exceptions or exclusionary rules to the general rule that allrelevantevidence is admissible. The exceptions include: (a) Opinions of witnesses; (b) Hearsay evidence.

3 You will appreciate therefore that a valuer giving evidence as an expert is allowed to do so as an exception to the exclusionary rule and is able to give opinion evidence and may to a large extent rely on hearsay. It should be recognised however that ordinary opinion evidence and hearsay evidence are excluded for very good reasons namely that they may be unreliable, inaccurate, downright dangerous, and cannot be properly tested by cross-examination.

4 Generally speaking, the valuer's opinion must be based on facts which are in evidence or on data or statistics acquired from textbooks, Government valuations, recorded sales/leases, Real Estate Institute records of sales/lettings etc., Land Transfer Office searched transactions and the like. It is common practice for valuers to give evidence about other sales and lettings of which they have only indirect knowledge.

5 No doubt it will delight you to know that the law in this area is unclear. The leading English case appears to be: *English Exporters (London) Ltd v. EldonwalLtd* [1973] CH.415, Megarry J. pp.420-2 cid

'As an expert witness, the valuer is entitled to express his opinion about matters within his field of competence. In building up his opinions about values, he will no doubt have learned much from transactions in which he has himself been engaged, and of which he could give first-hand evidence. But he will also have learned much from many other sources, including much of which he could give no first-hand evidence. Textbooks, journals, reports of auctions and other dealings, and information obtained from his professional brethren and others, some related to particular transactions and some more general and indefinite, will all have contributed their share....No question of giving hearsay evidence arises in such cases: the witness states his opinion from his general experience ... It seems to me quite another matter when it is asserted that a valuer may give factual evidence of transactions on which he has no direct knowledge, whether per se or whether in the guise of giving reasons for his opinion as to value. It is one thing to say 'From my general experience of recent transactions comparable with this one, I think the proper rent should be $x' : it is another thing to say 'Because I have been told by someone else that the premises next door have an area of x square feet and were recently let on such and such terms for $y a year, I say the rent of these premises should be $z a year' ... Details of comparable transactions upon which a valuer intends to rely in his evidence must if they are to be put before the Court, be confined to those details which have been. or will be proved by admissible evidence. given either by the valuer himself or in some m�ay. I know of no special rule giving expert valuation witnesses the right to give hearsay evidence of facts; and notwi thstanding many pleasant days *spent in the Lands Tribunal while I was at the Bar, I can see no compelling reasons of policy why they should be able to do this. The valuer's statement that someone reputable had told him these facts, or that he had seen them in a reputable periodical, would not in my judgment constitute admissible evidence."*

6 In that case, the Judge cited and approved a 1916 NSW authority to the same effect but an opposite view was taken by the Supreme Court of Canada in *City of Saint John v. Irving Oil Co. Ltd* (1966) 58 DLR (2d) 404.

7 Indirectly, the decision of our Court of Appeal in Re *Dickinson & Ors* (1991) 1 NZ ConvC 191039 is quite powerful support for the English view, that is, only precise first hand evidence of truly comparable lettings based on full knowledge of incentives contained in secret side deals that can be relied upon.

8 Cooke P pl91,041:

"Such genuine market rentals are not always easy to discover, and when discovered they may be of great importance in assisting an umpire in carrying out his difficult task of assessment. It is a fair inference in the present cases that the rents agreed for the IBM Centre may well be of true significance for the umpire concerned with the Trust Bank Centre. Of course one infers as much without any detailed knowledge of the situation and without in any respect seeking to fetter him, but it is desirable that he should be able to get at the truth as to these allegedly comparable rentals. Plainly details will be required such as *the terms of collateral contracts offering side benefits and the like."*

9 In short, I would argue that if a valuer knows that a secret side deal exists then the letting evidence itself should be entirely disregarded unless first-hand evidence of the whole transaction is available. Or, if the evidence is admissible, it should be entirely put to one side as being unreliable and meaningless.

How Can a Valuer Satisfactorily Perform all these Roles?

1 The first point to note is that every one of roles identified as 1 to 5 may lead to the valuer being involved in the roles identified as 7, 8 and 9. Therefore, the valuer will risk loss of face, injury to reputation and maybe downright humiliation if he has gone out on a limb at one of the earlier stages and then has to justify a partisan stance under cross-examination. It takes only one or two bad cases to destroy an expert's reputation forever. At the end of the day that is the ultimate sanction for the partisan valuer. Arbitrators however are generally not unkind or critical of valuers whose evidence they don't accept. In my opinion, this is due at least in part to the selection process of arbitrators, a subject to which I will return.

2 Your own Institute's Code of Ethics contains some valuable rules.

"SERVICE

1 The first duty of every member is to render *service to his clients* or his employer with absolute fidelity, and to *practise 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.

CONDUCT OF MEMBERS

2 Members shall so order their conduct so as to uphold the reputation of the Institute and the dignity of the profession."

"CONDUCT IN RELATION TO OTHERS I

16 Reliance placed by clients, employers, shareholders, investors, creditors, and the public in general on the accuracy and good faith of statements prepared or certificates given by members constitute one of the most valuable assets of the profession and the utmost care and goodfaith are necessary to ensure the maintenance of the hiqhest standards in this respect.

17 When asked for a valuation of real property, or an opinion on a real estate problem, a Valuer should never give an unconsidered answer. His counsel constitutes professional advice which he should render only after having ascertained and weighed the facts.

17A In submitting any report on real property, a member should observe the hiqhest standards of professional competency expected of a valuer having regard to the nature of the assignment being undertaken.

18 A member should not give expert evidence in the Courts or before other judicial bodies if he has any financial interest in the proceedings other than proper and reasonable fees payable for services. Even a remote interest should be disclosed. In preparation for his appearance in Court he should make a careful and detailed examination of the property concerned with consideration of all relevant factors which might tend to influence the value. His evidence shall be frank and given without mental reservation, and must be his honest opinion on the subject."

3 Both the spirit and letter of these rules require the valuer to put completely to one side the wishes or need of a client for a weighted valuation.

However, the rules do not provide any guidelines for the necessary subjective interpretation that a valuer inevitably brings to the interpretation of the data available to him.

4 Rule No.1 in the legal cross-examiner's weapons for cross-examining any expert is that the end opinion is only as good as the facts on which it is based or any legal assumption on which it is based. Destroy the facts or the assumption and the opinion itself is destroyed. Secondly, there are many subjective considerations which the valuer applies to the facts. e.g. analysing an improved sale into land value andbuilding value, corner influence, trends in the market, amalgamation potential to name but a few. Once again these subjective opinions usually have a factual basis and can be attacked by driect cross-examination. Alternatively, if a valuer can be shown generally to be partisan, selective or less than fair and objective, his subjective interpretations are unlikely to be accepted.

5) Many valuations and briefs of valuation evidence that I have read over the years are remarkable for their fudginess and obfuscation.

As a lawyer, and a consumer, I would like to see all valuations clearly identify: (a) the facts relied upon; and (b) the subjective consideration s which give rise to the opinion.

6 I can see nothing wrong with a valuer expressing a range and identifying a point along the range which he prefers and his reasons for that preference. It never ceases to amaze me that all valuers have a divine ability to precisely pinpoint the exact "v" spot but it no longer surprises me that depending on the client's interest, the valuer often is at or beyond the extreme limit of the likely range.

7 Some quotations from a recent award of Sir Ronald Davison (former Chief Justice of New Zealand and for many years Judge of the Land Valuation Court) delivered on 17 July 1992 will be of interest to you.

