

VALUERS' JOURNAL

DECEMBER
1994

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NEW ZEALAND VALUERS' JOURNAL

DECEMBER 1994 ISSUE

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

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

Articles and correspondence for the NEW ZEALAND VALUERS' JOURNAL should be submitted to the Editor at the following address:

The Editor, NEW ZEALAND VALUERS' JOURNAL,
PO Box 27-146, 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 (1994) N.Z.V.J. December, page.

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EDITORIAL COMMENT

Moving on and a Salute to the Institute

In my first editorial comment in the December 1988 issue of the New Zealand Valuers' Journal I drew an analogy in taking on the job of Editor as being like stepping into the shafts of the rickshaw and fearing an uphill pull into an unknown street. Now, as I relinquish the appointment I am able to reflect that the trip over the last six years has proved to be not so daunting and while not the "breeze" that the previous editor of long standing assured me it would be, it has mostly been comparatively flat going. The editorship has in fact been a task I have enjoyed and it has provided me with a challenge and experience I could not have otherwise obtained. The New Zealand Valuers' Journal has undergone significant changes and I believe improvement mainly through the impetus of the NZIV Council and the Editorial Board in the last six years. The cover design has been changed and through the appointment of a new production editor Anna Hudson of Visual Impact in Wellington, the layout and format has been brought up to a more modern standard. There have also been some changes in personnel on the Editorial Board in this period. Bill Burgess, Councillor for Northland, became Chairman in 1989 and guided the board until his retirement from office in March this year when he was replaced by Prof Bob Hargreaves, long standing Councillor for Central Districts. Original members still serving on the Board are Squire Speedy and Rod Jefferies, both of Auckland, but Rod has recently advised of his imminent resignation.

Taking up appointment in the period and still serving on the board is Prof Terry Boyd of Lincoln University and appointments have been held by Alex Laing the previous chairman, Evan Gamby the previous editor, Bryan O'Keefe, Jon

Gaskell, Prof John Baen, Peter Young and Leonie Freeman. Ian Mitchell has replaced Leonie Freeman as the compiler of the Technology Forum, formerly the Computer Forum section of the Journal. All these people have contributed to the production and evolution of the New Zealand Valuers' Journal in my term as editor and I record my thanks for their assistance and expertise. My grateful thanks are also due to John Gibson, Chief Executive Officer and General Secretary of the NZIV who has provided me with enthusiastic support. Appointment as editor of the Journal has brought an involvement for me with the councillors of the NZIV through attendance at all Council meetings. In this period I have observed great changes in the role of councillors and the increasing responsibility and work load they have taken on in administering the affairs of the Institute. I believe that most members have little appreciation of the dedication to duty and personal sacrifices in time made by most councillors and particularly the senior office holders. In the last six years through reorganisation of the council into committees and boards which have particular responsibilities all councillors have had to become much more actively involved in the administration and operation of the continuous expansion of the affairs of the NZIV.

At the risk of overlooking some individuals I mention particularly the following people who I believe have had an outstanding involvement over the period. The presidency of the Institute has to be acknowledged as a very time consuming task but in the period it has been enthusiastically and competently carried out by Rod Jefferies of Auckland and Alex Laing of Otago, Roger Hallinan of Canterbury-Westland was just completing his term and John Larmer of Taranaki is soon to complete his term. The current vice-presidents are Bill Cleghorn of Rotorua-Bay of Plenty and Iain Gribble of Auckland. Bill Cleghorn has been the chairman of the NZIV Education Board for many years and has had a significant influence

in the development of the liaison between the Institute and the three valuation teaching universities at Auckland, Massey and Lincoln and in the NZIV Continuing Professional Development programme. Iain Gribble has lead a team who looked in depth at the future direction of the Institute and the challenges it faces in terms of membership and services, and has more recently been involved in the review of the NZIV Insurance certificate. Among the councillors, significant work has been done by Ted Fitzgerald of South & Mid Canterbury branch in the development of computer sales lists and the formation of the NZIV Services company which provided computer software packages and the sales list data to members. This work was carried on by Roger Stone former councillor for Hawkes Bay, until the company was wound up last year.

Some of the administrative functions of the Institute are carried out by the Executive Committee appointed by Council and members who have provided outstanding service are John Wall of Wellington who has been chairman of the Professional Practices Committee for decades and Graeme Kirkaldie of Wellington who has only recently stepped down after a long association. Earl Gordon of Wellington has served on the Executive Committee for many years and has been very closely involved with the formation and fostering of the Institute of Plant and Machinery Valuers. Graeme Horsley of Wellington has made a tremendous contribution to the Institute over a long period of years particularly in his long standing appointment as Chairman of the NZIV Standards Committee and having also served a term as President of the International Asset Valuation Standards Committee. The contribution made by councillors and other appointed office holders and the staff of the New Zealand Institute of Valuers to the ongoing work and well-being of the Institute and its members is often done at great personal sacrifice and I offer a salute to those few who have provided so much.

Trevor J Croot

From The President's Pen

As the end of the year draws near there is a high level of activity in Institute affairs. Councillors have put much effort into developing initiatives with a forward looking focus while staff and members of Executive work through various possible outcomes.

The Council in September determined that membership should decide, by way of postal ballot, a new "merger" proposal, and by now the outcome will be known. The October Council meeting then considered a number of matters relating to future planning, with alternatives dependent upon the outcome of the "merger" vote. Changes may need to be considered with respect to Council representation and administrative structures in due course, to better reflect the needs of modern management and present day cost effectiveness.

I referred to the MRL research in my September contribution. This report on how valuers are perceived will prove to be a valuable marketing and planning resource. Following on from the initiative of our Marketing Committee, I undertook a series of meetings throughout New Zealand during August and September to convey a summary of the MRL findings to branches. The research provided, in my opinion, compelling evidence that we need to embrace much wider concepts of asset valuation, land economics, and financial expertise, to prosper in the conditions

dictated by the global economy that we now belong to. Those who availed themselves of the chance to hear Professor Crosby during his August lecture tour received a financial perspective on property markets; while Professor Boyd at the NZIV Lincoln Spring Seminar again reiterated that valuers must have knowledge of the wider land economy. He also said that valuers must be in closer touch with their real estate markets and not become too removed.

These are demanding but exciting times for all professionals, as old ways are challenged and historical frameworks questioned. Accountants are expanding their services, lawyers are marketing themselves, and bankers are competing aggressively. Although some members have felt uncomfortable with the discussions and debate of recent years, we are no exception and must be seen to respond to the legitimate requirements of the marketplace. Research tells us that a wider range of property and economic advice is required of valuers, and that there is also insufficient awareness of the expertise encompassed within the profession.

A forum on marketing at the October Council meeting agreed that our main function in this area, apart from national profile, comment and visibility, was educative.

J P farmer

The series of branch meetings on recommendations in the MRL report was the first step in this process, and further material from MRL will continue to be put before members. Future CPD programmes may also look at marketing, in association with other areas of good business practise.

The economy continues to improve and there is an increasing demand for the services of competent, skilled, and up to date valuers. Sadly, those who do not take off their blinkers and make a greater effort to upskill themselves may be sidelined or even "sinbinned" by market forces.

Competence will almost certainly be the test of the future, requiring continuing professional development to achieve and maintain. The truism: "Nothing is permanent except change" certainly applies at the present time.

I extend to all members the compliments of the season and a prosperous New Year.

New Zealand Institute of Valuers

Annual Manuscript Competition

CONDITIONS OF ENTRY

The New Zealand Valuer's Journal Editorial Board offers an annual Award for a leading article to be published in the Journal. The Award has a value of NZ\$1,000 and shall be paid to the successful applicant who meets the following conditions:

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

Current Fellows NZIV

Allan, Kevin Michael	16/4/86	Fright, Raymond Harry	14/4/81	McSkimming, Andrew	21/4/90
Archbold, David James Owen	2/5/88	Gamby, Michael Evan Leigh	13/4/86	Millar, Nathaniel Malcolm	14/4/80
Armstrong, Donn James	15/4/84	Gardner, Anthony Ross	11/4/92	Molesworth, Thomas Frederick	1/9/72
Babe, Edward James	5/4/82*	Gardner, Robert Southwell	19/2/60	Molloy, Sean Boyd	3/10/77
Baker, David Harold	15/4/72	Garton, Evan Herbert	31/8/48	Monds, John Frederick	1/9/72
Baker, Robert Keith	9/4/69	Gibson, John Gledhill	9/5/77	Morgan, John Preston	1/4/77
Barraclough, Colin Thomas George	15/4/62	Gibson, Albert Eric	6/7/76	Morice, Stuart Digby	21/4/65
Barratt-Boyes, Derek Benjamin Cave	15/4/72	Goldfinch, Paul James	14/4/87	Morrison, Douglas George	6/4/76*
Bell, John Mathew	15/4/70	Gordon, Earl Francis	16/4/94	Ng, Tee Geok	10/4/83
Bell, Robin Allen	16/4/94	Green, Leonard Thomas	20/4/91	Nicholls, Alistair Charles	16/4/94
Bernau, Timothy John	20/4/85	Greig, Gordon Alexander	9/6/78	O'Brien, Peter Conor	16/4/94
Blackmore, Geoffrey John Harold	17/4/93	Gribble, Iain William	2/5/88	Oldfield, John Henderson	14/4/87
Blincoe, Herbert James	21/4/90	Grinlinton Bruce Gregg,	15/4/85	Osborne George	1/4/74
Briscoe, Joseph Wade	16/4/74	Guy, Andrew Donald	14/4/87	Ower, Derek Keith	15/4/70
Bryant, Alan	5/9/70	Hadcroft Bryce Harold,	30/5/75	Parker Kenneth Eber,	11/4/92
Burgess, William Andrew F	16/4/94	Hallinan Roger Ernest,	30/5/84	Pedrotti Albert William,	15/4/67
Burns, Graeme Errington	10/4/73	Halstead Graham Allan,	20/4/85	Pne Alan Fredericky	15/4/59
Calderwood, Alexander Ross	12/4/75	Hanna, Malcolm Russell	12/4/77	Ralston, Stanley W Alexander	1/4/74
Cameron, Ian Ross	11/4/92	Harrington, William Owen	13/4/81	Rawcliffe, Terrence	1/4/85
Caselberg, Angel Ernest	28/8/47	Henshaw, Thomas David	11/4/92	Reid, Charles Gibson	15/4/67
Chamberlain, Charles Nelson	21/4/90	Hillary Naylor George,	15/4/70	Riley Richard Graeme,	22/12/82
Chappell, Raymond John	14/4/87	Hilson, Brian John	16/4/94	Robinson, Arthur Neil	14/4/87
Cleghorn, William Alan	15/4/86	Holmes, Peter Robert	15/4/66	Roper, George Charles	21/11/83
Coleman, Kerry Arthur Francis	16/4/94	Horsley, Graeme John	15/4/83	Rowse, Gamet William	19/3/61
Cook, Peter John	8/4/89	Hudson, John Frederick	24/4/91	Sceats, Edward Ray	15/4/66
Cooke, Peter Gaydon	9/4/73	Jefferies, Rodney Lynn	1/4/79	Scholefield, Guy William Hardy	8/4/89
Cooper, Kelvin John	14/4/81	Jensen Rex Hemmingsen,	2/5/88	Sellars Gary Russell,	16/4/94
Croft, Cedric Spencer	16/4/94	Jones, Gordon	16/4/94	Sellars, Michael Andrew John	11/4/92
Croker, Charles Harry	12/4/79	Kingston, John Richard	9/4/73	Sharp, Geoffrey Hey	22/5/68
Croot, Trevor James	8/4/89	Kirkcaldie, Graeme	8/4/89	Sharp, John Robert	2/5/88
D'Arcy, Brian Edward	17/4/93	Laing, Alexander Philip	15/4/82	Shera, Ronald Blakely	17/4/93
Darroch, Neil Kelvin	15/4/85	Larmer, John Patrick	30/5/84	Smith, Ormsby Bryce	30/5/69
Davies, William George	15/4/76	Livingstone, Robert Reuel North	23/2/70	Smithies, Edgar Brett	16/4/94
De Lautour, Brian	30/5/75	Long, Alan Desmond	20/10/70	Sole Leslie Mervyn,	20/11/68
Dean, Stephen Nigel	20/4/91	Lord, Robert	1/4/76	Seed Suire Lionel p y, q	23/4/90*
Dodd, Hugh Morley	15/4/63	Lugton, David Bruce	13/4/86	Stabler John Alfred,	2/5/88
Donaldson, Robert Morley	30/5/75	Lyall, Ian Wylie	11/4/83	Stevenson Kenneth Geore,	20/4/91
Dunkley, John	11/4/92	MacPherson, John Ogilvie	6/8/65	Stewart Arthur Geoffre, y	13/4/86
Elsmore, Stanley William	15/4/65	Mahoney, Peter James	27/7/82	Svensen Mervyn Leonard,	30/4/78
Englebrecht, Robert Lester	21/4/90	Mander Murray Raymond,	22/4/85*	Telfer Ian Robert ,	16/5/85
Eyles, Russell	11/4/92	Marks Thomas Ian ,	20/4/91	Tetzner Sergus Alexander,	9/10/50
Farrell John Paul,	15/4/70	Marshall Barry Anderson,	30/5/75	Tierney Peter Edward,	15/4/76
Findlater, Murray James	1/5/77	Marshall Alfred Warwick,	11/4/92	Todd Donald Bruce,	20/4/91
Fitzgerald Edward Thomas,	8/4/89	McAlister, Allen Lindsay	2/5/88*	Townshend, Edwin Gray	16/4/94
Flux, Peter Arthur	22/5/68	McDonald Hamish Ferguson,	14/4/87	Veale, John Bowden Henry	14/4/80
Foster, Graeme Thomas	13/4/86	McGlone, Vincent Patrick	15/4/55	Wall, John N Beaufort	1/6/69
Fowler, Ronald Franklin	21/4/90	McGough Robert Morrin ,	13/4/87*	Watters, John Alexander	14/4/87
		McNabb Ronald Stuart,	15/4/51	Wilson, Alan Reid path	15/4/78
				Wilson Allen Ross,	15/4/65
				Young, Robert Peter	19/4/93*

* Life Fellows

People Profiles

Bill Cleghorn NZIV Councillor

Practising valuation in the Rotorua district provides the opportunity to specialise in some unusual aspects of the property industry for Bill Cleghorn, NZIV Councillor for Rotorua-Bay of Plenty. He is also one of the vice-presidents of the Institute. Mr Cleghorn is the founding partner of Cleghorn, Gillespie, Jensen and Associates, based in Rotorua, the largest valuation practice in the Bay of Plenty.

He specialises in valuation of rural prop-

erty with particular interest in forestry and the assessment of areas used for radio and telephone transmissions (something that takes him all over the North Island). But unique to the Rotorua region is his expertise with thermal resorts.

Born in Auckland, he grew up in Remuera, but so badly wanted to do an agricultural course he caught the train each day to travel to Otahuhu College, one of only two colleges offering such a course in the Auckland area.