"Over very many years of dealing with valuation evidence, in a great variety of cases, I have found that it was not uncommon for there to be, at times, a considerable disparity between valuations produced by valuers on behalf of one party, and valuations produced by valuers on behalf of another. Differences of 10%-15% might commonly be expected, but differences of 50% and 100%, which are present in this case, must cause me to question why this is so. One cannot help but feel that there is a tendency at times for some valuers to support the party engaging them and for valuers to be almost advocates for a cause. In this case the basic materialsfor valuation of the subject landswere readily available to all four valuers, as is evidenced by the comparative Table of properties considered, which follows."

*In that table I have set out the transac-*tions *used, or available to be used, by the valuers, particularly those in the most relevant categories. When I am faced with such a difference in values almost 50% in the one case and almost 100% in the other case I endeavour to resolve the differences by asking myself in respect of all the valuations:* a) Has *any valuer failed to consider any relevant transactions? b) Has any valuer made any mistake which has affected its valuation? c) In the area of value judgments affecting the values, has any valuer failed to make reasonable decisions, having regard to the information available to him for his analysis?"*

8 The Arbitrator then proceeded to dissect the valuation evidence and in relation to one valuer found that he had not had any real regard to his own warning in his written evidence: "Any analysis of these four transactions (the Queen Street ones) must be treated with considerable reservation as they involve substantial improvements and they are all significantly influenced by investment income considerations."

He further held that the same valuer was quite mistaken in his evidence as to the nature of the improvements on one of the properties he analysed. (The valuer obviously had not even carried out a proper inspection of the property!) The arbitrator also referred to the fact that both the lessors' valuers had"discounted the importance of the Arcadia sale as it was clearly an embarrassment to them in supporting their valuations, and Mr X, for his part, did not even produce an analysis of it." The arbitrator also put to one side freehold land sales outside the Queen Street area as being not particularly helpful when there was good sales evidence in that part of Queen Street. The arbitrator also took the view that receiver sales which hadbeen put to one side by the lessors valuers "I do not believe that the fact that the sales were mortgagee or receiver sales had any real bearing upon the price received. In the unusual circumstances that existed in the market at those times, I believe that the prices received under mortgagee or receiver's sales reflected the true state of the market in relation to those propertiesatthe various times, and I have not thought it proper to make any adjustment to such of the sale prices as may have resulted from such sales." The lessors valuers also had added 25% and 26% respectively for comer influence and the arbitrator held "for myself, I would estimate a fairallowance to be no more than 10%, that is the figure I fix." He also ruled against the lessors valuers opinion that there should be an addition of 10% and 7.5% respectively for "plottage", criticised them for both completely ignoring highly relevant sales in High Street (the subject property ran from Queen Street through to High Street) because they weremortgageeorreceiversales and alsoheldagainst them completely in relation to the meagre discount they had offered in respect of a special discount that had to be applied due to an existing prior registered lease at a nominal rental which took priority to the ground lease in that case.

9 I mention that arbitration as an example where valuers acting for the lessor on a ground rental review ignored relevant sales and took extreme positions on virtually every element that was open to subjective interpretation. The initial assessed asking rental by these valuers was $480,000. Two days before the arbitration commenced they amended this to $292,500 and the arbitrator fixed the ground rental at $169,256!

10 I am aware of another ground rental arbitration where the lessees valuerwent into baton his own, against three valuers on the other side, with an extremely low valuation of $130,000. The lawyer/arbitrator Mr Bruce Bornholdt rejected the evidence totally because he formed the view that the valuer had adopted an extreme position, accepted the lessors valuers evidence almost in totality and fixed what in my opinion is a very high ground rental. So in the end, extreme, positions without a good factual base will not, if the arbitration is properly conducted, serve a client well in the long run.

One Lawyer's Perspective

1) I offer the following personal opinions as to how valuers may rationalise the many roles that they are called upon to fulfil. These observations are easy for me to offer because I suffer from none of your conflicts. As a barrister, I am unashamedly a gun for hire, subject of course to my right to choose to take a brief or not, to my right to run a case how I see fit and subject of course to professional and ethical responsibilities.

2) In every valuation you do, you should from the start strive for perfection. Sir Laurence Olivier when asked the key to his success as an actor replied, "One should always strive to do the best one can. One must not do less." If a client doesn't want to pay for a perfect or excellent job initially then by all means do a preliminary valuation, but say so in your report.

3) Be honest in the role you are performing. If you are taking an extreme position, your report should say so. Identify facts/data that are disputable. Identify subjective areas. Provide a range. Adopt your preference within the range. Give the reasons why.

4) Always do your homework. Your valuation will be exposed if the hard facts and data on which your opinions are based can be substantially criticised.

5) Get legal opinion on the provisions of leases. Many leases these days are a minefield of legal interpretation. Most lawyers don't even know what they mean. Be prepared to give alternative valuations based on alternative legal interpretations or legal assumptions. *Jefferies v. Dimock* example.

6) One area that I wouldlike to see changed is the system of appointing arbitrators. I believe that the present system, whereby the valuer/arbitrators appoint an umpire who almost inevitably becomes the sole arbitrator and hears evidence from the valuer/arbitrators, this leads to "soft" arbitrators. Career arbitrators whether lawyers, retired judges, or valuers, know that they are not going to be reappointed if they say unkind things about the valuers who give evidence before them and who were instrumental in that appointment. In the Courts, Judges are appointed permanently. They are not beholden to witnesses for their appointment, future work or remuneration. They can say what they like. Experts appearing before them who don't measure up are seen for what they are, word gets around and it is the witnesses who are not invited back. With the present system of valuer/arbitrators appointing the umpire, the valuer/arbitrators generally feel safe that they are not going to be caned for giving biased evidence. So, under the present system, there is in my opinion the potential for self perpetuating rottenness. I venture to suggest that Sir Ronald Davison is not likely to get another appointment to arbitrate a ground lease in Auckland. Fortunately, I don't think Sir Ronald cares!! Similarly, a few years ago it was said that the Hon. Mr Evan Prichard was blacklisted for awhile by ground lessors for similar reasons.

7) In my opinion, it is essential that the present method of appointmentbe changed and that appointments be handled by an independent authority beholden to no one. For more than ten years now, I have been advocating an independent appointor in all contracts I draft or peruse with an arbitration clause. Whether it should be the President of the Auckland District Law Society, the President of the Institute of Valuers, or the President of the Accountants Society etc. depends on the nature of the likely dispute. I venture to suggest that because New Zealand is such a small place, Auckland is a smaller place, and valuers have to deal with each other continually, negotiate, mediate, and in very many cases settledisputed valuations that may be it is better that they should not accept appointments as an arbitrator or umpire; that they should insist on sitting with a lawyer as co-arbitrator or advisor or yield the role of sole arbitrator/umpire to a lawyer. In my view you are in an impossible position if you are mediating and agreeing valuations one day, appointing each other as arbitrator/umpire the next, and sitting in judgment on each other the day after. In difficult times "happy hypothetical higglers" may no longer be appropriate. There are real people out there whose businesses and lives are being/may be ruined by faulty valuations/arbitrations.