After leaving school he worked on a dairy farm near Edgecumbe before taking up a Rural Field Cadetship. He recalls the bond was three thousand pounds and said it was probably the biggest thing, apart from the mortgage, his father had ever signed. His grandfather went guarantor, and Mr Cleghorn remembers the older man looking him in the eye and saying sternly, "Well Bill, you had better make it work."

The five years training took him to a hill country sheep farm near Dannevirke, then to Waimate and Rakaia for cropping experience, on to another dairy farm at Te Awamutu and a period with a fat stock buyer at Papakura.

"We call ourselves property consultants, but they don't see us like that. It seems obvious that while we should protect and expand our core business of valuation, we should also expand the consultancy role," he said.

He points out there is competition from other areas, for example, financial planners are a "new breed" and doing block courses on valuation.

He sees NZIV as being at an "interesting stage", and would be quite comfortable about deregulation for the Institute.

Mr Stewart took Valuation and Farm Management (VFM) at Lincoln College (as it was), and he did go farming for about a year, but then joined the Rural Bank, first at Timaru then Dunedin.

In Timaru he met and married his wife Jan. Together they took off for two years OE. Their oldest daughter, Jacqui, was born overseas. She is now 21 and a veterinary student at Massey University.

Son James, 19, is a first year commercial student and daughter Claire, 15, is sitting school certificate. Jan, a qualified nurse, manages an "aged persons hospital".

Interspersed with this were courses at Lincoln College (as it was) and a year's intensive course in dairying at Massey Agricultural College (as it was).

Then came eleven year's working for the Valuation Department in Auckland, Hamilton and finally Rotorua, where he married Annette and they brought up their family.

He and Annette own a small Dorset Down stud, and run a few Angus cows. He tries to find time for a bit of golf and fishing. Mr Cleghorn is Trustee of the Massey University Property Foundation, an active Justice of the Peace, is involved in arbitration and refereeing in valuation matters. He is a mediator for Midland Regional Health and a member of the Land Valuation Tribunal.

In 1993 Mr Cleghorn became the eleventh recipient of the John M Harcourt Memorial award in recognition of his outstanding service to the valuation profession and the New Zealand Institute of Valuers.

For his services to New Zealand he was awarded the 1990 Commemoration Medal by the Queen.

Back in New Zealand, Mr Stewart started with the Valuation Department in Christchurch, and although he had his rural valuation ticket he was keen to get urban qualifications too.

He put the urban qualification to use when Pyne Gould Guinness bought out an urban valuation firm and he was appointed to run that practice.

For over five years he was doing two thirds urban valuation, then left to become a partner in the Christchurch branch of Robertson Young Telfer. He was back to doing more rural work, and admits he likes that best.

Three years ago one of the directors Roger Hallinan and Mr Stewart set up their own property consultancy. Now trading as Hallinan Stewart Ltd, Alan is doing more rural work and that also involves a number of small holdings and subdivisions closer to town.

Mr Hallinan is a commercial specialist involved in a lot of umpiring and litigation work.

"We still do investment and residential work, but we tend to specialise more and we do property consultancy rather than straight valuation," he said.

Alan Stewart NZIV Councillor

As chairman of the marketing committee that carried out a major marketing research project for the NZIV. Alan Stewart, Councillor for Canterbury-Westland, is in a good position to know how valuers are viewed by the rest of the population.

"The message we got essentially from the corporate sector, was that they see valuers, whilst very professional and doing an excellent job, as in a very narrow field. They see us as providing figures in terms of what assets are worth," said Mr Stewart.

October Council Meeting 1994

Report by the Editor

The October meeting of the Council of the New Zealand Institute of Valuers was held at Quality Hotel, Oriental Bay, Wellington on 9-10 October 1994 commencing at 9.30 am.

President John Larmer welcomed councillors, invited guests and a representative of the Executive Committee, Earl Gordon and the Chairperson of the Professional Practices Committee, John Wall. Apologies for late attendance were received from Iain Gribble and John Dunkley. Alex Laing, Immediate Past President and Lindsay McAlister NZIV representative of the Land Professionals Mutual Society Incorporated attended on Monday.

Minutes of the previous Council meeting held in April at Auckland were confirmed as being a true and correct record of that meeting and the minutes of the extraordinary Council meeting held in September were confirmed as being a true and correct record of that meeting. In Matters Arising from the April Council meeting, President John Larmer reported that in his meeting with the Valuer General he was given the assurance that it was not the policy of Valuation New Zealand to compete for nonstatutory valuation work. Vice President Bill Cleghorn reported that legislation nominating the Valuer General as exclusive valuer will be under constant review by the Council of the NZIV and brought to notice as appropriate. President John Larmer reported that the name change by the South Canterbury branch to South & Mid Canterbury branch has been approved by the Minister.

Membership Issues

John Gibson, Chief Executive Officer advised Council that there are approximately 400 overseas members, retired and non-active members of the Institute who have elected not to take subscriptions to the New Zealand Valuers' Journal and Newsline and that their only publication contact with the Institute is through the NZIV annual report. Council agreed that a Vice President's newsletter and copies of Newsline will be provided free to overseas members.

Vice President, Bill Cleghorn presented a report from Executive Committee recommending that application requirements for advancement to Associate status in the Institute be amended to provide for a

longer period of 12 months in which reports may be selected for presentation; and that reports be required to cover a wide range of the applicant's experience to demonstrate the range of skills and experience of the applicant.

Forum Session

Mr Douglas Wood of MRL Research Group presented a brief report illustrated with overhead transparencies on the marketing research carried out on "How Valuers are Perceived" and councillors held wide ranging discussions through the Chairman of the Marketing Committee Alan Stewart on the issues involved in the implementation of an NZIV marketing programme.

Forward Planning

Council considered several procedural matters in respect of a further merger vote amongst members including the nomination of a transitional board of management elected by the NZIV Council.

Council considered the future objectives of the NZIV in the event that the merger vote to be held amongst members in November 1994 results in a merger not being achieved. The objectives were outlined by Vice President Bill Cleghorn which included a review of legislation to clarify the status of intermediate members and expanding the membership base; review of the Code of Ethics; review and rationalisation of present Branch boundaries; investigation of a change in the NZIV financial year from 31 December to 31 March or 30 June; implementation of Continuing

Professional Development on a mandatory basis and to implement appropriate procedures recommended in the NZIV office audit.

A report from Price Waterhouse on the audit of the national office structure and procedures which included wide ranging consideration of compulsory membership of the NZIV compared to voluntary membership and the necessary changes that would bring to staffing issues and responsibilities and efficiency was considered by Council.

Pan Pacific Congress

President John Larmer reported on the recent 17th Pan Pacific Congress held in Yokohama, Japan in May 1994 attended by the President, Vice President Bill Cleghorn, Chief Executive Officer John Gibson and Peter Mahoney, branch member from Auckland. Bill Cleghorn and Peter Mahoney presented papers at the Congress.

New Zealand was successful with its bid for the 20th Pan Pacific Congress to be held in Auckland in 2000.

Reciprocity

President John Larmer reported that he and Vice President Bill Cleghorn had met with the President of the Hong Kong Institute of Chartered Surveyors at Hong Kong to discuss a reciprocity agreement. He also reported that further communication has been made with representatives of the Valuers Institutes of Malaysia and of Singapore at the Pan Pacific Congress in Japan.

Standing Committee Reports

Executive Committee

John Gibson, Chief Executive Officer, presented various budget alternatives that had been prepared for Executive Committee. John Wall, Chairman, reported that numerous complaints against valuers are being received some of which are frivolous in nature. He commented that a small number of valuers, against whom numerous complaints have been received, are causing concern but that appropriate action is being taken against them by the Valuers Registration Board. John Wall advised Council that the Valuers Registration Board has expressed concern that valuers are not considering or satisfactorily

establishing the GST status of sales used as comparative sales bases for valuations. He reported that it has been established that the Valuers Registration Board has power to consider complaints against registered valuers carrying out valuations of property other than land and buildings e.g. plant and chattels valuations.

Marketing Committee

Alan Stewart, Chairman reported that sales of computer sales data has increased significantly in the last two years and that the current NZIV computer hardware is becoming rather fragile. He advised that replacement downloading hardware and some software packages will need to be

replaced at a cost of approximately \$23,000. Alan Stewart reported that his Committee considers that there may be advantages to the NZIV in a joint venture with a computer industry company proposed by Ted Fitzgerald, Councillor for South-Mid Canterbury Branch, to upgrade the sales data system on a 50% shareholding basis. Council agreed that a sub-committee comprising Councillors Alan Stewart and John Dunckley, consider proposals to be put forward by SISCO, represented by Ted Fitzgerald and report back to the Executive Committee.

Alan Stewart reported on the work that the committee had undertaken through the guidance of Adrian Brady of Wellington in setting up the survey conducted by MRL Research Group into "How Valuers are Perceived". John Gibson, Chief Executive Officer, presented budget alternatives for the Marketing Committee.

General Business

Council held an election for appointment to the NZIV Transitional Board at which the following members were elected:

John Larmer
Iain Gribble
Bill Cleghorn
Ted Fitzgerald

Council agreed to amend advancement procedures and application forms to extend the time over which reports may be selected by candidates for Associate status from six months to twelve months. A selection of not less than six reports should be provided to demonstrate the range of valuation experience and that candidates are expected to have a broad knowledge in their specialty e.g. urban or rural valuation. Following the Forum Session council decided that the Marketing Committee should direct its focus on informing members on ways in which they can market their professional services and that one or two national projects which will enhance the commercial and public image of the valuation profession and the NZIV should be pursued.

Education Board

Vice President Bill Cleghorn, Chairman of the Education Board outlined the sections of the NZIV rules and Code of Ethics of the Institute under which mandatory Continuing Professional Development could be enforced.

Land Professionals Mutual Society

Lindsay McAlister NZIV nominee to LPMS reported that there had been quite significant growth in the number of registered valuers covered by the Society but at the same time a small drop in the number of valuation firms as members. He advised that the Society had a lower claims experience in the last year although two major claims have been settled, one for a sum in excess of \$400,000.

Lindsay McAlister reported that the LPMS made a small profit in the past year which will be contributed towards reserves. Premium levels have generally been maintained and it is hoped by LPMS that the present lower claims experience will be reflected in premium levels in the future. Institute of Plant & Machinery Valuers Earl Gordon the NZIV representative on the IPMV reported that membership numbers of the IPMV had remained fairly constant with new members balancing

John Gibson, Chief Executive Officer reported that a survey of members has been carried out on the Modal House and a review undertaken of the concept and the standard specifications. Bob Hargreaves, a member of the review committee presented a report of the survey results which is to be submitted to the review committee for further consideration. Vice President Bill Cleghorn reported on the formation of the Pacific Rim Real Estate Society which has evolved from the Real Estate Educators Conference.

Standards Committee

Vice President Iain Gribble, in the absence of the Chairman, Graeme Horsley, who was attending a TIAVSC meeting in Indonesia, reported that a technical handbook incorporating the NZIV Standards is to be produced by the committee and sold to members at a cost of \$100 plus GST and with a computer disc available at an extra cost of \$15 plus GST.

Iain Gribble reported that a sub-committee chaired by Rod Jefferies has been reviewing discounted cash flow valuation methods and a report on the various methodologies is being prepared for the Standards Committee.

The NZIV Insurance Certificate review has now been completed and the new Insurance Report form as it will now be termed has the support of the NZ Insurance Council sub-committee and has been confirmed by the Standards Committee. Council approved the Insurance Report

resignations to the present 48 full members, 14 probationary members and 1 overseas member. He reported that the management committee is concerned to promote membership of the IPMV and may need to develop further categories of membership or perhaps lower the entry criteria to increase membership. Earl Gordon advised that all IPMV members now practice with compulsory indemnity insurance and that compulsory professional development has also been introduced.

Massey Foundation

Vice President Bill Cleghorn reported that Mr Neil Darroch has been appointed Chairman of the Massey Foundation following the death of Graeme Bringans. He reported on the recent activities of the Foundation and advised that assistance had been provided for Professor Bob Hargreaves to attend a real estate congress in Chicago USA where he presented a paper.

form which will be produced in the near future and will be available from December 1994. Iain Gribble advised that the Provisional Practice Valuation Standard No 4 on suburban commercial properties has been elevated to become Practice Valuation Standard No 4.

Editorial Board

Bob Hargreaves, Chairman reported on the activities of the Editorial Board and that considerable difficulty was being experienced in finding a replacement editor for the New Zealand Valuers' Journal. He advised, however, that discussions are currently being undertaken with possible interested parties. Bob Hargreaves reported that Rod Jefferies of Auckland has indicated that he will resign from the Editorial Board at the end of the year.

Trevor Croot, Editor of the New Zealand Valuers' Journal reported that a satisfactory flow of articles is being received for publication in the Journal mostly sourced from seminars promoted by the NZIV and seminars conducted by the various universities. He appealed to Councillors to encourage branch members to produce papers on valuation topics of their particular interest for presentation at branch seminars and being made available for publication in the New Zealand Valuers' Journal.

He advised that highly satisfactory service is being provided by Anna Hudson of Visual Impact as production editor and that a good standard of print publication is

being produced by the printer at Wellington.

Westbrook House - Body Corporate 66017

John Gibson, Chief Executive Officer, reported that the structural alterations and redecoration work to the building had now been completed generally on target and within budget.

TIAVSC

Vice President Iain Gribble in the absence of Graeme Horsley, the NZIV appointee to the International Assets Valuation Standards Committee reported that 10 additional standards are currently being prepared by TIAVSC.

1995 Subscriptions

Council approved the following membership subscriptions for 1995:

	Plus GST	Discount Prompt Payment + GST	(Newsline Free) NZIV Journal
Registered Valuer	\$375	\$325	included
Non Registered Valuer	\$210	\$180	included
Overseas	\$ 90	\$ 80	by subscription
Retired rule 14(1)	\$ 90	\$ 80	by subscription
Affiliates	\$210	\$180	by subscription
Non Active - earning	\$135	\$120	by subscription
Non Active - non earning	\$ 90	\$80	by subscription

Forward Meetings of Council

The first Council meeting in 1995 will be on Thursday 30 and Friday 31 March 1995 at Twizel before the AGM and Seminar on Saturday 1 and Sunday 2 April 1995.

The second Council meeting will be held on Sunday 8 and Monday 9 October 1995 at Wellington.

Property Valuation A Business With A Future?

by A J Brady

This paper is a sequel to the article titled "Marketing Valuers' Myopia" published in the June issue of the New Zealand Valuers' Journal and has been prepared following the completion of the market survey commissioned by the NZIV Marketing Committee and undertaken by MRL Research Group. Adrian Brady is an Associate of the New Zealand Institute of Valuers and has a sole practice at Porirua.

Your Institute undertook a comprehensive market research programme during July of this year and it produced some interesting results. The intent of this paper is to provide a brief summary of the key points, outline my perception of some of the hidden messages and offer some solutions to the current malaise that pervades our profession. I have deliberately adopted a provocative stance and the intent of the paper is to stimulate some individual thought from members and practitioners on what they may or may not do in the future to sustain their business.