8) I return to my topic, "The Role of the Advocate in the Valuation Profession". First, let me say that being an advocate is a happy role to play. Unashamedly the advocate adopts the best possible position for his client. There are only two real restrictions on his role. He must not misrepresent the law and he must not call evidence which he knows to be false. Within these limits he can happily adopt an extreme position, be creative, exercise the most favourable subjective interpretation of the facts and case law and happily take that stance in negotiation, mediation, and at the hearing. Not for the advocate the trauma of having to go into the witness box and pretend to be independent and unpartisan or to cast off these extreme positions as an arbitrator/judge and apply the judgment of Solomon to his own position! I believe you are deluding yourselves if you think you can fulfil all these roles well. If you do believe it you are either highly dangerous or in line for canonization by the Pope.

9) Of course, advocates who lack judgment, can't properly interpret case law, assemble, present and marshall facts appropriate to the issues or are not objective or credible, suffer accordingly. So too valuers. But that is another issue.

10) Your code of ethics in my opinion *prevents* you from being *advocates* either in your research and analysis, in exercising your judgment, advising interested parties, negotiating giving evidence or deciding. So in my opinion you should stand aside from the role of advocate as well. Otherwise the "Reliance placed by clients.. investors . . and the *public in general* on the accuracy and good faith of statements prepared or certificates given by members" will no longer "constitute one of the most valuable assets of the profession." A

Legal Decisions

Arbitration - Appointment of third valuer or umpire for the purpose of determining ground rental whether a valuer or lawyer in circumstances could best perform function of umpire Arbitration Act 1908, S6; Arbitration Amendment Act 1938, S6

IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY
M.351/92
M.389/92

IN THE MATTER of the Arbitration Act 1908

BETWEEN THE NEW ZEALAND LAW SOCIETY A li an

AND THE WELLINGTON CITY COUNCIL Respondent

Date of Hearing: 17 August 1992
Date of Judgment: 17 September 1992
Counsel:
C R Carruthers QC for the Applicant J E Hodder for the Respodent

JUDGMENT OF HERON J

These are cross applications for the appointment of a third valuer or umpire for the purposes of determining ground rental in respect of the Society's well litigated lease of its property at 26 Waring-Taylor Street, Wellington.

The applications to this Courtare made pursuant to s.6(1) Arbitration Act 1908 which reads:

"In any of the following cases
(a)...
(b)...
(c) Where the parties or two arbitrators are at liberty to appoint an umpire or a third arbitrator or where two arbitrators are required to appoint an umpire and do not appoint one ... any party may serve the other party or the arbitrators as the case may be with a written notice to appoint an arbitrator or umpire or a third arbitrator.

(2) If the appointment is not made within seven days after the service of the notice, the Court, may, on application by the party who gave the notice, appoint an arbitrator or umpire or a third arbitrator, who shall have the like powers to act in the reference and make an award as if he had been appointed by consent of all parties."

Section 6 of the Arbitration Amendment Act 1938 provides:

"(1) Where a submission provides that the reference shall be to three arbitrators, one to be appointed by each party and the third to be appointed by the two appointed by the parties, the submission shall have effect as if it provided for the appointment of an umpire, and not for the appointment of a third arbitrator, by the two arbitrators appointed by the parties.

(2) Where a submission provides that the reference shall be to three arbitrators to be appointed otherwise than as mentioned in the last preceding subsection, the award of any two of the arbitrators shall be binding."

The lease contains the following relevant provisions.

"III. AND IT IS HEREBY AGREED AND DECLARED that if the Tenant shall at least six calendar months before the expiration of the term hereby granted serve upon the Town Clerk of the Corporation or leave at the public offices of the Corporation a notice in writing addressed to the Corporation signed by the Tenant or signed on behalf of the Tenant by the Tenant's attorney or agent or solicitor stating the desire of the Tenant to have a valuation made of the annual rental of the said demised premises for a term of Twenty-one (21) years to commence from and after the expiration of the term hereby granted and naming an independent person appointed by the tenant to act as the tenant's valuerfor the purposes of such valuation and containing an address at which all notices under the provisions hereinafter contained may be served and if the term hereby granted shall not have been determined by reentry or otherwise then and in such cases the following provisions shall have effect, namely:-

1. A valuation shall be made to ascertain the said annual rental. Such valuations shall be made by three (3) independent persons, one appointed by the Tenant as aforesaid, one to be appointed by the Corporation (of which appointment notice in writing under the Common Seal of the Corporation or signed by the Town Clerk or otherwise on behalf of the Corporation shall be served upon the Tenant or left at the address for service contained in the notice served by the Tenantas aforesaid at leastfive calendar months before the expiration of the term hereby granted) and the third valuer to be appointed by the two valuers as aforesaid by writing under their hands before proceeding to the valuation.

2. At least three calendar months before the expiration of the term hereby granted and not afterwards the said three valuers or any two of them shall make their valuation and reduce the same in duplicate into writing and sign each of such writings and also at least three calendar months before the expiration of the term hereby granted and not afterwards serve one of such writings upon the Town Clerk of the Corporation or leave the same at the public offices of the Corporation and serve the other writing upon the Tenant or leave the same for the tenant at the address forservice contained in the notice served by the Tenant as aforesaid.

3. In ascertaining such new rental the valuer shall take into consideration the full and improved ground rental of the land including any buildings and other improvements thereon erected or made by the Corporation but excluding any other buildings or improvements thereon."

In this case the Council have nominated Sir Duncan McMullin, a retired Judge of the Court of Appeal, as the third valuer. The Law Society have appointed Mr Peter Mahoney, a valuer of Auckland, as their third valuer. By virtue of the provisions referred to earlier that third person is effectively the umpire. Accordingly in the event of a failure to agree on the person to fill that position this Court can make the appointment.

Naturally there is no question as to the suitability of the individuals concerned. The concern is one of principle, whether a valuer or a lawyer can in the circumstances of this case best perform the function of umpire.

Three recent cases were cited where in arbitration proceedings a choice between lawyer and valuer had to be made. The first is my decision in *Harbour City Realties Ltd v Hoosons Menswear Ltd.* In that case the lease specified that the two arbitrators were required to be persons competent in rental valuations. I said:

"In my view the umpire should be a valuer. I take that from the emphasis placed on the qualifications of the two arbitrators as requested by the lease in reaching that view, and the statement in Russell on Arbitration *20th Ed. 236 to the effect:*

'An umpire is a person appointed to take over the reference from arbitrators who are unable to agree amongst themselves. In general, he is in the same position as a sole arbitrator, must be appointed in the same way and must possess *the same qualifications or absence of qualifications.'*

I think in the specialist area of commercial rental valuations it is essential to have a valuer as *an arbitrator. What is being argued for by the landlord is that there is a quirk in respect of this lease which requires a different approach to the valuation. It must be remembered however that this is an inquiry into the full market rent. That word means the price people will pay in respect of this commodity on the open market. It is common ground that this requires a knowledge of other rentals fixed in the marketplace, either by agreement or by other arbitration, and applying a series of distinguishing factors or factors of similarity in arriving at the appropriate rental to be paid for this particular property. The* analysis *of those other examples is best left in my view, to a person trained in valuation methodology and principle."*

I went on to say:

"The only cases where lawyers seem to play apart are where there are easily recognisable questions of construction, or where provisions of the Public Bodies LeasesAct 1969 apply. Paragraphs 7 to 11 of the First Schedule of the Public Bodies Leases Act 1969 have a degree of formality about them somewhat different from the arrangements in the present lease, and as a matter of practice the arbitrator and umpire sit together and hear evidence in a judicial setting, not envisaged, as I understand it in this case."