MRL Research

In many respects the research has reinforced some of the perceptions many valuers have of their profession and this is quite heartening. For example, there was a strong indication that valuers have a particularly good image, they are professional and provide a professional product. However, valuers are perceived as having the expertise, qualifications and credibility to provide only a very narrow range of services. In other words, to the Public, the name "valuer" does not convey the many other types of work within the property

sector that they may be able to undertake. From the perspective of individual clients and influencers, the valuation profession is seen as occupying a relatively specialised niche and is one of a number of professions operating under the "property professionals" umbrella, but they are not regarded as being preeminent or the central profession through which other property services can be obtained.

There was a strong suggestion flowing through the research report that the niche in the market occupied by valuers was increasingly under threat. In spite of many Banks being the source of much residential valuation work, there was a perception they perceived valuations to be an unnecessary expense for their clients. In the residential market the lending decision was increasingly based upon the potential client's ability to service the loan rather than an assessment of the property's worth.

Even in the commercial sector, valuers were perceived as simply providing "the number" and many saw the use of a registered valuer as protecting both the Bank and the borrower from the conse-

quences of a decision to lend or Company Directors from their decisions on property. A very high proportion of valuers were recommended by the lender or corporate person and the recommendation was made simply on reputation and past performance. Only 4% obtained their valuers from the yellow pages. In this light it is important to understand the difference between advertising and marketing and seriously question whether your advertising is targeting those who are going to provide you with the bulk of your work.

There was a strong suggestion that many clients simply saw valuers as providing a valuation and the absence of any real contact between the valuer and the client had reinforced that perception. Valuers have continually focused on providing a product, a valuation, and have lost sight of customer service and adding value to the report which could only be achieved by personal contact and focusing on the client's needs. I will refer to this matter later in this paper.

Respondents perceived valuers to have little competition for property consultancy services simply because they are not seen as natural providers of the majority of these services. In other words, valuers provide a narrow range of services which are useful on some occasions but if they can be avoided - all to the good. Indeed, one respondent described valuers as "technical type people who give factual technical information and provide voluminous reports, bound, double spaced and wordy". A further comment was "unimaginative - give factual information but have no instinct for future activities or prospects".

Almost all respondents were aware in a vague sort of way that registered valuers belong to a professional organisation. Most were unclear, however, as to its exact role and tended to assume its functions were those of education and a watchdog; disciplinary role which are the activities of most professional bodies.

For some members of the Institute of Valuers, this comment may be total condemnation of the role the Institute has played over the past, but others such as myself would argue, does it really matter? Which comes first? The marketing of the individual practitioner by him or herself and the Institute awareness following from that or vice versa. Personally I would argue for the former, but with a different focus this could be reversed. I will elaborate on this further in the paper.

Many respondents saw limited potential for valuers to increase the amount of use of their services simply because the circumstances in which they are used are so clearly defined and their level of demand so much a result of forces beyond their control, such as economic factors. In my view this comment reinforces the perception gap of the abilities of valuers and their understanding of property in the wider sense.

From a strategic observation, I believe the strongest point to come out of the research is the product focus of valuers. We have consistently concentrated on the quality, quantity and presentation of our reports, conscious all the time of the Registration Board looking over our shoulders and trying to meet standards imposed by the Institute (of which there is very low awareness). Consequently the clients and their needs have been completely neglected. Those who have adapted the focus of their practice are now beginning to prosper while those who have not continually complain about cut fees.

The research indicates the image of our profession is strong, and we provide a professional product with professional people. Therefore, all the matters the Institute and their members have focused on in the past two or three decades have

been well received by the public and have met with a good deal of success. In spite of this most of the thinking members of our profession are aware of the malaise and eroding influences impacting upon our profession. We are operating under principles the market has now discarded and others have stepped into the gap. So what do we do?

Macro Environment

My previous article referred to the railroads of the United States of America experiencing difficulty and losing business because they perceived themselves to be in the railroad business rather than the transportation business. It is interesting to note in the 17-23 September 1994 issue of "The Economist" an article entitled "The Return of the Railway". The article refers to Eurostar trains whisking passengers from London's Waterloo Station to Central Paris in three hours upon the opening of the Channel tunnel, without airport hassle or traffic jams. As a result British Airways was rattled enough to upgrade its European business class services with high dollops of air miles to keep passengers off the rails (so to speak). Further, high speed trains are arriving all over Europe - Germany, Spain and Italy have their own versions of France's "trains a grande vitesse". Even America's Amtrack is pondering which sort of high speed train will be chosen to run in the lucrative north east corridor between Boston, New York and Washington.

The railroad has finally understood it is in the transportation business and is there to meet customer's needs. It is now competing with the airlines by exploiting a competitive time advantage and an infrastructure.

It is unlikely valuers will have to wait thirty years for the renaissance of their profession because the research has provided the answers and the remedy is in the hands of the individual practitioner guided by a proactive institute or society offering strategic support.

Deregulation of the New Zealand economy has been particularly difficult for our profession as it was established in a regulated environment where Government control had a significant impact on the market, our services were virtually required by statute supported by a scale fee and with advertising outlawed. Those within the profession had little real competition. Consequently, when Roger Douglas had his way and deregulated the finance sector and the market moved into the first depression of any significance for 50 years, valuers were caught with their pants down. The environment within which they are now operating required expertise beyond the simple valuation techniques that have been taught and employed from the inception of the Valuers' Act through to the late 1970s.

A mindset had developed within the profession that was slow to recognise the macro environment and the opportunities available. For decades a retrospective view of the world has restricted valuers' ability to think- strategically as they continually focused upon the coal face. Consequently the big picture eluded them when the need was greatest. Although many valuers have recognised that their practice, and the Institute for that matter, is now a business and that it should be operated on business lines, many have not known where to start. There have been attempts to manage the transition by bringing in the "vaudeville style" delivery with a hit and run showman presenter that often had a temporary affect. The time has now come for valuation business and the Institute to move away from the one-off affect to develop a structure that will permit a continuous relationship through time, with a key executive educator who has strong "action learning" skills and can lead from the front. The present formation of the Institute is a constraint to this strategy.

Recommendations

The Institute has set in place a continuing professional development programme which will be compulsory by January 1996. The thrust of this programme is focused on our profession with many of the topics qualifying for credit, directed at standards or technical aspects of valuations. In my view the focus of CPD should be widened to include a wider range of skills such as marketing, financial management, service management, business information systems, entrepreneurial and new ventures and business policy. The intent of much of this tuition would be not only to provide a "how to" concept to members of our profession, but to stimulate a wider thinking and a wider understanding of the business environment and thus give practitioners a background and understanding upon which to develop strategies for their practice and to compete more practically with each other. This would also assist members to move away from the product focus to a customer focus and develop service strategies.

Tuition should be undertaken professionally and it would be the Institute's role to facilitate this wider education of its members. The onerous compulsory provision would be removed principally because I believe those who do not avail themselves of the benefits of this education and personal development will eventually fail. Coupled with this, I believe the Institute will need to address its structure and modus operandi. In my view the most beneficial way for the Institute to raise its profile and that of its members would be by the development of a public relations campaign generated from Head Office focusing on future trends rather than the past. The present structure would not

Investment Valuation Approaches in a Changing Rental Market

by N Crosby

Professor Neil Crosby has a Doctorate in Philosophy attained at the University of Reading in the United Kingdom and he is an Associate of the Royal Institute of Chartered Surveyors. He is the Professor of Land Management in the Department of Land Management and Development at the University of Reading and in the course of presenting these seminars in New Zealand was the visiting Research Fellow at the School of Land Economy, University of Western Sydney, Hawkesbury, Australia.

Professor Crosby has completed extensive research into open market rental values and the accuracy of valuations and he is

the author of numerous articles on valuation topics and co-authored the book "Property Investment Appraisal" published by Routledge in London in 1988.

allow this to function efficiently and such a campaign would require a change of thinking from many of our members simply because our basic philosophy has always been focused on history. This sector of the market is well covered by the Real Estate Institute and their monthly sales statistics and Valuation New Zealand with their very credible six monthly releases. In my view there is a substantial gap for a professional organisation to examine economic trends and to attempt to make some projection for future trends for different sectors. Further analysis of the likes of Property Trusts and the development of property indices particularly in the commercial sector from a well qualified research team based within the Institute operating in conjunction with private practitioners would substantially sharpen the profile of the Institute and all its members.

For some time now the Institute of Valuers has struggled with promoting the awareness of its members and various attempts have been made to develop corporate advertising or general advertising programmes. While it is difficult to measure the level of penetration these programmes have achieved, I believe their impact has been minimal simply because they had no specific message or target. Even if the

Institute was able to identify certain matters which could reimage the organisation, there are insufficient resources to carry out a campaign of any significance that could change people's view. After all, the research we undertook states plainly that we are a professional organisation of considerable credibility with a particularly good image. If we are to survive in the 21st Century it is necessary for the Institute to refocus its direction, begin thinking strategically and plan in that manner. To undertake a successful public relations campaign, our members must be sufficiently educated, have a breadth of thinking, understand the business and macro economic environments that impact upon all their decisions, and have a knowledge of the matters their Institute is commenting upon.

At the time of writing, the vote for amalgamation with the Property Management Institute has not been made. If amalgamation was to proceed this may enable the development of a new structure that will facilitate a strategic refocusing of our profession. However, if the amalgamation fails, I believe considerable soul searching will be required because our profession is under serious threat. A report prepared by Macquarie Bank entitled "Property Market Changes" published in August 1994 stated "the term valuer and the valuation profession as such are an endangered species". Unless we totally reconsider our place in the market this may be a very prophetic statement.

1. Introduction

The increasing globalisation of the world economy has implications for property as well as other markets. Although the timing may differ slightly due to local differences, there is a distinct similarity between the performance of property markets in the UK and Australasia. Increasingly, property market analysts are investigating international property and financial markets to see if lessons on their own markets can be learnt.

Property valuation is no different. Certain techniques such as discounted cash flow (DCF) have no domestic boundaries and are utilised world wide in the appraisal of investment properties. In this paper, DCF is used as a generic term to encompass all applications of cash flow appraisal, be they traditional income approaches to determine market value (which discount the current level of cash flow into perpetuity at a yield which reflects all of the risks inherent within the investment) or more sophisticated explicit cash flows which make subjective judgements regarding future rental levels, redevelopments, future sale values, etc.

In the U.K., the term DCF tends to be used to identify only the latter model and a review of the valuation literature in New Zealand suggests a similar interpretation here. However, all present value models discount cash flows, the real debate is regarding the role of the model (market value i.e. exchange price) or calculation of worth (i.e. an analysis of the rationality of the market price) and the correct application for the particular role. In Australasia, the distinction regarding price and worth models is less accepted and there is a body of opinion that would like to see full explicit DCF models used to determine the open market value, i.e. price. In the U.K. investors do not believe that a rational discounting of the prospective cash flow will necessarily equal the price and until it does a separate methodology is acceptable. In the U.K., the debate centres on the use of investment valuation approaches for market value, calculating the price the market will demand of any purchaser. The application of the DCF model for the calculation of the worth of an investment is not in dispute as it is widely accepted that this role demands explicit cash flows based on forecasts of rental growth, refurbish-

This paper was presented at NZIV Seminars held in Auckland, Wellington and Christchurch on 22, 23, 24 August 1994.

ment/redevelopment cost forecasts and the timing of these events, changes in resale valuation yields (termed all risks yield or capitalisation rate in the U.K.) and estimates of the costs of holding and subsequently selling on the investment (the timing of which is also a subjective element in the appraisal). Given this almost universal view in the U.K. that price and worth are not always the same figure, explicit DCF techniques incorporating forecasting, although they may have some

influence on it, do not determine price. This leads to the conclusion that any valuation advice to clients concerning buy/sell or strategic portfolio planning should include two appraisals; an estimation of the price that could be achieved in the market place (open market value with some adjustment for market changes over the future marketing period) and an estimation of the worth of the investment. A difference in these two figures will generate the information necessary for decision making

if one criterion for individual stock selection is market under/over pricing. This paper is not about calculations of worth. This paper aims to critically examine the application of traditional all risks yield/capitalisation rate models in the light of the recent recessions in property markets in New Zealand and the U.K. In order to draw these comparisons, the similarities and differences between the two markets need identification and this is undertaken in section two below.

2. The property markets in New Zealand and the U.K.

There have been major similarities between the general shape of the performance of the economies in the two countries over the recent past. Both have been the subject of recession after a period of significant growth and both economies show signs of recovery. Figures 1 to 3 illustrate (source OECD).

The property market difference which has the most effect on the discussion regarding valuation techniques is lease structures. Outside of the Pacific Rim, there are a variety of different relationships between landlord and tenant, some caused by legislation and others caused by the relative strength of both parties in the past. Table 1. sets out some of these differences. In the U.K., there has been considerable debate regarding the length and terms of the institutional lease since the start of the recession in 1990. This culminated in the Government proposing to outlaw upward only rent reviews (ratchet clauses), confidentiality clauses and change the system of review rent determination. Although it is not expected that any of these proposed changes will reach the statute book, the removal of Privity of Contract in new leases is expected.

Apart from legislative changes, there is a pressure from occupiers to reduce the length of leases and to make more use of break clauses. Expectations vary but 15 years as the standard lease term after the recession may well satisfy the conflicting needs of landlords and tenants. It will still mean that the U.K. has the most attractive lease terms for investors in the world and is a significant reason for the substantial flow of overseas funds into the U.K. property market over the last six years (DTZ, 1993). However, the one lease term which has been resisted by landlords and not achieved by tenants in any great numbers is the upwards and downwards rent review.

Fig 1 : Gross Domestic Product

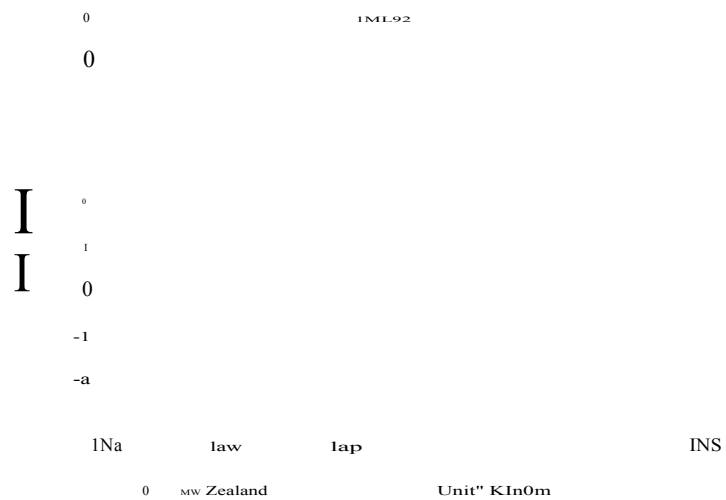
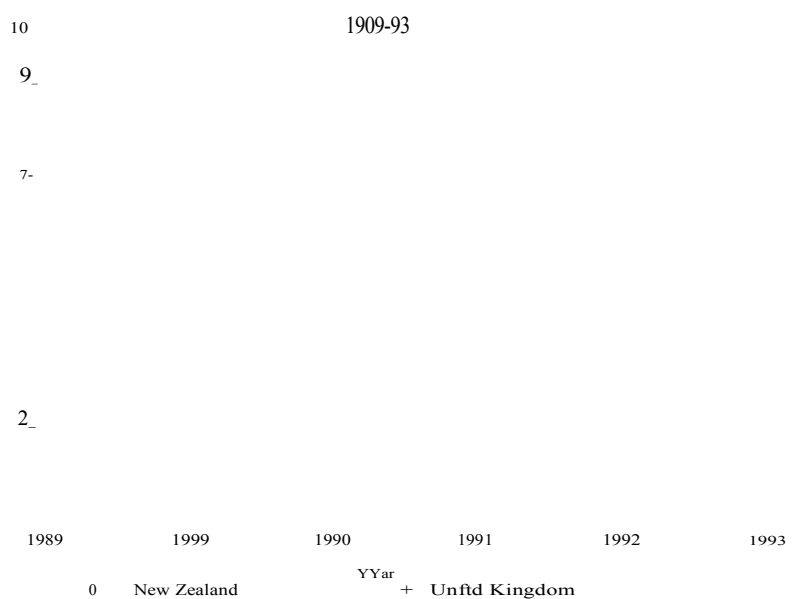


Fig 2 : Consumer Prices



In a recent survey sponsored by the Investment Property Forum (1993), landlords indicated which lease terms had

been 'given away' and the results are set out in Table 2.