Jeffries J in *Government Life Insurance Corporation v Wellington Hospital Board* (unreported, Wellington Registry, M.233/89, 13 July 1989) thought that in the case before him the choice was more open having regard to the absence of the requirement of specified qualifications. He appointed a lawyer and said:

"In the present state where the originally appointed arbitrators are in dispute on the market rent and cannot even agree on the qualifications of the umpire they are in a distinctly adversarial stance. In those circumstances this court is of the view a lawyer trained in balancing opposing viewpoints especially when firmly held and expressed, is the better qualified. Furthermore the Court largely rejects the contention of the applicant's deponent that with a lawyer umpire the parties 'would be required to educate the umpire to a degree of understanding of the principles of valuation'. The parties in choosing a lawyer umpire would select one of sound commercial background of which an appreciable partof hisexperience would have been with property owning clients. In his capacity as a lawyer throughout his professional life he would have been examining valuation reports not simply for rental reviews but for purposes over a wide *spectrum of his practice. Such a lawyer becomes very familiar with the main strands of valuation theory even if he does not have the narrow technical expertise possessed by a qualified valuer. In addition it is to be hoped that in the role of sole arbitrator or umpire he would call up his education experience with the necessity for fairness and impartiality when acting in any type of judicial function. So much more is that qualification available when the selection is of a person with conventional judicial experience as suggested for this case. Moreover in the years he or she would have sat as a Judge there would have been countless times he or she would have been called upon to have at least a working knowledge and understanding of complex technical evidence. Likewise for a* lawyer *engaged in litigation in Courts."*

With respect I agree with those observations and when applied to the particular circumstances of that case are unarguable.

The final case is *Sun Alliance Insurance Ltd v Jackson Russell Digman Armstrong* M.518/9019 June 1990 Barker J. This case was different. It was a reference to a single arbitrator. Barker J felt that there were difficulties with a single arbitrator being a valuer, particularly because there was always a danger that personal preferences and opinions might intrude, not necessarily ones that had been disclosed to the parties. I think there is always some difficulty in that regard and as I say that case concerned the appointment of a sole arbitrator. The Judge went on however:

'In the present case, on balance and not without some hesitation, I rule in favour of the lawyer or retired Judge as the arbitrator. That is not to say the valuer should not be or should not be used for rental review arbitrations. If this had been a 'two arbitrators plus umpire' situation I would have thought it probably desirable to have the arbitrators as valuers, leaving possibly the identity of the umpire to be decided in the light of the wording of the particular lease and circumstances."

This amalgam of views in this area is of general assistance, but in the end one has to address the particular situation facing the umpire and the task to be performed. Mr Hodder put it on the basis that neither lawyers nor valuers had a monopoly of wisdom in this area and neither were automatically excluded from acting in this capacity. I agree. He also said that the issues in cases of this kind were diverse, usually involving avarietyof experts from different disciplines.

It was not simply an inquiry into current market value. He also submitted that the issues were well suited for determination by a person with extensive judicial and more recently arbitral experience.

The present value of the unimproved freehold must be settled.

That is largely a valuation exercise with little need in my view for legal or judicial experience and one where a third valuer could act as adequately as a legally trained person. I would categorise that as essentially a valuation question, largely determined by analysis of comparable sales. A not easy analysis sometimes having regard to the fact that downtown vacant land in such size is rarely sold as such but capable of analysis by reference to improved freehold sales and otherwise and where some direct assistance can be obtained from marketplace experience.

The second and more difficult question is the rate of return on that investment as valued. This has to be fixed bearing in mind that the lease is to run a further 21 years. Accordingly like rates of return on like investments have to be analysed and considered. In doing so forecasts as to the future rate of inflation and consequent 0 interest rates and investment matters generally are considered.

As Mr Hodder says a variety of experts from different disciplines hold wide ranging views and the best of those have to be chosen. What is required is an analysis of quite complex evidence, an ascertainment of the preferred evidence and an analysis of the reasons therefor in the event that there is no consensus. In my experience there may not be consensus in the controversial area of future rates of inflation and interest rates, dependent as they are on wide ranging governmental policy decisions; matters of complexity from an economic point of view. To ascertain the true nature of the evidence likely to be given on both sides considerable cross examination may be required, and the various economic theses tested. That is generally best done in a judicial setting with witnesses being examined and cross examined and the evidence examined carefully.

It will likely be blatantly adversarial. In my view an arbitration of that kind, where strongly held views one way or the other are held by witnesses and possibly by the arbitrators themselves, is demonstrably better left in the hands of a lawyer and more appropriate in this case in the hands of a former Judge. It is not just a simple inquiry into commercial rentals, although the end result is to arrive at such a rental.

Mr Carruthers *referred* to the wording of the *lease,* indicating that the third valuer had a special role, emphasising that the valuation could be of any two of the three valuers, including the "umpire". He submitted that really was determinative of a valuer as the person to beappointedhaving regard to the procedure required by the lease.

However the situation with the third valuer is that in effect he is the umpire and as such may be required to act in that capacity. In the event of wide divergences of view his role will be essentially balancing the viewpoints taken by the arbitrator valuers on either side.

Presumably those valuers will be selected, as they often are, by virtue of the approach that they favour. It would be unusual and unlikely an approach unfavourable to the tenant was ever advanced by the valuer appointed by that tenant.

However I should not overlook the point of Mr Carruther's submissions in one respect. Nothing in what I have said commits either party to a full scale arbitration hearing if between the three of the valuers to be so appointed they can reach a consensus or it would seem any two of them can agree. I think this circumstance may sometimes be overlooked and parties committed to an extensive arbitration where the valuers might well, with the benefit of the intervention of the umpire, be able to reach agreement without the necessity of a full scale hearing. That will largely depend on the divergence of views. It seems to me this can properly be ascertained prior to launching into the arbitration proper. It is I suspect only because of the wide divergence of opinions and volatile economic conditions that it has been necessary in recent years to formalise these arbitrations in the way I have described. If the positions are not so far apart it may well be the matter can be resolved without that degree of formality.

Finally I should say on this point that both the recent and not so recent history of these cases clearly indicates that in so far as umpires are concerned they have been more the province of the lawyer than the valuer. See *In Re A Lease* (1933) NZLR 184.

Sir Duncan McCullin is appointed third valuer and umpire accordingly.

The City Council are entitled to costs which I fix at $600 plus all proved disbursements.

Solicitors: Kensington Swan for the Applicant
City Solicitor for the Respondent

IN THE COURT OF APPEAL OF NEW ZEALAND
C.A. 295/92

BETWEEN THE NEW ZEALAND LAW SOCIETY
Applicant
AND THE WELLINGTON CITY COUNCIL
Respondent

Coram: Cooke P
Richardson J
Hardie Boys J

Date of Hearing: 19 November 1992
Date of Judgment: 17 December 1992

Counsel:
C R Carruthers QC and Pamela J Andrews for the Appellant.
J E Hodder and Catherine W Stewart for the Respondent

JUDGMENT OF THE COURT DELIVERED BY COOKE P

The Wellington City Council as lessor and the New Zealand Law Society as lessee are parties to a deed of lease dated 19 June 1973 of the land in Waring Taylor Street, Wellington, on which the Society's building stands.

The lease recently expired is for 21 years from 1 January 1971 with perpetual rights of renewal for similar terms. A valuation of the annual rental for the term commencing on 1 January 1991 has fallen to be made.

The lease requires it to be made by three independent persons, being one appointed by the tenant, one by the Corporation and the third valuer to be appointed by the other two valuers The Law Society has appointed as its valuer Mr G J. Horsley of Wellington, registered valuer, and the Council has appointed Mr R.S. Arlidge of Wellington, registered valuer, but the two appointees have been unable to agree on the third person. The Society wishes to have appointed another registered valuer, Mr P.J. Mahoney of Auckland. The Council wishes to have a lawyer, Sir Duncan McMullin. Cross-applications having been made to the High Court, Heron J. in a judgment delivered on 17 September 1992 appointed SirDuncan McMullin. The Society appeals.