The retention of upwards only reviews or ratchet clauses stands out from the rest.

The reason for this stance by landlords can be explained by reference to the valuation

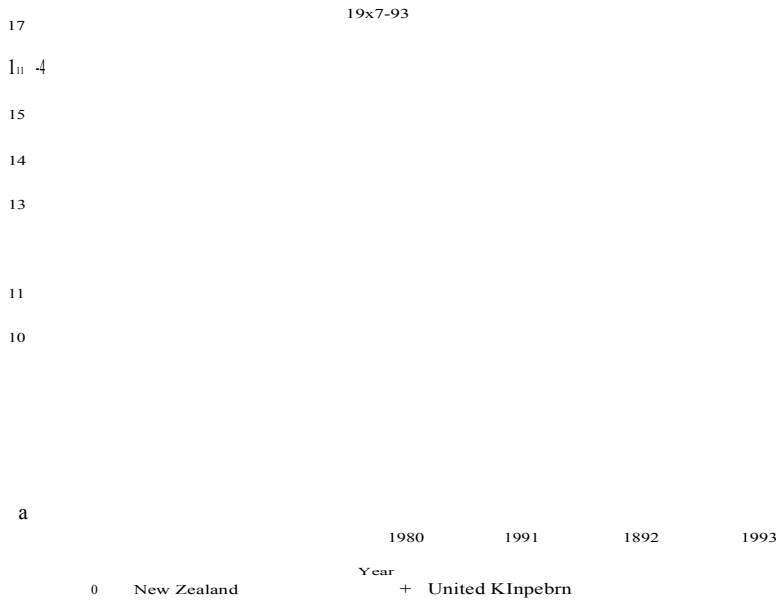
problems raised by recession.

These problems fall into three camps.

- (i) The appraisal of lease incentives/ inducements to obtain new tenants.
- (ii) The valuation of properties leased at contract rents which are in excess of open market rental value (over-rented properties).
- (iii) The valuation of investment properties which are vacant.

However, they are not three separate issues as they are inter-related and the same basic approach can be adopted to appraise each situation. However, the approach that will be put forward in this paper is not solely applicable to recessionary circumstances and was developed for use in rising markets during the 1970s and 1980s. It is ironic that it has generated more interest in a falling or fallen market, however this is because of the limitations of conventional methodology which are even more marked in recessionary markets than in rising ones.

Fig 3 : Government Bond Yields



3. A growth explicit market valuation model (short cut DCF)

An example of a typical rising market scenario of the late 1980s can be used to illustrate the application of a growth explicit approach to market valuations.

Example 1. A suburban shop investment was leased in 1988 on a 12 year lease with 3 yearly ratcheted (upward only) reviews at \$50,000 pa. The property is to be valued in 1989. The effective rental value (ERV) has risen to \$60,000 pa and the all risks yield of a similar shop leased at its current rent is estimated to be 9%. Government bond yields in 1988 averaged around 10% in the UK but over 13% in NZ.

A conventional approach to the valuation, using a layer technique, might be as follows:

Bottom Slice	\$50,000
PV pa in Perp @ 9%	<u>11.1111</u>
	\$555,555

Top Slice	\$10,000
PV pain perp @ 10%	10.0000
PV 2 yrs @ 10%	<u>0.8264</u>
	\$82,645

Valuation before costs \$638,200

There are a number of other variations on the conventional theme. Emary (1993) identifies three others in NZ, equivalent yield, shortfall and term and reversion, and suggests that there is a place for these techniques in fixing price if they are used flexibly. Whilst it is impossible to refute the view that a market valuation model

must reflect the views of the valuers in the market place, the suggestion that these conventional applications should be retained on any grounds of rationality is rejected by this author. Emary (1994) goes on to suggest that split yield applications such as the layer technique have their place if the yields are based upon comparables with other investment markets. No mention is made of property market comparables. The core of this debate is the role of the model. It is a model which assesses price in comparison with other prices. If similar properties are leased on identical terms to an identical covenant strength tenant, there is no debate about market value and no technique other than direct comparison is necessary. All of these conventional applications have been developed for one reason only, to adjust for imperfect comparable evidence. Although information from other capital markets is very important in this process, it is virtually impossible to incorporate the information from property market and other comparables into the conventional model.

A more rational analysis of this information can be undertaken using a more explicit model. The fine tuning of conventional techniques is a bit like tweaking the engine of a steam train, much loved as it is, rather than inventing a diesel, which is more efficient. Having invented the diesel, it can be fine tuned to perform better.

The growth explicit market valuation model starts by analysing the all risks yield for implied rental growth. This requires a target rate of return assumption. If gilts are assumed to be the closest vehicle to a risk free investment, a property investment is usually assumed to be more risky, and therefore requires a higher target return. This yield, often termed the equated yield, is dependent upon the property to be valued and there is no reason why prime and secondary properties should have the same risk. This point is discussed further after the calculation is set out. Assume 13% for the purposes of this example.

The next step is the calculation of implied rental growth. One formula for implied rental growth is:

$$(1 + g)^t = \frac{PV \$1 \text{ pa in perp @ } k\% - PV \$1 \text{ pat yrs @ } e\%}{PV \$1 \text{ pa in perp @ } k\% \times PV \$1 \text{ t yrs @ } e\%}$$

Where:

e = Equated yield (13%)

t = Rent review pattern of the all risks yield (3 yrs)

k = All risks yield of a rack rented property (9%)

g = Implied annual rental growth rate

$$(1 + g)^3 = \frac{PV \$1 \text{ pa in perp @ } 9\% - PV \$1 \text{ pa 3 yrs @ } 13\%}{PV \$1 \text{ pa in perp @ } 9\% \times PV \$1 \text{ 3 yrs @ } 13\%}$$

Table 1: International Leasing Structures Outside of the Pacific Rim

	France	Germany	England and Wales	USA
Typical Lease Length	9 yrs minimum. Longer leases also found.	Office suites 5 yrs. Prime shops 10 yrs with renewal. Single lettings 5/10 yrs.	Standard institutional lease 25 yrs. Shorter for secondary props.	Variable. Office suites 3/5 yrs. Shops 10 yrs+
Rent Revision	Based on construction index.	Indexation. Market review less common.	5 yearly to open market value. Occasionally 3 yrs.	Annually by indexation.
Options to Determine	Tenants can go at end of any 3 yr period. Landlord likewise but on certain grounds only.	Only if included in terms of lease.	Only if included in terms of lease.	Only if included in terms of lease.
Lease Renewal	Tenant entitled to new 9 yr lease (unless longer lease at commencement).	No automatic right of renewal. Has to be included in terms of lease.	Right of renewal under Landlord and Tenant Act 1954.	No automatic right of renewal. Has to be included in terms of lease.
Termination	Landlord prescribed grounds only.	Lease falls in automatically.	By service of statutory notice.	No notice needed unless prescribed in lease.
Determining Rent At Renewal	Offices or leases longer than 9 yrs open market value. Others at rent indexed from original lease rent.	Open market rent.	Open market rent, negotiated or determined by court.	Open market rent.

Source: University of Reading (1993).

$$0+ 9)^{11.1111} - 2.3612 = \frac{8.7499}{11.1111 \times 0.6931} = 1.1363 = 7.7005$$

$$g = 1.1363^{(1-1)} = 4.3503\%pa$$

Valuation:

Contract rent \$50,000

PV \$1 pa 2 yrs @ 13% 1.6681

\$83,405

Reversion to ERV \$60,000

Growth in rents

(1.0435)² 1.0889

Inflated rent \$65,334

PV \$1 pa in perp

@9% 11.1111

PV 2 yrs @ 13% 0.7831

\$568,512

Valuation before costs \$651,917

There are numerous observations which can be made regarding the application of the short cut DCF model. These can be discussed under the headings of:

(i) A comparison of answers between conventional and contemporary approaches.

(ii) The choice of equated yield based on the risk margin above gilts.

(iii) The nature of the implied rental growth rate.

(iv) Adjustments for differences between comparable and subject property.

In assessing the limitations of the model, a distinction must be made between comparable and subject properties which are deemed to be identical in terms of location and physical characteristics (apart from size) and those situations when they are not. The first three parts to the discussion assume the former before the final part relaxes the assumption.

(i) A comparison of answers between conventional and contemporary approaches.

The only difference between comparable and subject property in the example used in this paper is lease structure and size of ERV. The comparable is rack rented while the subject property is reversionary. The short cut DCF valuation is higher than the layer technique and this is normally the case when the unexpired term to review is less than the normal review pattern. The growth potential of a reversionary property in these circumstances is better than a rack rented property and therefore the equivalent yield tends to be less than the rack rented yield to reflect this. In conventional valuation, the equivalent yield of a reversionary property is often increased over that of a rack rented one to reflect the additional uncertainty of obtaining the estimated level of ERV on reversion while the full ERV is already contracted from the rack rented property. These perceptions can be adjusted for in the DCF model. This would not affect the growth rate in rental value therefore any adjustments which the valuer deemed necessary should be to both the all risks exit yield and the equated yield, allowing implied growth to remain unchanged.

(ii) The choice of equated yield based on the risk margin above gilts.

The equated yield choice is subjective and should be based upon a number of factors, many of which relate to the individual property. Assuming similar locational and physical characteristics, the equated yield chosen to analyse the comparable should also be the equated yield used in the valuation, subject to (i) above. The factors include the uncertainty of the cash flow based upon the risk that the implied growth rate may not materialise (both overall level and timing), as well as risks associated with the assumption that certain events not explicitly set out in the cash flow will occur, such as redevelopment or refurbishment, costs of management and sale, voids, etc (in fact all those factors which are explicitly dealt with in a full appraisal of worth). These items can be subjectively assessed in comparison with the redemption yield on long dated gilts which, if held to redemption, are risk free in nominal terms.

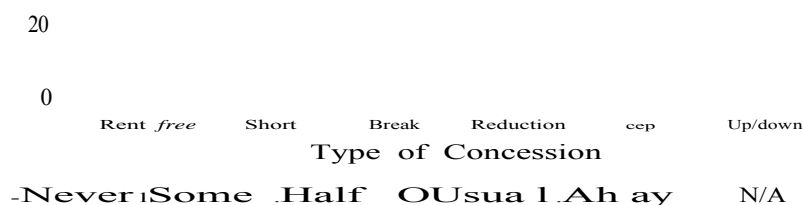
Different properties should have different equated yields and the risk margin above bond yields can be varied. A highly over-rented office block in the centre of London or Auckland occupied on a long unexpired lease by a blue chip tenant has very few traditional property risks and might be valued at an equated yield only marginally above government bonds. Highly geared head leasehold investments with modern sub leases and historic headleases might be discounted at over 20%.

Table 2: Frequency landlords have granted concessions on new leases or renewals since 1990

	Frequency (% of Respondents)							Total
	Weighted average frequency	Never	Some times	Half the time	Usually	Always	No answer/don't know	
Rent free period	3.49	1	25	9	44	14	7	100
Shorter leases (less than 5 yrs)	2.62	4	48	24	16	2	6	100
Break clauses	2.42	8	51	23	11	1	6	100
Rent reduction	2.34	17	46	11	11	5	10	100
Capital allowances	1.72	40	40	7	4	0	9	100
Up and down rent reviews	1.16	80	11	0	1	0	8	100

Source : CIG (1993)

New Lease Concessions 1990-90 Frequency of Granting



However, under the assumption that the properties are very similar locationally and physically, and therefore the equated yields are the same, the actual level of equated yield choice makes no real difference to the answer for reversionary freeholds with less than 10 years unexpired; the majority of portfolio valuations in practice up to 1990. The choice of equated yield is important in the valuation of leaseholds and long term over-rented properties.

(iii) The nature of the implied rental growth rate.

As the implied growth rate is a function of the all risks yield and the equated yield it

is difficult to assess its limitations in isolation. Given the constraint of similar location and physical characteristics, the over-riding consideration is that the same growth rate will occur in both comparable and subject property. Different covenant strength should not disturb this as the growth rate is location and property based. This is especially true as the implied growth rate is a function of the equated yield which has an implicit depreciation factor built into it. This suggests that the implied growth rate is before reduction for depreciation in the specific property as ageing takes place.

These points aside, the main criticism of implied growth is that the long term

average is used over the short as well as the long term. This is a very definite limitation but the solution must include a rational analysis of the comparable evidence. Nanthakumaran (1988) suggested using a combination of short term forecasts followed by longer term implied growth rate analysis and this solution appears to satisfy both the need to be true to the market evidence and the obvious shortcomings of perpetual implied growth rates used over short time spans. It would also fit in with the view of Emary (1994) that the yield could be varied to take into account the different risks at different times. In this model all these refinements could be discussed in the context of a rational base, unlike the conventional models. This point has been taken further in Baum and Crosby (1995).

(iv) Adjustments for differences between comparable and subject property.

The reality of valuation is that comparables and subject properties are not always similar in terms of location, physical characteristics, covenant strength and lease structure. The equated yield models using implied growth were developed to make better use of comparables which had different lease structures. When lease structures are identical, all models can be abandoned in favour of direct comparison. To this extent, short cut DCF (along with other investment methods) is comparison valuation using yield as the unit of comparison. They do, however, attempt to use cash flows to make the best use of the comparables.

In this context, the models can be amended for differences between the comparables. If the location is inferior, the all risks yield may be adjusted upwards which would reduce the growth rate.

However, different locations may be assessed as more likely to retain the same growth rate. In this case, it is the risk of the investment which has changed and the equated yield can be moved upwards as well as the all risks yield to maintain the implied growth rate, while reducing the capital value relative to the better location. A poorer physical property would also have a higher all risks yield and a higher equated yield (to identify the earlier prospect of refurbishment).