By the Arbitration Act 1908, s.2 'Arbitrator' includes referee and valuer. In this judgment we will use 'arbitrator' and `valuer' interchangeably. 'Submission' means a written agreement to submit present or future differences to arbitration, whether an arbitrator is named therein or not, or under which any question or matter is to be decided by one or more persons to be appointedby the contracting parties or by some person named in the agreement. As to the effect of those statutory provisions in creating an arbitration, *seeHamill v. WellingtonDiocesan Board of Trustees [1927] G.L.R.* 197.

The jurisdiction exercised by the Court in this case is under s.6(1) of the 1908 Act:

6. Appointment of arbitrator or umpire - (1) In any of the following cases:

(c) Where the parties or 2 arbitrators are at liberty to appoint an umpire [or a third arbitrator] [or where 2 arbitrators are required to appoint an umpire] and do not appoint one;

any party may serve the other party or the arbitrators, as the case may be, with a written notice to appoint an arbitrator or umpire [or a third arbitrator].

In s.6(1)(c) the second set of words in square brackets, referring to an umpire, were inserted by the Arbitration Amendment Act 1938. The reference to a third arbitrator had been inserted by earlier legislation. For the reasons which follow, this case is one where two arbitrators are required to appoint an umpire.

Section 6 of the Arbitration Amendment Act 1938 provides:

6. Provisions on the appointment of 3 arbitrators

(1) Where a submission provides that the reference shall be to 3 arbitrators, one to be appointed by each party and the third to be appointed by the 2 appointed by the parties, the submission shall have effect as if it provided for the appointment of an umpire, and not for the appointment of a third arbitrator, by the 2 arbitrators appointed by the parties.

(2) Where a submission provides that the reference shall be to 3 arbitrators to be appointed otherwise than as mentioned in the last proceeding subsection, the award of any 2 of the arbitrators shall be binding.

The relevant clauses of the lease are:

Provisions for renewal: Lessee to give notice requiring valuation of new rental

III. AND IT IS HEREBY AGREED AND DECLARED that if the Tenant shall at least six calendar months before the expiration of the term hereby granted serve upon the Town Clerk of the Corporation or leave at the public offices of the Corporation a notice in writing addressed to the Corporation signed by the Tenant or signed on behalf of the Tenant by the Tenant's attorney or agent or solicitor stating the desire of the Tenant to have a valuation made of the annual rental of the said demised premises for a term of Twenty-one (21) years to commence from and after the expiration of the term hereby granted and naming an independent person appointed by the Tenant to act as the Tenant's valuer for the purpose of such valuation and containing an address at which all notices under the provisions hereinafter contained may be served and if the term hereby granted shall not have been determined by re-entry or otherwise then and in such case the following provisions shall have effect, namely:

Valuation to be made.

1. A valuation shall be made to ascertain the said annual rental. Such valuation shall be made by three (3) independent persons one appointed by the Tenant as aforesaid one to be appointed by the Corporation (of which appointment notice in writing under the Common Seal of the Corporation or signed by the Town Clerk or otherwise on behalf of the Corporation shall be served upon the Tenant or left at the address for service contained in the notice served by the Tenant as aforesaid at least five calendar months before the expiration of the term hereby granted) and the third valuer to be appointed by the two valuers as aforesaid by writing under their hands before proceeding to the valuation.

Valuation to be notified to both parties

2. At least three calendar months before the expiration of the term hereby granted and not afterwards the said three valuers or any two of them shall make their valuation and reduce the same in duplicate into writing and sign each of such writings and also at least three calendar months before the expiration of the term hereby granted and not afterwards serve one of such writings upon the Town Clerk of the Corporation or leave the same at the public offices of the Corporation and serve the other writing upon the Tenant or leave the same for the Tenant at the address for service contained in the notice served by the Tenant as aforesaid.

Principle of Valuation.

3. In ascertaining such new rental the valuers shall take into consideration the full and improved ground rental of the land including any buildings and other improvements thereon erected or made by the Corporation but excluding any other buildings or improvements thereon.

4. The reasonable cost of and incidental to the valuation shall be paid by the Tenant.

It is common ground that no particular qualifications are required by this lease for the independent persons described therein as valuers and that, as Smith J. held long ago in *In re a Lease, Auckland City Corporation to Grey Buildings Ltd* t1933] N.Z.L.R. 184, a person with knowledge of legal principles has in some respects expert qualifications for the duty of fixing a valuation. In that case Smith J. appointed Sir Walter Stringer as umpire under similar but not identical legislation.

A consideration urged by the Law Society has been the cost of a full-scale arbitration hearing presided over by a lawyer. Heron J. drew attention to the possibility of the arbitrators agreeing without the necessity of such a hearing, mentioning also that the umpire might assist at that stage.

We doubt whether the umpire should become involved so early, but agreement without formal arbitration is certainly to be encouraged, even although the tone of the exchange of correspondence between the parties here does not suggest that the prospects of this are particularly strong. It is worth bearing in mind that in addition to the expertise of the two appointed valuers and such evidence, if any, as may be available of truly negotiated rentals for comparable lettings (which evidence would obviously be of first importance: *see ModickR. C Ltd v. Mahoney* [1992] 1 N.Z.L.R. 150), comparablearbitral awards are not to be neglected and may be helpful in some cases. Thus there is an award of 10 June 1992 by Sir Joseph Ongley fixing the rental under the similar lease of the adjoining site of the Dunbar Sloane Building.

Heron J. was influenced by the prospect that the matter could become, as he put it, `blatantly adversarial'. In his view an arbitration of that kind, where strong views one way or the other are held by witnesses and possibly by the arbitrators themselves, is demonstrably best left in the hands of a lawyer, and more appropriately in this case in the hands of a former Judge.

He cited several unreported High Court judgments concerned with such appointments and expressed agreement with the following observations of Jeffries J.:

In the present state where the originally appointed arbitrators are in dispute on the market rent and cannot even agree on the qualifications of the umpire they are in a distinctly adversarial stance.In those circumstances this Court is of the view a lawyer trained in balancing opposing viewpoints especially when firmly held and expressed, is the better qualified. Furthermore the Court largely rejects the contention of the applicant's deponent that with a lawyer umpire the parties `would be required to educate the umpire to a degree of understanding of the principles of valuation'. The parties in choosing a lawyer umpire would select one of sound commercial background of which an appreciable part of his experience 0 *would have been with property owning clients. In his capacity as a lawyer throughout his professional life he would have been examining valuation reports not simply for rental reviews but for purposes over a wide spectrum of his practice. Such a lawyer becomes veryfamiliar with the main strands of valuation theory even if he does not have the narrow technical expertise possessed by a qualified valuer. In addition it is to be hoped that in the role of sole arbitrator or umpire he would call up his education experience with the necessity for fairness and impartiality when acting in any type of judicial function. So much more is that qualification available when the selection is of a person with conventional judicial experience as suggested for this case. Moreover in the years he or she would have sat as a Judge there would have been countless times he or she would have been called upon to have at least a working knowledge and understanding of complex technical evidence. Likewise for a lawyer engaged in litigation in the Courts.*

We agree with Heron J. and Jeffries J. and would add that the guidance of a presiding lawyer of standing is all the *more* desirable because since at least *D.I.C. v. Mayorof Wellington* (1912) 31 N.Z.L.R. 598 in this Court, a long line of cases, including *Wellington City Council v. National Bank* [1970] N.Z.L.R. 600 also in this Court, have shown that questions of law are apt to intrude into rent reviews of this kind.