The art of market valuation is the adjustment of comparables and the DCF model does not inhibit any of this expertise when comparables are not very similar. It does, however, help the valuer adjust for different lease structures and this is why it is not just a few academics who are beginning to feel that the growth explicit market valuation model is a step forward. It also allows for the introduction of information from outside of the property market which is not rationally possible when applying conventional techniques.

4. Valuation in a fallen market.

4.1 Over-rented properties.

The methods adopted to assess the market value of over-rented properties are numerous but fall mainly into three camps.

(i) The initial yield approach: This entails simply taking the passing rent and capitalising into perpetuity at an initial yield, gained from comparables, gilt yields and the valuer's 'feel' for the market place.

(ii) Conventional reversionary valuation applications adapted for the different lease structures : The most popular (and most dangerous) by far is the reverse layer/hardcore method which is called the core and top slice approach. During the 1970s and 1980s the horizontally sliced layer method took over from conventional term and reversion as the staple diet of investment valuations in the UK (Crosby, 1991) and it was only natural that, when estimated rental values fell below passing rents, valuers would stick to the shape of what they had done in rising markets. This approach will be critically examined in this paper.

(iii) Growth explicit market valuation models : The adoption of the short cut DCF model in U.K. practice has started for over-rented properties and numerous articles have been written on the subject in the *Estates Gazette and Journal of Property Valuation and Investment*. These are Goodchild (1992) Martin (1991), Rich (1992), Epstein (1993), Crosby (1992) and Crosby and Goodchild (1992).

4.1.1 Application of method where long unexpired term.

Example 2: A CBD office block leased with 17 years unexpired. The reviews are ratcheted (upwards only) every five years and the next one is in 2 years time. The current contract rent is \$1,500,000 pa and the estimated current rental value (ERV) is only \$1,000,000 pa.

There are a number of problems, the most basic being how the ERV is estimated in a market where incentives are rife. As no properties are leased at their real rents, the next basic problem is the estimation of the all risks yield. However, in applying the different methods, the ERV of \$1,000,000 is the perceived real rental value, not the contract rent, and the all risks yield of a fully leased property is estimated to be 6%. At the valuation date, the redemption yield on bonds is assumed to be 7%.

Rent
Rent
\$1.5m
ERV
\$1m

Figure 5. Conventional cash flow

2 7 12 17 Years

(i) Initial Yield

The only major focus for discussion is the yield. If the tenant is rock solid and there is perceived to be no risk of default then the risk of the investment lies in the liquidity of property and the uncertainty of the cash flow in 17 years time. There is no uncertainty in the rental level at each review (as there is when the property is not over-rented) and the investment therefore has the characteristics of an liquid bond. Assuming a small margin for this (gilts plus 0.5%), the valuation

becomes:

Contract rent	\$1,500,000
PV \$1 pa in perp @ 7.5%	<u>13.3333</u>
Valuation	\$20,000,000

(ii) Core and Top Slice

The core of the valuation is the ERV which is expected to be maintained even if the tenant defaults due to the pressure of paying \$500,000 pa over the real market value. The assumption is that the property could be re-leased, but only at its ERV. The ERV is capitalized at the ARY on the assumption that it can grow in the future. The top slice element is called the overage or froth. This is more risky than the core

because it is totally dependent upon the tenant's ability to continue paying substantially over the real rental value. It is also a fixed amount with no growth potential therefore it should be valued as if it was a terminable, risky, fixed income. Assuming an equated yield (fixed income property yield) of 10% (3% above gilts), and that the soundness of the tenant implies no substantial risk of default, the valuation becomes:

ERV	\$1,000,000
PV \$1 pa in perp @ 6%	<u>16.6667</u>
	\$16,666,667
Overage	\$500,000
PV \$1 pa 17 years @ 10%	<u>8.0216</u>
	\$4,010,777
Valuation	\$20,677,444
Initial Yield	7.25%

There are a number of major flaws in this valuation. The most important is that the technique values some of the income flow twice. Figure 6. illustrates this with the shaded part being the element which is double counted. The 6% ARY implies growth from the ERV and, while the contract rent is higher than the ERV, the

growth at each rent review eats into the overage. This growth has been capitalized within the valuation of the core. The overage actually diminishes during the lease term but the valuation assumes that it stays the same. The other major problem is that the overage might be eliminated before the end of the lease and therefore the valuation for 17 years is too long.

To amend the valuation, the valuer has to make assumptions regarding the growth in rental values from the existing ERV and when the overage is eliminated. These are precisely the assumptions behind the growth explicit alternatives.

(iii) Growth Explicit Short Cut DCF

Figure 7. illustrates the cash flow approach which treats the term as a fixed income cash flow and then reverts to a rack rented property as soon as the ERV rises above the current contract rent.

Rack Rented

A.R.Y. 6% (k) (Assessed from Comparables)
 Review Pattern 5 Years
 Assumed Equated Yield 10 % (e)
 Implied Growth Rate Formula

$$(1 + g)^t = PV \$1 \text{ painperp} @ k - PV \$1 \text{ patyrs} @ e$$

$$PV \$1 \text{ painperp} @ k * PV \text{tyrs} @ e$$

Where:

Rental Growth Rate = g%pa
 Review Pattern = t years
 All Risks Yield (ARY) = k%
 Equated Yield = e%
 $(1 + g)^5 = \frac{16.67 - 3.790}{16.67 \times 0.620} = \frac{12.87}{10.34}$
 = 1.244

$$g = 4.4668\% \text{pa}$$

The growth rate can now be used to assess the date at which the ERV would overtake the contract rent of \$1,500,000 if the implied growth rate was actually achieved.

$\$1,000,000 \times (1.044668)^2 = \$1,091,331$
 $\$1,000,000 \times (1.044668)^7 = \$1,357,838$
 $\$1,000,000 \times (1.044668)^{11} = \$1,689,429$

This suggests that the first rent increase will take place at the review in year 12. The valuation is as follows:

Valuation

Current Rent Paid \$1,500,000pa
 No. of Years Unexpired 12
 (Prior to Reversion to CRV)
 Current Rental Value \$1,000,000
 (Based on 5 Yr Reviews)

Figure 7. Growth explicit short cut DCF

Rent
 \$1.5m
 ERV
 \$1 m

2 7 12 17 Years

The valuation requires an assessment of the rental growth rate implied by the all risks yield. This in turn requires a target rate of return for a rack rented property (based upon property risks above gilts). Assuming the equated yield of 10%, as in the core and top slice valuation, and the ARY of 6%, the implied rental growth rate can be calculated as follows:

TERM RENT	\$1,500,000
PV \$1 pa 12yrs @ 10%	<u>6.8137</u>
Value of Term	\$10,220,538
REVERSION TO CRV	\$1,000,000
Amt \$1 12 yrs @ 4.4668% 1.6894	
	\$1,689,429
PV \$1 pa in perp @ 6%	16.6667
PV 12 yrs @ 10%	<u>0.3186</u>
Value of Reversion	\$8,971,733
VALUATION (before costs)	\$19,192,271
Initial Yield	7.82%
Reversionary Yield	5.21%

Initial yield valuation to reconcile with above
 $\$1,500,000 \times PV \$1 \text{ pa in perp} @ 7.82\%$
 $\$19,192,271$ (say \$19.2m)

This investment could be termed a fixed income bond with an equity kicker. The above valuation identifies the two parts, the term is the fixed income bond investment with all the risk tied into tenant covenant. The reversion is tied to assessments of rental growth, which may be wrong, and possibilities that the property might be obsolete at the end of the lease; typical 'property' risks.

For this reason, the term yield can be varied within the valuation; reduced where there is a strong covenant, increased substantially where the tenant is suspect. Using a yield of 8% on the term produces a higher valuation and an initial yield of around 7.5%. The implied rental growth calculations are the same as before, only the valuation part changes.

Valuation

Current Rent Paid	\$1,500,000pa
No. of Years Unexpired (Prior to Reversion to CRV)	12
Current Rental Value (Based on 5 Yr Reviews)	\$1,000,000
TERM RENT	\$1,500,000
PV \$1 pa 12 yrs @ 8%	<u>7.5361</u>
Value of Term	\$11,304,117
REVERSION TO CRV	\$1,000,000
Amt \$1 12 yrs @ 4.4668% 1.6894	
	\$1,689,429
PV \$1 pa in perp @ 6%	16.6667
PV 12 yrs @ 10%	<u>0.3186</u>
Value of Reversion	\$8,971,733
VALUATION (before costs)	\$20,275,850
Initial Yield	7.40%
Reversionary Yield	4.93%
Initial yield valuation to reconcile with above	
$\$1,500,000 \times PV \$1 \text{ pa in perp} @ 7.4\%$	
$\$20,275,850$ (say \$20.3m)	

This does raise questions concerning the use of one equated yield; however, the 10% was the equated yield for an investment leased at its rental value, assuming a fixed rent only to first review.

4.1.2 Application of method where short unexpired term.

Example 3: A suburban shop property leased with 2 years unexpired at a rent of \$50,000 pa. The current rental value is estimated to be only \$30,000 pa and the tenant market is relatively thin as most of the expanding multiples are already

represented in this location. Fully leased property investment yields are estimated to be 9%. Assume an equated yield of 11%

The main focus of attention in this over-rented valuation is not the security of the rent, but the possible outcome of the lease renewal to the existing tenant or the chances of obtaining a new tenant in two years time. An initial yield approach is relatively pointless as the yield has to imply the fall in rent within two years, the possible void and the future prospects after re-letting. The following valuations therefore only adopt core and top slice and short cut DCF approaches.

(i) Core and Top Slice

If it is assumed that the lease is renewed to the existing tenant and there is no void period then the valuation takes the same form as the CBD office. Figure 8. illustrates the cash flow.

ERV	\$30,000
PV \$1 pa in perp @ 9%	1 1.1111
	\$333,333
Overage	\$20,000
PV \$1 pa2yrs@ 11%	<u>1.7125</u>
	\$34,250
Valuation	\$367,583
Initial Yield	13.6%

The previous criticisms regarding double counting of cash flows do not apply when there are no further reviews before the end of the lease. However, the layer technique becomes more unwieldy when the valuer wishes to assume a void for the time to obtain a new tenant after the lease expires, for example one year.

The bottom layer now has a break in it (or, to be exact, the bottom layer has a zero cash flow). The valuation could be undertaken as follows but lacks any real rationality. Figure 9. illustrates the cash flow.

ERV	\$30,000
PV \$1 pa 2 yrs @ 9%	<u>1.7591</u>
	\$52,773
Reversion to ERV	\$30,000
PV \$1 painperp@9%	1 1.1111
PV 3 yrs @ 9%	<u>0.7722</u>
	\$257,394
Overage	\$20,000
PV \$1 pa2yrs@ 11%	<u>1.7125</u>
	\$34,250
Valuation	\$344,417
Initial Yield	14.52%

(ii) Short Cut DCF

The growth explicit approach can deal comfortably with the void if required as it is a cash flow rather than a horizontally

Figure 8. Core and top slice without a void on renewal

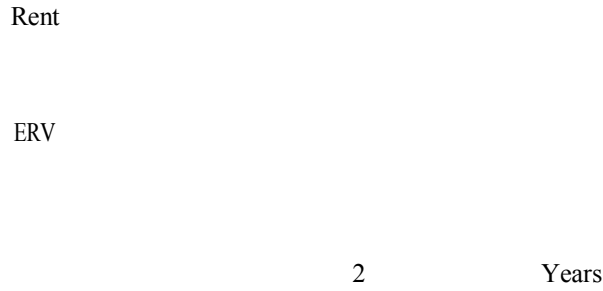


Figure 9. Core and top slice with a void until new tenancy

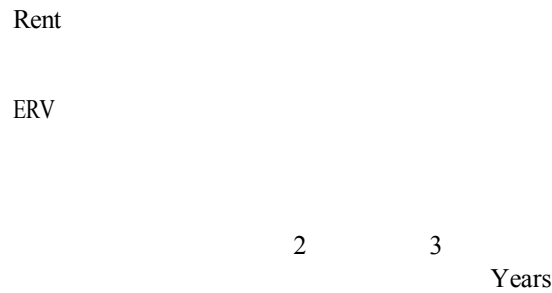
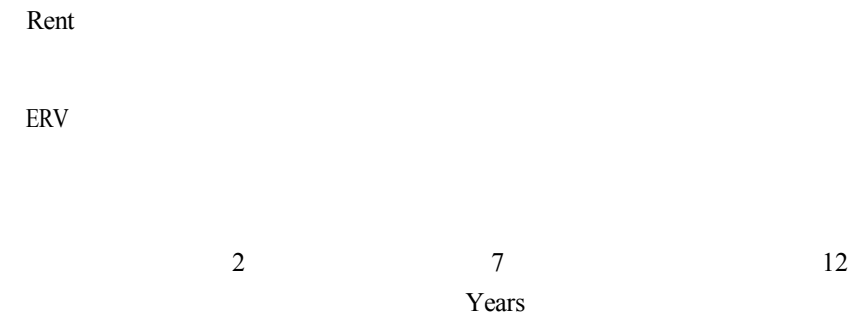


Figure 10. Core and top slice without a void on renewal



sliced model. Figures 10 and 11 illustrate, followed by the two valuations. The first valuation excludes the void and the second one includes it.

Rack Rented A.R.Y. 9% (k) (Assessed from Comparables)
 Review Pattern 5 Years
 Assumed Equated Yield 11 %(e)

Implied Growth Rate Formula

$$(1 + g)^t = \frac{PV\$1 \text{ painperp}@k - PV\$1 \text{ patyrs}@e}{PV \$1 \text{ pa in perp @ k} * PV \text{ t yrs @ e}}$$

Figure 11. Short cut DCF with a void before new tenancy

Rent			
ERV			
	2	3	
			8
			13
			Years
Where:			
Rental Growth Rate	= g%pa		
Review Pattern	= t years (5 yrs)		
All Risks Yield (ARY)	= k% (9%)		
Equated Yield	= e% (11%)		
$(1 + g)^5 = 11.1111 - 3.6959 =$		7.4152	
$11.1111 \times 0.5935 =$		6.5939	
		= 1.1246	
g =	2.3755%pa		
Valuation			
Contract Rent Paid	\$50,000pa		
No. of Years Unexpired	2		
(Prior to Reversion to ERV)			
Current Rental Value	\$30,000		
(Based on 5 Yr Reviews)			
CONTRACT RENT	\$50,000		
PV \$1 pain2yrs@ 11%	<u>1.7125</u>		
Value of Term	\$85,626		
REVERSION	\$30,000		
TO CRV			
Growth in 2 yrs @	<u>1.0481</u>		
2.3755%			
		\$31,442	
PV \$1 pa in perp @ 9%	1.1111		
PV2yrs@11%	<u>0.8166</u>		
Value of Reversion	<u>\$283,545</u>		
VALUATION (before costs)		\$369,171	
Initial Yield		13.54%	
Reversionary Yield		8.13%	
If a one year re-leasing period is required,			
the reversion can be delayed for that year			
as follows. The implied growth calcula-			
tions are the same, the valuation part			
changes.			
CONTRACT RENT	\$50,000		
PV \$1 pa2yrs@ 11%	1.7125		
Value of Term	\$85,626		
REVERSION	\$30,000		
TO CRV			

Growth in 3 yrs @	1.07297
2.3755%	
PV \$1 painperp@9%	\$32,189
	11.1111
PV3yrs@11%	0.7312
Value of Reversion	<u>\$261,515</u>
VALUATION (before costs)	\$347,141
Initial Yield	14.4%
Reversionary Yield	8.64%

4.1.3 Conclusions

There are a number of conclusions to be made from the study of how valuation techniques perform when applied to over-rented property. Some of these conclusions have nothing to do with over-rented properties but the last three years have highlighted them.