While not a binding precedent, Sir Joseph Ongley's reasoned award is evidence of the helpfulness of a judicial approach to the resolution of the kind of issues that develop between professional valuers in this field.

Perhaps some of the questions that arise from time to time are better described as pseudo-questions of law. At times valuers are known to espouse particular theories or formulae capable of distracting attention from the task of assessing market values as between freely negotiating parties.

On the appeal the main burden of the argument presented by Mr Carruthers was that the nature of the task of making a valuation is more suited to the skills of a valuer third arbitrator than a lawyer third arbitrator.

He suggested that the required procedure is that each of the three persons makes an independent valuation and they then confer to see whether two of them agree; if not, the valuation of the third will apply by virtue of s.6 of the 1938 Amendment Act.

We think, however, that to put the situation in that way is to understate the impact on the lease of s.6(1) of the 1938 Amendment Act.

In its plain wording the subsection, whose object is to avoid a deadlock (*British Metal Corporation v. Ludlow* [1938] 1 All E.R. 135, 139), is that the submission in the lease is to have effect as if it provided for the appointment of an umpire, and not for the appointment of a third arbitrator, by the two arbitrators appointed by the parties.

This perpetually renewable lease seems to have been originally granted in 1950: see *Wellington City Council v. New Zealand Law Society* [1990] 2 N.Z.L.R. 22, 23. If so, in selecting and agreeing to the terms it should have been realised that they would take effect as if they provided for an umpire. And, no matter when the wording in the lease was chosen or from what precedent it was copied, s.6(1) is overriding. Different language would have been needed to bring the valuation process within s.6(2) of the 1938 Amendment Act whereunder the award of any two of the valuers is required.

The ordinary role of an umpire is to settle differences between the two arbitrators: *In re Eyre and Corporation of Leicester* [1892] 1 Q.B. 136, 140. If it falls to him to make the award because the arbitrators cannot agree, he is said to have entered on the reference and it is his award: Arbitration Act 1908, Second Schedule, clauses 4 and 8. By s.7(2) of the 1938 Amendment Act the Court has power to order the umpire to enter on the reference in lieu of the arbitrators and as if he were a sole arbitrator.

Nevertheless, as is said in *Mustill and Boyd on Commercial Arbitration,* 2nd ed. (1989) 190-1, it is very common to agree for the umpire to take part in the hearing if the arbitrators have not reached agreement without a formal hearing. That practice is familiar in New Zealand. It is not necessary for either of the valuers appointed by the parties to concur in the umpire's award.

Clearly, when the parties have agreed on a three valuer arbitration in the terms found in the instant lease, the Arbitration Amendment Act modifies their agreement, converting the third valuer's role to that of umpire.

It may be noted that this statutory modification has now been abandoned in England, in the interests of party autonomy, albeit with results to which English practice is said not to have fully accommodated itself: *Mustill and Boyd,* 9. Whether or not such a change is desirable in New Zealand is of course not an issue for consideration on this appeal, but an argument for the *status quo* is that the authority of an umpire produces a more clear-cut system.

Whatever view might be taken about possible change, the Court has to apply the present legislation. There can be no doubt that thereunder the independent person referred to in the instant lease as the third valuer becomes in truth an umpire.

There can be no need or justification for him to contribute a valuation at the outset. The main prop of the argument for the appellant Society must therefore go. That being so, the case seems to us to be one calling for the appointment of Sir Duncan McMullin, for the reasons already explained.

A subsidiary grievance of the Society was that the lease provides that the tenant shall pay the reasonable cost of and incidental to the valuation.

Mr Hodder was able to point out that this was remedied by Parliament rather more than 50 years ago. Such a provision is void by virtue of s. 14 of the 1938 Amendment Act.

As to the unfairness thus rectified and the 1938 amending legislation generally, see the remarks of the Hon. Mr Perry (later Sir William Perry) in the Legislative Council in (1938) 253 N.Z.P.D. 46.

For these reasons we dismiss the appeal. Costs to the respondent should follow the event, in the sum of $3000.

<u>Solicitors:</u>
Kensington Swan, Wellington, for Appellant
The City Solicitor, Wellington, for Respondent

Roll Value Objection multi-storeyed apartment building - Unit Titles - Method of val uation of land Approach to be taken with strata interests whether Departments methodology erroneous Valuation of Land Act 1951 SS 2, 8; Unit Titles Act 1972 SS 2, 4.

IN THE LAND VALUATION TRIBUNAL HELD AT AUCKLAND
LVP 435/91

IN THE MATTER OF AN OBJECTION UNDER S.19 OF THE VALUATION OF LAND ACT 1951

BETWEEN S L & A I SPEEDY
Objectors

AND VALUATION NEW ZEALAND
Respondent

Before the Auckland Land Valuation Tribunal
Chair: Judge B N Norris
Members: R M McGough Esq
P J Mahoney Esq
Hearing: 28.4. 1992
Decision: 21 December 1992
Appearances S L Speedy for S L and A I Speedy
M T Parker, Crown Law Office, Wellington for the respondent

DECISION OF THE TRIBUNAL

This objection relates to the 1990 Review of the Roll Value for the objectors' apartment situated in Windermere Apartments, corner the Promenade and Killarney Street, Takapuna. The operative date of the valuation is 1 October 1990 and it is:-

Land Valuation $220,000
Improvements $265,000
CV $485,000

The objectors' concern is towards the land value and the issue for us is the determination of the principles to be followed when ascertaining the value where the land is a stratum interest under the Unit Titles Act 1972, and having established that principle, to consider the correctness or otherwise of the valuation appealed against in accordance with the provisions of the legislation.

In accordance with the Tribunal's invariable practice over a long period of time, and with the consent of the objectors, notwithstanding the burden of proof being on the objectors (s.20(8) Valuation of Land Act 1951) the respondent opened the proceedings by Mr Parker presenting written submissions and calling the evidence of Mr D E Everiss, Registered Valuer, who presented a valuation report with supporting data in seven appendices.

Mr S L Speedy acted as his and his wife's advocate and gave evidence on their behalf. He is a Registered Valuer, a graduate in commerce and urban property economics.

He is the publi shed author of a number of texts in the area of land valuation and land economics published by Butterworths and the New Zealand Institute of Valuers. With his 35 years experience in the valuation profession, he is an acknowledged expert and an elder statesman of the profession in this country.

Respondent's Case:

The respondent says that the effect of a strata title where as in this case the building is a multi-storied apartment building, is to give legal ownership of air space. In carrying out the valuation the District Valuer has valued the land as including the air space which is represented on the title.

The objectors' other land interests include accessory units, which are situated at ground level, and a share of the common area, some of which are aground level.

The objectors' estate in land is a mixture of physical land and air space. That entitlement is conferred by the flat's plan appended to Mr Everiss' evidence. And a Registered Valuer has certified the assessment of the unit entitlement on that plan in accordance with the Unit Titles Act 1972.

We are told by the respondent that there is no Roll Value for Windermere Apartment block itself. Each unit is valued separately so that the building gives rise to ten different entries in the Roll Value, one for each apartment for which a unit title is issued.

Apparently there is a composite entry for No 11 Killarney Street, which shows as the legal description Lot 1 DP 48402, together with the legal description of the various units as taken from the strata plan, and also shows a capital value which represents the total of the various separate valuations. Mr Parker, for the respondent, contends this is not a Roll Value under the Valuation of Land act 1951. He says it is simply a summation of various Roll Values done to satisfy the computer programme used by Valuation New Zealand, which requires each entry to show the land area. Further, no land area is shown on the entry of the stratum title and therefore for total purposes it is necessary to do a summation entry.

Finally, Mr Parker tells us that the entry has no legal or valuation significance. This position is not challenged by the objectors..

The objectors had objected to the valuations of the other nine units, but it is accepted that Mr and Mrs Speedy's objection is the only one to proceed. Mr Parker indicated that if the Tribunal finds that the Valuer General has followed the wrong principle, then it is likely that an adjustment will be made to the Roll Values for the other apartments.

The Tribunal would expect such action to follow, and if the principle is upheld but the valuation allowed for other reasons, then the other nine valuations would accordingly be reconsidered in the light of the decision that we reach.

The respondent relies on s.8 of the Valuation of Land Act 1951 and the definition of land in s.2 of that Act. Section 8 provides:-

-8. Preparation ofDistrict Valuation Roll-(1) A district valuation roll shall be prepared for each district by the Valuer General, and shall be in the prescribed form, and shall set forth in respect of each separate property the following particulars:

(a) The name of the owner of the land, and the nature of his estate or interest therein, together with the name of the beneficial owner in the case of land held in trust:

(b) The name of the occupier...:

(c) The situation, description, and area of the land:

(d) The nature and value of the improvements:

(e) The [land value] of the land:

(fl The capital value of the land:

[(ff) Where applicable, the special rateable value or the rates postponement value of the land:]

(g) Such other particulars as are prescribed.

(1A) An annual value valuation roll shall also be compiled by the Valuer for any district of a territorial authority where the annual value rating system is in force, and shall in a prescribed form contain for each separate property the following particulars: 0

(a) *The name of the owner:*
(b) *The name of the occupier:*
(c) *The situation and description of the property:*
(d) *The annual value:*
(e) *Where applicable, the rates postponement value or the special rateable value, as the case may require:*
(f) *Such other particulars as may be prescribed.*

[(2) For the purposes of this section any land that is capable of separate occupation may, if in the circumstances of the case it is reasonable to do so, be treated as separate property whether or not it is separately occupied."]

In terms of s.2 "land" is defined as follows:-

"Land' means all land, tenements, and hereditaments, whether corporeal or incorporeal, in New Zealand, and all chattel or other interests therein, and all trees growing or standing thereon."

Land Value is defined as follows:-

"Land Value', in relation to any land, means the sum which the owners estate or interest therein, if unencumbered byany mortgage orother charge thereon, might be expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a bona fide seller might be expected to impose, and if no improvements (as hereinbefore defined) had been made on the said land."

Mr Parker then submits that it is clear from the definition and trite law, that land value relates not just to the physical land but also to the legal interest in land. He submits that the land value of a specific physical area of land will change depending upon the nature of the legal interest by valuation.

For example, whether it is an estate in fee simple or an estate in leasehold. He contends that it follows that where the legal interest in land represents the right to occupy or use air space then that interest can be valued as land.

As authority for that proposition he cites the Australian case *Resumed Properties Department v Sydney Municipal Council,* the Unit Titles Act 1972 and an extract from Mr S L Speedy's own publication "Property Investments". Mr Parker quoted from p. 72 of that work and we reproduce the passage:-

"Once ownership of useable space above ground was established it naturallyfollowed that a person could build in space as part of a new building. The next logical step was the sale of air space independent of the surface ground.

The basic legal principles-relating to air space have emerged. The air space vertically above or below a parcel of land which is capable of developmentprimarily belongs to the surface owner but a parcel of air space may be owned by a person other than the land surface owner. Although the air space lacks any physical form other than what is built within the defined area of volume of space it is nevertheless legally a tangible form of property. Airspace can be thought of as land space as distinguished from land surface."

Insofar as the Unit Titles Act 1972 is concerned, it is the respondent's submission that that Act enables definition of that space (that is air space independent of the surface ground), and further creates a legal estate in that air space and that once land is subdivided into units under the Unit Titles Act, then a stratum estate is created. Counsel points to the alternative method as being the cross-lease system whereby the unit owner held an equal share in the fee simple, together with the lessee's interest in the unit occupied by him.

Mr Parker quoted to us the provisions of s.4(2) of the Unit Titles Act, and that section confirms that on the deposit of a unit plan a stratum estate in freehold or leasehold as the case may be in the units in the common property to which the proprietor of the unit is entitled, and in all the units to which the proprietor is contingently interested, is created.

Counsel submits that the Unit Titles Act recognises the common law concept of land defined by horizontal boundaries, and expands on it by creating a system of subdivision which enables issue of a title to a stratum estate in a unit. counsel points to the definition of unit in s.2 of that Act:-

"' U'`Unit' relation to any land means a part of the land consisting of space of any shape situated below on or above the surface of the land or partly in one such situation and partly in another or others all the dimensions of which are limited and thatisdesignedforseparate ownership."

Again by reference to s.4(l) of the Unit Titles Act Mr Parker submits that the word "unit" relates to an interest in land and not to a physical unit in the building.

By reference to the unit plan already mentioned Mr Parker contends that the objectors hold a stratum estate in freehold in the unit4A in Windermere Apartments. The plan shows this unit is substantially above ground level.

The objectors in their submission have legal ownership of the space occupied by that unit and the right to occupy it to the exclusion of any other person including any owner of any other units in the building. The Unit Titles Act 1972 was passed as:-

"An Act to facilitate the subdivision of land into units that are to be owned by individual proprietors and common property that is to be owned by all the unit proprietors as tenants in common and to provide for the use and management of the units and common property."

Mr Parker relies on *Elwood v Valuer General* (1989) 1 NZLR 884 (a Court of Appeal decision) and *Valuer General v Alfred Kohn Family Trust* (unreported decision, Greig J, Wellington, High Court, 10 December 1990).

In *Elwood* the Court of appeal held:

"(1) The influence of zoning on development under a Town Planning Scheme is relevant to land value for the purposes of the Valuation of Land Act 1951. The right to build two units on a section without subdividing it is a matter which affects land value rather than the value of the improvements. The system of cross-leasing effectively provides the benefits of a limited method of subdivision and should in principle be treated in the same way for valuation purposes as if it were a subdivision.

(2) In assessing the land value the Valuer General was obliged to ask what sum the appellant's estate might have been expected to realise if offered for sale the potential for cross-leasing having been realised. He was also obliged to contemplate the land as at the moment of valuation with the buildings notionally removed."

As the Valuer General had fulfilled those obligations and correctly valued the land the appeal was dismissed.

In the *Kohn* case, Greig J, sitting with an assessor, considered the valuation of a development known as Quay Point Development situated between Lambton Quay and The Terrace in the central business district of Wellington.

The land was divided into four lots, and the essential point for the Court's consideration was whether the value of each of the properties should be valued separately, or whether the value of each of the properties should riot exceed the sum which would have been realised had the land been sold as one entity.

The Court decided that the separate property should be identified and valued accordingly and held that though Lots 1 and 3 were separate properties, Lots 2 and 4 had to be treated as one property. Greig Y described the properties at p 3 and 4 of the decision, and some of them are quite clearly air space properties. At p 6 Greig J says:-

"The crux of this appeal or what is pivotal to this appeal is the meaning and application of s.8 of the Act."