(a) The cash flow from investment properties has both the attributes of a fixed income bond and an equity. The valuation of property cannot be undertaken in isolation from an understanding of what drives other investment markets unless irrational identification of discount rates is acceptable to the valuation profession. The over-rented office market has been driven by factors other than traditional property risks and the initial yield is therefore a meaningful indicator of value in certain circumstances (long unexpired terms, good covenants and substantial over-renting).

(b) Conventional investment valuation techniques have always been simplistic compromises of the truth, but now they are logically and mathematically incorrect when applied to over-rented properties. Layer techniques seriously overvalue the income flow by valuing parts of it twice, and both they and other conventional techniques need a

view of rental value growth to determine the expiry date of the overage. They are redundant in the modern valuation context.

(c) Short cut DCF and other similar growth explicit approaches are based on market evidence and a rational (if simplistic) analysis of that evidence. They can be used flexibly but most importantly, they give consistent and credible solutions to investment valuations in both rising and falling markets. They can be the future.

4.2 Interpreting incentives

This subject has already been given considerable coverage in the property press around the world, including one issue of the *Journal of Property Valuation* (Volume 12:2, 1994) which incorporated four papers on the subject from two NZ and two UK contributors.

Most solutions to the problem of unpacking a deal including some incentives have either ignored any rational analysis of the future prospects of the cash flow or have incorporated explicit forecasts of rental growth, even though there is general agreement that valuation models which forecast variables rather than interpret them from market comparables do not address the market value question.

In the UK, the arguments between valuers revolve around the period of write off (with some polarisation between landlords, who want the incentive spread over the whole lease on the basis that it is a one off payment to get the tenant in, and tenants, who claim that the incentive is lost at first review as soon as the review rent becomes full market value) and the yield to discount the cash flows (most conventional valuers claiming that the yield adopted should be the investment or all risks yield).

An example should illustrate the consequences of these two positions and it is of the most simple case of a new 12 year tenancy with three yearly upward only (ratcheted) rent reviews which has been leased with a one year rent free period and no other incentives. Assume it is an office which has been leased at a contract rent of \$50,000 pa with bond yields at 8% and an estimated investment yield of 7%.

The two extreme positions are illustrated in Figures 12 and 13:

Landlord - contract rent	\$50,000
PV \$1 pall yrs @ 7%	7.4987
PV 1 yr @ 7%	0.9346
	<u>\$350,407</u>
Divide by PV \$1 pa	7.9427
12 yrs @ 7%	
Real rental value	\$44,117pa

Tenant - contract rent	\$50,000
PV \$1 pa 2 yrs @ 7%	1.8080
PV 1 yr @ 7%	0.9346
	\$84,487
Divide by PV \$1 pa 3 yrs @ 7%	2.6243
Real rental value	\$32,194pa

Contract
Rent
ERV

There is a major problem with both these answers. The tenant suggests that the real rent is \$32,000 because they have written the incentive off over the first review period, implying that the rent on review will be the full rental value. If the review is a ratchet clause, the rent will either be \$50,000 or ERV, whichever is higher. The annual rental growth to get \$32,000 to \$50,000 in 3 years is 16% pa.

By writing it off over the full 12 years of the lease, the landlord implies that the gap between real rent and contract rent will remain static over the lease, another very dubious assumption.

The result is two unsustainable positions, both self defeating. However, in certain circumstances they could both be correct. If the property sub market in question has very poor long term prospects and the investment yields have no implication of growth within them, the landlords view is sustainable. If high growth is expected over the first review period (or the rent free period is quite short) the tenant's viewpoint may determine a real rent which could easily grow to the contract rent before the first review. A write off to first review would then be a correct interpretation. In this case, the assumptions underpinning the two valuations are unsustainable.

In order to determine the real rent in this case, a view of the position at each review is necessary. If growth occurs, the gap between contract and real rent will diminish at each review until it is extinguished. At that point, a landlord or tenant will get or pay the same amount regardless of a lease with or without initial incentive. Figures 14 and 15 illustrate the shape of the cash flow assuming the real rent catches up the contract rent by the third and the second review respectively. Explicit DCF techniques require a view on growth rate. In the market valuation models used in this paper, growth is a product of market analysis rather than forecasting. In order to attempt to provide a solution to the incentives problem using short cut DCF, an intuitive view of the crossover point (at which review does real rent overtake contract rent?) is needed. If

Figure 12. Conventional cash flow to first review



Figure 13. Conventional cash flow to end of lease

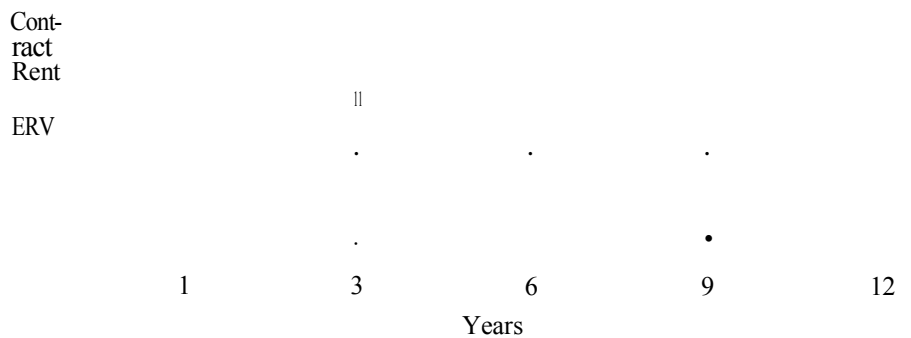


Figure 14. Growth explicit cash flow (ERV does not overtake contract until after second review)

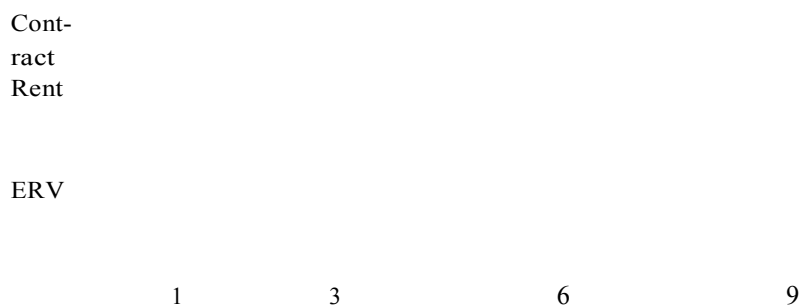


Figure 15. Growth explicit cash flow (ERV overtakes contract before second review)



this view is subsequently proved to be incorrect, the result can be re-calculated using a different scenario. The first calculation assumes it is not until the review in year nine.

$$(1 + g)' = \frac{PV \$1 \text{ pa in perp @ } k - PV \$1 \text{ pa } t \text{ yrs @ } e}{PV \$1 \text{ pa in perp @ } k * PV t \text{ yrs @ } e}$$

$$(1 + g)' = \frac{14.2857 - 2.4018}{14.2857 \times 0.7118} = \frac{11.8839}{10.1683} = 1.1687$$

$$g = 5.3344\% \text{ pa}$$

Valuation of contract rent to review in year nine.

Contract rent	\$50,000
PV \$1 pa 8 yrs @ 12%	4.9676
PV \$11 yr @ 12%	<u>0.8929</u>
	\$221,770

Valuation of real rent to review in year nine.

Real rent	\$x
PV \$13 yrs @ 12%	<u>2.4018</u>
	\$2.4018x

Real rent	\$x
Inflated at 5.3344%	<u>1.1687</u>
pa 3 yrs	

	1.1687x
PV \$13 yrs @ 12%	<u>2.4018</u>
PV 3 yrs @ 12%	0.7118
	\$1.9980x

Real rent	\$x
Inflated at 5.3344% pa	<u>1.3659</u>
6 yrs	

	1.3659x
PV \$1 3 yrs @ 12%	2.4018
PV 6 yrs @ 12%	<u>0.5066</u>
	<u>\$1.6621 x</u>

Total	\$6.0619x
-------	-----------

Solve for x:

$$x = \frac{\$221,770}{6.0619} = \$36,584$$

The answer must now be checked to establish whether the right rent review has been identified. The calculation is based upon a growth rate of 5.3344% pa. Will a rent of \$36,584 stay below the contract rent until after the second review?
 $\$36,584 \times (1.053344)^1 = \$42,757$
 $\$36,584 \times (1.053344)^6 = \$49,971$
 $\$36,584 \times (1.053344)^9 = \$58,402$
 The assumption is just accurate. This calculation shows that the contract rent is nearly overtaken by the second review.

As before, the first step is to determine the implied rental growth rate from the investment yield and the equated yield, based on bond yields plus a risk margin. Assuming an equated yield of 12% with an investment yield of 7%.

Had the calculation been undertaken on the assumption that the crossover date was before the second review, it would also have indicated a similar rent which did not make the contract rent after six years.

Valuation of contract rent to review in year 6

Contract rent	\$50,000
PV \$1 pa 5 yrs @ 12%	3.6048
PV \$1 1 yr @ 12%	<u>0.8929</u>
	\$160,928

Valuation of real rent to review in year 6

Real rent	\$x
PV \$1 3 yrs @ 12%	<u>2.4018</u>
	\$2.4018x

Real rent	\$x
Inflated at 5.3344%	<u>1.1687</u>
pa 3 yrs	

	1.1687x
PV \$1 3 yrs @ 12%	<u>2.4018</u>
PV 3 yrs @ 12%	0.7118
	\$1.9980x
Total	\$4.3998x

Solve for x:

$$x = \frac{\$160,928}{4.3998} = \$36,576$$

$$\$36,576 \times (1.053344)^1 = \$42,747$$

$$\$36,576 \times (1.053344)^6 = \$49,959$$

If this calculation had been done first, the assumption would have been shown to be incorrect and the calculation to nine years would have had to be undertaken (in this particular case it is so close as to make an insignificant difference).

Subject to the same limitations as discussed previously in section 3 of this paper, these valuations show that short cut DCF can also be used to provide a possible solution to the determination of real rents where incentives are involved. The calculations compare the capital value of the contract rent with incentives with a notional real rent let from day one with no incentives.

All these approaches assume that incentive packages are driven by the trade off in future rental flows between real rents and contract rents. In a previous article,

such a simplistic analysis of incentive packages was questioned and the capital valuation implications of incentives were examined (Crosby and Murdoch, 1994). In the UK, incentives have been used by landlords to increase capital values and this factor has had more influence on packages than the value of the rental trade off. The capital values can be increased due to some of the more simplistic approaches highlighted in the previous section of this paper which over-valued investment properties in the recession. In the field of rent review, the rental trade off calculations have been used in the UK to determine comparable rental levels. Some of this analysis has been at a level even less sophisticated than where this examination started (i.e. not even the time value of money taken into account).

4.3 Vacant investment properties

The third major problem of valuation in a fallen market is the treatment of vacant properties. Obviously, change of use is a major development option, i.e. certain fringe office locations may be profitably converted to residential. An alternative is a sale to an owner occupier. Currently, in markets as large as Central London, many investors do not have this option. In the absence of these options, the approach which was adopted by U.K. valuers was based upon a letting for the existing use, taking full account of the time taken to find a tenant, the level of incentives which must be offered to the tenant and the expense of keeping the property empty during the marketing period.

Take the example of the office used to illustrate lease incentives. It is assumed that it could be leased at a contract or face rent of \$50,000 pa with a one year rent free period, but that it would also take a year to find a tenant. Bond yields are at 8% and it has an estimated investment yield of 7%.

The effective rental value was assumed to be around \$36,000 pa. Had the property just been let, a short cut DCF valuation would be as follows.

Step 1 Implied rental growth rate from $k = 7\%$ and $e = 12\%$ is 5.3344% pa as before.

Step 2 The crossover date to get an effective rental value of \$36,000 pa to overtake the contract rent of \$50,000 pa is just after the second review, therefore the contract rent will remain unchanged until the review in year nine.

Step 3 Valuation	
Contract rent	\$50,000
PV \$1 pa 8 yrs @ 12%	4.9676
PV\$1 1yr@12%	<u>0.8929</u>
	\$221,770
Reversion to ERV	\$36,000
A \$1 9 yrs @ 5.3344%	<u>1.5964</u>
Inflated rent	\$57,469
PV \$1 pa in perp @ 7%	14.2857
PV \$1 in 9 yrs @ 12%	<u>0.3606</u>
	<u>\$296,056</u>
Valuation	\$517,826

The valuation of the property needs to be reduced for the time lag before a leasing is affected and for the costs of holding the empty property (this should also have an effect on the application of the rental growth rate to the valuation but this intricacy is not bothered with here. A typical reduction in the UK would be as follows:

Landlord's outgoings while vacant

Uniform Business Rate	\$5,000
Letting	\$5,000
Security	\$2,000

Total	\$12,000
Cash Flow	Year 1
	-\$12,000
	\$517,826
PV @ 1 year @ 12%	0.8929
Valuation	\$451,602
The vacancy has reduced the valuation by 13%. In some cases in the UK during 1992-93, the reductions were nearer 30%. This increased the pressure to find a tenant at almost any cost in terms of incentives given.	

5. Conclusions

One of the major features of the fallen market in the UK has been a re-assessment of the methods used by valuers to assess the market value of investment property. The major changes have been the increasing acceptance by practitioners that growth explicit methods have a role to play in assessing market value, that the quality of the tenant's covenant has a fundamental effect on the value and that no valuation can be undertaken in isolation from the wider market within which property investment takes place. This wider market includes the techniques used by investors and valuers in other countries.

The valuation of over-rented properties has focussed the valuer on all of these issues. A heavily over-rented property on a long lease with ratchet review clauses takes on the characteristics of a bond investment secured on the ability of the tenant to continue paying a rent which is above market rental value. The introduction of overseas funds as major purchasers of over-rented London offices has forced UK property professionals to have a much wider perspective than before.

The recession has had a number of other effects. The characteristics of property security for loans, the capacity of a single snapshot in time pricing valuation to service the requirements of certain clients and the ability of valuers to provide contextual information to underpin their valuations have all been questioned in the UK (Mallinson, 1994) and elsewhere. The valuation profession is under increasing pressure to review and overhaul both bases and methods and fit them to the roles of the different appraisals demanded by clients taking account of this increasing globalisation of markets.

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Commentary

by A E O'Sullivan

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Mike O'Sullivan is the managing director of Rolle Associates and is resident in Wellington where he has practised as a valuer for twenty years. He is an Associate of the New Zealand Institute of Valuers and he specialises in retail commercial and leisure industry property valuations.

It is fair to say that I am just an ordinary practising valuer but I am also the managing director of a very large Valuation Practice, which implements a number of the systems advocated by Neil Crosby. When I qualified as a valuer, discounted cash flow analysis was a thing so far in the future that nobody even knew how to do it. I remember my first introduction some years ago to DCF investment analysis via a small blue book published by Mobil Oil New Zealand Ltd, and every valuer had a copy in his library. Be that as it may, very few, if any of us, really understood much about the methodology. However, with the advent of computers and the advancement of technology, we are now in the situation where the use of discounted cashflows techniques has become a necessity in certain types of valuations. It is fair to say that I am a fan of their use in subdivisional statements, shopping centre developments, and hotel valuations. In other words, for developments where there is a growth element or renting up phase, and they are also probably the only method which can deal effectively with shopping centres which

are undergoing or are about to undergo, major refurbishment and upgrading.

As practising valuers, our firm uses the methodology continuously for major hotel developments, and especially where

funding is being sourced from the United States or Britain, where they have become the only acceptable check method. The cashflow in such circumstances is spread over a ten year period. However, I do not agree with this kind of cashflow analysis as the main method of valuation when we are dealing with office buildings. I believe it is a check methodology only and should be used carefully, in fact very carefully. I have seen many instances especially in New Zealand where the use of such sophisticated analytical techniques have given higher values than can be sustained in the market place. I also come back to a general criticism, that such models are sometimes not practical, and in the main, can prove any figure one wants. This is because there are too many subjective judgements such as future rental levels, refurbishment, rent free periods etc. One problem which I see occurring is that of estimating the growth of rentals over the period of the lease. With the reluctance for inclusion of ratchet clauses in new leases bringing in much more subjective judgement to such models.

Who requires and uses these analytical techniques? I have already stated that I consider that when one is doing subdivisional statements, shopping centres and hotel valuations, this kind of cashflow analysis is 100% acceptable and in effect is the main method which we should incorporate in our valuations.

I have read Neil Crosby's paper and as I have stated earlier, I am just a simple valuer and find it very difficult to be perfectly frank - to completely understand why or how one is able to solve a valuation problem by such mathematical techniques. It is a brilliant paper and covers the main aspects in completely acceptable fashion, but I question whether it is practical in some of the assumptions being made. Discounted cashflows have recently taken off throughout the world - why? solely because of the recession and excess rental and excess vacancy factors. Prior to the recession other methods of valuation were completely acceptable and in effect were the main methods. We are now again finding, as we come out of the

recession, that many bankers and financial institutions want us to continue with the traditional capitalization of rental approach. In many cases what they are saying is the rental income should be treated as a financial instrument with a fixed income being received over the period of the lease.

Criticisms of the use of the methods?

My reason for perpetuating the use of discounted cashflows in such valuations as hotels and subdivisions, is because of the management and marketing factor. The ability to produce income is tied in with the value of the business. Whereas in conventional property investments, income is completely market driven. Why, therefore, are we endeavouring to come up with a theoretical approach to what in reality are purchases of property by unsophisticated investors, who in the main never approach a valuer until a transaction is completed, and then only to arrange finance?

The first question I have to ask myself is this. Had the paper by Neil been produced in March 1987 indicating the use of such theoretical and analytical basis of valuation, would the value have indicated a continuous upward momentum or would it have taken into account the effects of a recession, as perceived by the over supply occurring in office space. A demand for such office space which could not be sustained. I question the use of an analytical approach to valuations against what is actually happening in the market place. Many of you will recall the paper delivered last year by Dr Shannon Pratt in which he advocated the use of the discounted cashflow method as a major tool and in most cases the only tool to be used in the valuation of business and property. In response to the question that, if given the same valuation was to be carried out in September 1987 and November 1987 would the figures be different; Dr Pratt's argument was that it would as the circumstances had changed, I therefore have to ask is the use of discounted cashflow as an analytical tool of valuation any more correct than a straight perpetual capitalization method? My argument is that they are both subjective and they may both be 100% accurate, dependent upon the ability of the valuer concerned, the only difference is that the DCF method brings in more subjective opinions. I believe Neil sums this up in his last paragraph where he states as follows:

This commentary to Professor Crosby's paper was given at the Wellington seminar.

"The major changes have been the increasing acceptance by practitioners that growth explicit methods have a role to play in assessing market value, and that the quality of the tenant's covenant has a fundamental effect on the value and that no valuation can be undertaken in isolation from the wider market within which property investment takes place".

It is all very well understanding the analytical techniques and when we are doing valuations for institutions, say, for some mystical financiers sitting in America who are funding some major portfolio in New Zealand, the method of valuation is completely acceptable. However, I do not believe that analytical techniques are what many of the local financiers are looking for in today's market.

Who Makes the Decisions?

Who makes the decision of whether to buy a property? It is all very well looking at historical evidence after the event. Always look at this question - in today's market how does the investor look at the property? First, and fundamentally he looks at the tenant - how strong is the tenant, how long will the income continue. Second, he looks for the 'ratchet' clause in the lease. Third, he will compare it as against financial instruments and political events. In other words will it last six years, seven years or ten years? Most investors I have spoken to have said "I don't know what is going to happen in six years time", yet many valuers are trying to tell us that there will be increases in rent occurring in say three years, four years or five years. Ask three valuers when increases in rent will occur and you will be given three different answers. Many investors are telling us, don't be fools. Tell me what is it worth at today's date, how long the income will last, tell me what the market rental is and how long will the excess rental last for. Many institutions are requiring analytical techniques, but don't tell me that these same institutions are setting the market, because I will tell you that it is rubbish. Institutions were the first to quit property after the crash of 1987. They are now buying after individuals and foreign investors have set the market trend, the capitalization rates and the returns necessary. Many of the individuals in the same

institutions are saying "we require analytical calculations", but many of them don't understand them. In considering Neil's paper, he has demonstrated cashflow calculations for over-rented properties, vacant properties and theoretical calculation of how to take account of leasing up periods. To me, some of the calculations are impractical. Vacant properties are more likely to become apartments, their purchase price will not have any relevance to achieving rental income in say six months time especially when we have vacancy rates running at 15% or 18%. Over rented properties to put it perfectly bluntly are purchased on a passing rental income determined by ratchet and the quality of the tenant. They have little relevance whatsoever to some theoretical calculation.

Rental Incentives

Rental incentives found in the market are quite varied and are as follows:

Abnormal rent free, periods

Cash payments

Rent subsidies

Free fit-outs

Take out of existing space

Payment of relocation costs

Put options on additional space

Caps on rent increases on review

Free naming rights

Free holidays

How are we as valuers meant to treat these. I note that Neil again comes up with an analytical approach to the way we should treat them. However, we as valuers, are very pragmatic and apply simplistic and arbitrary capitalization methods. Once the property is fully or substantially leased up, and the incentives have already been taken up, we therefore analyse the market which states "What is the passing rental and covenant of the tenant" and apply a capitalization rate. We do this because that is the way the investor looks at it. In stating this, I am very conscious of Mr Justice Henry's comments in the Coopers & Lybrand tower case in Auckland, whereby he ruled that contract or base rental rates achieved by the use of abnormal incentives are artificial rentals and that all aspects of the deals between landlords and tenants, and leasing agreements including any collateral agreements must be taken into

account. He held that it is erroneous to take the passing rental as for the totality of the exercise of the respective rights and obligations of the parties to the lease document.

I do not wish to cast disagreement on the approaches argued by Neil. These approaches in some form or other are used by myself and my practice in analysing sales. However, I do question whether they actually add value to the valuation or are we using them as a tool so that we can stand up in a witness box and can state, this is how I analysed that sale, knowing damn well that the figure comes back to what we, as a qualified valuer, feel that the figure should be, and have used the analytical method as a check only, indeed we may have juggled the figures to justify our first thoughts. They should be considered as one of the tools for valuing. They should be used in addition to normal capitalization and to assist in understanding the marked forces involved. To be a good valuer in a changing rental market we need to understand the purchaser. We need to understand the market, and the market in general is not sophisticated enough. It does not take account of human behaviour and we as valuers have to take account of the subjective behaviour of the purchaser and why they drive the market. How by such methods do you quantify a purchaser, acquiring a 3/a empty building, emptying it, constructing 23 apartments and making \$1,000,000 on the way through? I have found in analysis that a vacant building only sells if the purchaser already has a tenant in mind, or intends to redevelop the property or occupy the building himself. In these circumstances a mathematical calculation allowing a leasing up period has no relevance in the market whatsoever.

Conclusions

There is no doubt that we require analytical calculations as contemplated by Neil's paper, but what we must not forget is that such calculations do not determine what is happening in the market place. Such calculations cannot be taken in isolation from the wider market within which property investment takes place. By the use of such calculations are we either looking back or trying to guess the future, rather than taking account of the rapidly changing circumstances in the market place, today?

Value Implications of a Proposed Landfill Site

by S N Dean

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One could be forgiven for thinking that this paper should have been entitled "Against All Odds" especially since the process from the initial investigation to consent for the Redvale Landfill site took some seven years and of course the input from multiple independent consultants, the legal fraternity, the company and ultimately the judiciary.

While in general terms the process started well before the advent of the Resource Management Act 1991, in real terms the ultimate planning hearing required satisfaction of all aspects of the Resource Management Act and probably represents the most significant hearing subject to the new regulations.

It is inevitable with any proposed facility such as this, that the NIMBY (Not In My Back Yard), neighbourhood feeling will be stressed most emphatically.

It is perhaps a comment on our planning history, prior to the Resource Management Act, that most local resident objections referred to such aspects as a smelly dump, infested with birds and vermin, characterised by wind blown refuse, insect problems and the like. Indeed, most New Zealander's experience at the local dump in the past would have probably viewed such a description as being kind.

Indeed, having spent a significant part of my childhood not far removed from the Meola Road tip in Westmere and in later years visited the Rosedale Road tip, my own views of such facilities were not much different.

You may well ask what function valuers could possibly have in planning matters such as the Redvale Landfill, as past planning hearings would tend to suggest that such aspects as property values were generally irrelevant to the planning process.

In my view however, the advent of the Resource Management Act has forever

changed that perspective and placed valuers in a unique position to comment upon particular matters that are now required to be addressed by the Resource Management Act.

While clearly particular emphasis is placed on environmental matters, such environmental matters are generally required to be in human terms extending well beyond the oft quoted "preservation of the amenities of the neighbourhood". Impact on human beings can occur in a number of different ways, not only through physical considerations, but also mental and emotional factors, emphasised perhaps even more by such an emotional topic as a refuse landfill facility, exacerbated by aspects of ill informed public rhetoric.

The valuers role in the Redvale planning process specifically focused on two aspects of significance with respect to the local neighbourhood.

In the first instance, Guy Schofield, registered valuer, was retained to report on the general suitability of the area for farming purposes and the potential productive capacity of the surrounding landscape.

Of course, had the land being subject to the application had soil type to an adequate level which rendered it suitable, or potentially suitable for high value farm production or food production, then in all probability the success of the application or otherwise may have been much more problematic.

With respect to the Redvale site, the rural valuer was able to show by a careful study of soil maps, studies of water supply and climatic conditions etc, that the land in question was anything but suitable for any part of farming purposes.

In this respect it was perhaps somewhat helpful that the subject site was already utilised as a lime quarry with winning,

crushing and storage facilities.

The second principle aspects of involvement for valuers in this application, was the impact of the proposed facility on property values in the neighbourhood. Clearly, it was not just the dollar value impact of such a facility on property values, but the result of the emotional and psychological consequences that might flow, from an impact of property values. In trying to come to grips with the nature of the studies required, it is first necessary to outline a little of the history of the site. For many years the central part of the property had been operated as a lime quarry with an established pattern of truck traffic to the property, noises of machinery working, albeit comparatively slight and some unsightly scars on the landscape for the lime workings.

The nature of the locality as well was important in endeavouring to understand the nature of the assignment. In general terms, the Dairy Flat area in which the Redvale facility is situated, sits almost astride the interface between rolling open grass lands utilised for small holding subdivisions and larger rural holdings characterized by steep gullies and sidlings, scrub infestation, gorse and other unfortunate consequences of generally poor quality land.

The area to the south and east of the proposed facility, together with a small area extending to the north, has developed over a number of years into predominantly four hectare holdings with some smaller almost urban sections scattered amongst them. However, adjoining to the west, are much larger blocks of land of exceedingly poor productive capacity and due to aspects of contour and access, generally unsuitable for small holding sub-divisions. Other notable features in the locality were the Primary school at Dairy Flat, almost

directly opposite the entrance to the proposed facility, this in itself raising significant concerns from local parents. Additionally, the property is a short distance from the North Shore Aero Club air field and indeed, underneath one of the alternate flight paths for aircraft. Accordingly, any flight problem experience in such a facility would likewise be of extreme concern.

In value terms, the small holdings in the general area had a broad range of values between approximately \$150,000 up to \$500,000 with a number of comparatively large and highly valued homes on extensively developed small holdings in comparatively close proximity.

Essentially the question asked of the valuer in these circumstances seemed simple enough, perhaps even deceptively so.

Simply put, the valuer was required to report on the question and then "what would the effect be on surrounding property values of the establishment of a Sanitary Landfill on the site of the Redvale lime quarry".

The answer at first may seem almost as simple as the question, because clearly a dirty, smelly old tip, infested with rodents and birds and with blowing rubbish, will of course impact severely on property values in the area.

Fortunately however, a valuers background and training clearly indicate that such responses which may ultimately be proven, cannot be made without the appropriate investigation.

The valuer must put to one side his own beliefs, ill informed opinion, media comment and even perhaps other precedents, to focus on the specific project in terms of all the known material and that which can be ascertained by proper research.

Methodology

It is fair to say that there is no commonly accepted methodology which would assist the valuer in preparing to answer the question asked of him in these circumstances.

The first, and in my view most important step to be undertaken, is complete familiarisation with the project, the engineering specifications, the work done by other experts on diverse topics, the manner in which the operation will proceed once such a facility is established, the length of period over which such a facility will be operated and last, but by no means least, what visual impact would such a facility have in the locality.

The valuer must satisfy himself that he knows what is intended to happen, before he can even begin to address the question of the impact on property values.

By way of elaboration, the required reading on this assignment included reading the reports of the site engineer, the ornithologist, the botanist, the town planner, the rodent specialist, the rural valuer, the traffic planner, the aviation specialist, the landscape architect and the geologist, without in my way exhausting the list of required reading.

The proposal put to the Planning Tribunal was in terms of all the experts reports and accordingly the valuer was left with a large number of "what ifs". Essentially, all this was put down to one "what if" being, "what if this facility was operated in accordance with the reports of all these experts, in accordance with the operations manual, the local authority regulations and the Resource Management Act". It is only after taking onboard that "what if" that the valuer can have any concept of developing individual methodologies to endeavour to answer the question of him.