He then sets out s.8 in full and goes on at p.7 to say:-

"What we think is essential in the preparation of the District Roll is first of all to identify the separate properties. That phrase is not defined but it must be the case that separate occupation is one aspect of that. Subsection (2) necessarily implies that separate occupation and the capability ofseparate occupation are two of the ways in which the separate property can be identified. Other matters which the appellant submits, we think correctly, to be among the criteria for that identification includes separate ownership, different or distinct land tenure, separate land use and availability of separate titles. Once the property has been identified as being a separate property then it is to be valued and the particulars as described in s.8 are to be provided for each separate property. It is not, we think, appropriate to make a single valuation of separate properties which may be contiguous as if one joint site whether they have been previously amalgamated as one, or can be in some way treated as being unseparated by some common feature or connection. It is not appropriate to apportion a single value of two or more separate properties or to attempt to put a cap or maximum value because of the assumption or fiction of conjunction of the properties because of the past or the future."

The Objector's Case

Mr Speedy says that the essence of their objection is directed against the method adopted by the Valuer General of valuing the objectors' estate or interest in their medium rise unit title apartment. The consequences of the erroneous methodology for the objector is that their value is too high. The objectors agree that the site on which the Windermere Apartment block is situated contains an area of 1378 square metres, and that under the Local Authorities Ordinances the land may be subdivided into sections of an average area of 689 square metres, each of which would then be suitable for two units. In his written submission Mr Speedy says "The site currently has existing use rights for the ten residential units".

He further submits however, that the notional air space approach by the Valuer General is wrong in law and he says wrong in valuation principle "Because it is a fictional creation not based on tangible land that lacks a bona fide market mechanism".

Mr Speedy contends that the proper approach to the valuation of the objectors' "land value" is to disregard all the apartments of Windermere and other above ground improvements, and to value the objectors' estates and interests in the unit entitlement share in the value of the Windermere section, together with the added value, if any, of the existence of the unit title plan.

The objectors then say that the basis of their objection is;-

"Land value is a statutory creation of the Valuation of Land Act 1951 as amended in 1971 intended to be used fortaxationpurposes. Unimproved land on developed properties like Windermere is not a separate legal entity, it is basic property law that all improvements form a legal part of the land."

Then:-

"Likewise the very substantial improvements are economically integrated with the land. Physically there is only one real section. Each apartment has not only a title to the above ground improvements but to various other legal rights, estates and interests. No separate market can exist for the air space content of a unit title (if only because it cannot exist in isolation), only for the fully existing apartment (and associated common property and other legal interests)."

Mr Speedy then in his submission draws a contrast with cross-lease vacant sections that can exist without any building, and says that they do not necessarily form a basis for comparison.

He also says that it is necessary to analyse the Unit Titles Act 1972 to understand more precisely what owner's estate or interest falls to be valued as unimproved land.

He acknowledges the situation under s.4 of the Unit Titles Act which on deposit of the unit plan creates the stratum estate for each unit that is comprised on the plan. He develops an argument around s.2 of the Valuation of Land Act and s.4 of the Unit Titles Act and he cites in support *Toohey'sLimited vValuer General* (1925) AC 439 an Australian case cited with approval in *Valuer General v General Plasti csNZLimited* LV CB 295 and (195 1) NZLR 857 and *Tetzner v Colonial Sugar Refining Company Limited,* which is also cited in the *General Plastics* case. On the basis of the principles of *Tetzner* and *Toohey* it is Mr Speedy's submission that the whole of the Windermere improvements must be regarded and not just the individual proprietor's apartment.

He says that it follows that the Valuer General's notional section in the sky that is based on the assumed existence of other proprietor's improvements remain in existence is then without any physical or legal foundation, and he submits that the correct approach is to assume that the whole of the above ground improvements had not been made but that the unit title and plan does exist albeit of limited value without the improvements.

He says that the highest undeveloped land value would be as a section with the potential of subdivision into two sections each capable of two units as of right, or as existing use for ten units for a lower value end of the market.

He looks at *Valuer General* v Elwood in a different way to the respondent, and he considers that the general statement concepts of principle in the *Elwood* case apply to cross-leases and not to unit titles. Insofar as the *Kohn* case he submits that Greig J recognised that the nature of the separate market for each separate property, and he considers that the points of special relevance to his objection are as follows:-

(a) The proportionate share of the land value does not set a cap.
(b) A sum should be added for the existence of a deposited plan for each separate property.
(c) Strata development in the eyes of the market generally are inferior and prices paid generally reflect this.
(d) Unit titles are inferior to fee simple titles and somewhat akin to leasehold title.
(e) Risk and development for unit titles are higher.
(f) A small fee simple lot on its own will command a better price.

(g) And lastly, it is necessary for the objector to show that the Valuer General's valuation was wrong.

Insofar as the legal principles are concerned we are of the view that the Valuer-General is correct and as in the words of Greig J, once the property has been identified as being a separate property, then it is to be valued and the particulars as described in s.8 are to be provided for each separate property.

In defining the legal principles to be applied, the Tribunal has then considered the valuation approach as adopted by the objector and by the respondent, Valuation New Zealand.

We agree with both Mr Speedy and Mr Everiss, that the valuation of the stratum interest in a multi-unit development enjoying existing use rights, is difficult and indeed very subjective.

In instances such as this, valuers are often required to operate in a "hypothetical vacuum" where there is no directly comparable evidence.

In essence, the approaches adopted and conclusions reachedby the two valuer witnesses are summarised as follows:-

(i) The Tribunal is not satisfied that the objectors' reliance upon the "Superview" property at 241 Hurstmere Road, is a valid comparison. In this instance, Valuation New Zealand had apparently not chosen to assess the individual interests in that property held under cross-lease title, but rather assessed a roll value for the total site. Further, no evidence was produced by the objectors to justify or support the 20% allowance they adopted in adjusting the assessed total land value from single ownership to multi-unit ownership for comparison with Windermere Apartments.

(ii) The objectors' alternative approach, of assessing the land value as a residual value commencing with the agreed capital value, is not accepted as being appropriate in this situation. Indeed, the approach as such is not consistent with the requirements of s.2 of the Valuation of Land Act 1951.

(iii)The valuation methodology adopted by MrEveriss on behalf of Valuation New Zealand stated: "My approach for valuing the land within the apartment block is fundamentally the same as valuing a block of separate property units on the ground..." is in essence the appropriate starting point for a valuation of this type.

(iv) By making reference to vacant land sales, Mr Everiss then arrived at a land value of $200,000 for what he considered to be aconventional land unit value for a ground level site. This figure was not contested by the objectors.

(v) By application of further subjective and significant adjustments, Mr Everiss then arrived at a land value applicable to unit 4A of $220,000. Again, the adjustments adoptedby the respondent's valuer were not contested.

(vi)Mr Everiss then endeavoured to arrive ataland value by analysis of improved sales. Whilst this is at best a secondary approach and may be appropriate in a market or location where there is insufficient actual sales evidence available, the primary method of approach is preferred based on the evidence available in this case.

In the circumstances, bearing in mind the burden of proof being on the objector, we are of the unanimous view that this has not been clearly established by the objectors and therefore we have no alternative other than to dismiss the objection.

Professional Directory

New Zealand Institute of Valuers

NORTHLAND

COUTTS MILBURN -
REGISTERED VALUERS & PROPERTY CONSULTANTS
16 Central Avenue, P O Box 223, Whangarei.
Phone (09) 438-4367, 438-4655. Facsimile (09) 438-4655
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