In the first instance, not only had the lime quarry been operating in the area for a considerable period of time, but for six years prior to the date of hearing, there had been significant and at times intense speculation about the future of the Redvale site, as a proposed landfill facility. Detailed newspaper research, was necessary to build a pattern of such public knowledge and speculation and once such research had been conducted it became apparent that sufficient had been said about the subject site over a significant period of time that if there was to be an impact in value terms on surrounding properties, then in all probability it would have been noticed in sales in the locality given the previous six years of intense speculation. Accordingly, such a situation gave a fertile field for survey of property values.

Having reached a realistic conclusion that if there were to be value impacts as a result of such a facility already noticeable, the next question to answer in methodological terms, was how far to survey. In other words, how far could the impact of such a facility be potentially felt?

The answer to such a question lies generally within the characteristics of the particular facility, and in the present circumstances, an appropriate distance was considered to be one and a half kilometres from the proposed facility. Such a distance was selected for a variety of reasons, not the least of which was the topography of the surrounding countryside

and the way in which natural vegetation and landscape features formed a physical barrier, beyond which it was inconceivable that property values could be impacted upon. The methodology now turns to how to measure impact on value. In my view, the valuer has to be innovative enough to develop possible solutions to suit the particular circumstances.

Clearly, while proof would be required to confirm such an opinion, it seems readily apparent that a refuse facility in the midst of an intensively developed urban area, would likely have a greater impact on property values than that at the other extreme, in open rural farm land. It is fair to say that somewhere in between may be found a small holdings locality such as that surrounding Redvale.

How then to measure possible changes in property values in terms of the foregoing. Essentially, three distinct scenarios were developed to this end.

The first required a computer search of all property sales within an approximately one and a half kilometre radius of the facility for a period spanning not less than six years, but in the final analysis was extended to approximately eight years. The search sample was then refined to highlight which properties over the same period had sold on more than one occasion.

Value changes between sale dates were measured and collated to build a profile of property value increases.

Having prepared such a sample, it was then necessary to prepare a control sample by venturing further afield to locations of similar type which were sufficiently far from the facility to provide certainty that they could not possibly be affected. The control area was also prepared.

A comparison of property value increases on a monthly and annual basis was made, the results showing remarkable similarities.

The second method adopted was based on an enquiry made to the district valuer for Valuation New Zealand as to whether or not the Valuer General's office had made any adjustments for the adverse affect of the existing lime quarry or the prospect of a landfill in the area.

A negative answer gave the key to another potential approach to measure value changes, albeit those assessed in relation to market evidence by the Valuer General, a method which might well have its criticisms and shortfalls, but was nonetheless a useful exercise. A cross section of government valuation from within a one and a half kilometre radius of the facility

was compared with those approximately five kilometres away over three valuation cycles.

The increases were compared in monthly and annual terms and again, a remarkably similar profile between each area was discovered.

The third aspect for investigation, was to take a sample of sales from within quite close proximity to such a facility and then endeavour to find comparable sales in terms of use, land area, house size, degree of modernization etc. Having isolated comparable sales in each location, the two comparables were compared in terms of the sale price and date in order to gauge if there were any price differences.

Naturally enough, what is a comparable sale, requires the valuers subjected judgement, but nonetheless, photographic evidence for each example provided a graphic comparison.

Again, after all the evidence under this method had been reviewed, approximately seven properties were isolated where good comparables existed within a control area which clearly showed there were not measurable differences between sale prices for comparables in close proximity.

In methodology terms, that is not the end of the matter. It is necessary to look for other examples and endeavour to make comparisons from these localities. In particular, reference was made to properties in close proximity to the Rosedale landfill and also residential properties in close proximity to the North Shore Sewage Treatment Pond, a facility which had the potential perhaps to be even more obnoxious than a landfill.

In both these areas, it was only possible to make inferences from the comparatively sketchy data samples which were available, but nonetheless experience in the area over a considerable number of years was of assistance in being able to determine the comparatively minimal impact aspect of such facilities located on the urban fringe.

Research was also conducted into numerous American examples, providing a measure of independent overseas experience. However, in weighting terms, significantly less emphasis must be placed on such material unless it can clearly be shown that it has sufficient points of comparison with the subject property.

In many respects, the weight to be given to various methods of research and the nature of the opinion of other experts and results of their research, is rather like the ranking of preferable evidence in a rental arbitration.

Finally, it is necessary to observe that some properties, generally those which had similar elevation and shared common boundaries with the proposed facility, would undoubtedly have some impact on them with the change of use from a lime quarry to a refuse landfill. Having completed the research and found no evidence whatsoever of value differences in the wider field, then the valuer is left with having to make a subjective judgement as to the impact on the very small number of properties so affected.

It is now a matter of record, that one such property has since sold at a price which shows no measurable difference in expected price, notwithstanding its close proximity. It is also a matter of record after searching examination of the analysis, that the planning tribunal found that the impact on property values from the proposed landfill was benign.

The Lusk Report And The Marshall Report On Leasehold Tenures

by D Knight

Don knight is an Associate of the New Zealand Institute of Valuers and has been employed in the Nelson office of Valuation New Zealand since 1986. He is Chairman of the Nelson/Marlborough Branch of the NZIV and has been editor of the branch newsletter and the branch statistical officer since 1987. Don has broad experience in the valuation of leasehold property and arbitration of rentals particularly through involvement with Wakatu Incorporation. His paper was written in May 1994 before public release of the Trapski report and before legislative action following the Ministerial Inquiries.

Introduction

This article is by and large a summary of parts of the Reports which I feel are relevant to Valuers. It is not a complete precis and is not a substitute for a full reading of the reports.

Both reports deal with Glasgow-type leases, but from a divergent criteria.

The Lusk report was prompted by lessee complaints brought about essentially by inflation in land values and consequen-

tially high rent reviews. It deals with certain leases which fall under the Public Bodies Leases Act 1969 (PBLA), and makes various recommendations to redress imbalances in favour of lessees. These leases almost all have rentals determined by arbitration, with the exception of a few which have rents prescribed at 5% of current, unimproved value.

The Marshall report deals with leases under the Maori Reserved Land Act 1955 (MRLA), and considers the statutory

constraints on the beneficial owners imposed by the Crown via the Maori Trustee, which have deprived Maori of reasonable use of and returns from their land. This report makes recommendations in favour of lessors, but attempts to balance the interests of lessees as well. Some leases are arbitrated, but most have rents prescribed at 4% for urban lands, and 5% for rural. It is noted that approx 80% of MRLA leases have prescribed rental levels.

Apart from the discussions on problems with leasehold tenure as contained within these reports, it is interesting to compare practice overseas, and a reading of Chapter 3 of "Ground Rentals - A National and International Perspective" by Leonie Freeman published February 1993 by NZIV reveals different practices, no commonality of approach and equivalent problems internationally.

Although it is interesting to compare the two reports, I must stress that the historical background to the PBLA leases and the MRLA leases makes a comparison faulty in principle. The convergence of

the statutes in terms of administrative matters may not be surprising, but the fact that the principal recommendations are at odds must be seen in the context of history, even though their effective purpose appears similar.

The PBLA is an Act to consolidate and amend the law relating to the powers of certain public bodies to lease land.

The MRLA is an Act to consolidate and amend the law relating to the administration of the lands comprised in Maori Reserves, West Coast Settlement Reserves and Maori townships, and to make

provision in respect of certain other lands administered by the Maori Trustee.

The central issue differentiating the two statutes is that Maori have been disenfranchised from their land. Public bodies have not been coerced by statute into inflexible terms. From the lessees point of view however, this distinction may appear academic, and proposed radical changes to the MRLA in favour of the lessor are viewed with suspicion by lessees subject to leases under the MRLA, and are likely to influence leases subject to other statutory prescription.

The Reports

1.0 The Lusk report was a Ministerial Committee of Inquiry, published April 1993, into certain perpetually renewable leases in Auckland, and chaired by A.A. Lusk Q.C. Leasing authorities included in the terms of reference as listed below administer about 2028 Glasgow leases.

St Johns College Trust Board

N.Z. Anglican Church Pension Board

Dilworth Trust Board

Auckland Area Health Board

Melanesian Mission Trust Board

General Trust Board of the Diocese of Auckland

During the course of the inquiry, ACPB sold its entire portfolio of leases.

1.1 The Marshall Report was a Ministerial Committee of Inquiry in 1991, but not published until April 1993, into leases under the Maori Reserved Land Act 1955. There are about 2300 such leases. The Committee comprised Wakatu Incorporation Chairman Steve Marshall, Barrister Denese Henare, and Federated Farmers senior Vice President Malcolm Lumsden. The constitution of the panel was severely criticised from the outset as lacking objectivity. Mr Lumsden did not agree with all recommendations made.

1.1.1 The government response to the Marshall report is discussed in Clauses 11.0-11.5.

1.2 Both reports make comparisons with previous investigations and refer to relevant authorities; in particular -

i) Lusk Report:
Public Bodies Leases Act 1969 (PBLA)

The Beatty Report 1968

ii) Marshall Report:
Commission of Inquiry into Maori Reserved Land 1975
Ngai Tahu Report 1991

1.3.0 Criticism of PBLA Leases

1.3.1 The Lusk Report is concerned solely with Glasgow leases of land owned by particular leasing authorities but notes that recommendations in the report, if implemented by legislation, will affect many lessees and leasing authorities other than those to whom the reference relate.

1.3.2 Each leasing authority has its own Deed of Lease which sets its own contractual obligations and responsibilities inter-party. Points in common are that they are all 21 year perpetually renewable leases without rights to interim rent review and although a 1969 PBLA amendment provides for reviews not more frequently than 5 yearly, former leases remain subject to contractual obligations. None of the leases confer any rights on the lessee to obtain the freehold.

1.3.3. Serious criticism of the lease terms from lessees prompted the report with main concerns being:

Ground rentals at renewal are too high.

Aspects of this problem include:

Specific Criticisms:

(a) The Boards' valuers are not independent and consistently value higher than do independent valuers retained by lessees;

(b) The land value should be assessed having regard to the actual use to which the land is put, and not to include its development potential ("highest and best use");

(c) The valuer should have regard to the existence of the buildings on the land, even if not including their value in his assessment of the land value;

(d) The rental rate ("rental factor") should not be left at large, but should be a fixed percentage specified in the lease and locked in perpetuity;

(e) Movements in rental rates should be in accordance with the Consumer Price Index or other recognised economic indicators such as the rate of inflation or the average wage,

(f) The valuation methodology being applied is flawed. (There are countless variations as to how and why this is alleged to be so);

(g) The personal and financial circumstances of the lessee should be taken into account when valuing the fair annual rent;

(h) The period of 21 years between rental reviews is too long - yet most lessees vehemently reject any solution that would involve intermediate rent reviews,

1.3.3.1 A fairer and independent system of resolving rental disputes should be established:-

(a) Arbitration in accordance with the lease is cumbersome, daunting for many lessees, and prohibitively expensive;

(b) It is unfair because of the disparity in the resources of the parties;

(c) A tribunal independent of both

parties should be set up, or jurisdiction given to the Land Valuation Tribunal.

- 1.3.3.2 Lessees should have a right to purchase the freehold of their sites at any time.
 - 1.3.3.3 The leasing authorities' present freeholding practices are unfair, and uncommercial, and the prices demanded are far above reasonable market prices:-
 - (a) The Boards' offers are not negotiable;
 - (b) The lessee has to pay for the Boards' valuation fee, but is not given access to the valuation;
 - (c) The Boards' freeholding policies are always changing, and at times freeholding is not available at all;
 - (d) The Boards' valuers wrongly adopt a highest and best use approach; their valuations are excessive; they are invariably above market; they are invariably higher than lessee's valuers figures;
 - (e) The land value should be assessed independently of both parties;
 - (t) The allowances made for the value of the lessees' interest are inadequate and unfair.
 - 1.3.3.4 There is a particular problem for flat owners on cross-leased sites where not all of them desire to freehold, and in these circumstances none of them are able to do so.
 - 1.3.3.5 A lessee who does not wish to renew and who is unable to sell, should be able to abandon the lease and obtain compensation from the lessor for improvements.
 - 1.3.3.6 The lease forms are archaic, and should be up-dated and expressed in plain English.

Many of the provisions are unfair to lessees and should be removed. They should record the relationship as one of partnership in the land, and not the "feudal" notion of landlord and tenant.
 - 1.3.3.7 The leasing authorities and those appointed to administer their leases are uncommunicative, uncooperative, lacking in basic public relations competence, and are unsympathetic to lessees' concerns.
- General Criticisms:
- 1.4 None of these concerns are new. It has been recognised for many years that Glasgow leases without

- intermediate rent reviews are unsatisfactory and unfair to both lessor and lessee in relation to rental levels. The 1968 Beattie report clearly identified this in relation to Crown land, and recommended legislative change. The short-lived S26(3) PBLA 1969 was an attempt by Parliament to redress this problem. However, this provoked a storm of protest that it was an unwarranted interference with the existing contractual rights of lessees and was promptly repealed. It came into force on 1 January 1970 and was repealed on 8 December 1971.
- 1.5 The question of compensation for improvements is the only express prohibition by the PBLA on leasing powers of residential land. Otherwise S20 confers upon the leasing authority a discretion to include such covenants and conditions as are not inconsistent with the Act. S7 provides that land may be let on any of eight types of tenancies or leases. Part II of the PBLA deals with leases of farmland and the 1969 Act contained some major changes. S14 provides for compensation for improvements for a lessee of farmland who does not desire to accept a renewal lease, or who surrenders the lease, or the lease is determined by re-entry or forfeiture.
- 2.0 Maori Leases

Many of the criticisms considered in the Lusk report may also be germane to MRLA leases, but the Marshall report deals essentially with matters of concern to Maori only. The central feature of Maori Reserved Land Leases are that they have a perpetual right of renewal at 21 year intervals. The significant difference and criticism by Maori is that they have terms fixed by Statute, rent prescribed by legislation, and that the Maori landowners have been effectively prevented from the control, use and occupancy of their land by the Crown.
- 3.0 History of the Leases
 - 3.1 The PBLA 1969 has a long history. Its predecessors were the PBLA 1908, the PB Leasing-Powers Act 1908 and the PB Powers Act 1887 as amendments to the PB Leaseholds Act 1886. The early statute was introduced when large parts of

- the country were held in large undeveloped and unprofitable holdings. At the same time there was heavy demand from settlers without large amounts of capital, for smallholdings. Most settlers were English, who had a long familiarity with and acceptance of long leasehold. There were also large areas of endowment land and land owned by charitable trusts and institutions, local authorities and public utilities such as schools, railways and harbour boards; Endowments were generally inalienable from sale, while charitable, institutional and local authority land owners had widely differing powers to enter into long term leaseholds.
- 3.1.1 Until the 1908 Act, the lessor had the opportunity upon renewal to purchase the lessee improvements. Only if the lessor did not do so was the lessee able to renew. The 1908 Act expressly proscribed against the lessor paying compensation for lessee improvements. The 1969 Act made major changes to leases of farmland with respect to compensation provisions. (Ibid 1.5). The 1969 Act also provided in S22 for rent reviews at intervals not less than 5 years for new leases. The S26(3) provision was an attempt to bring earlier leases into line with S22, but was short-lived.
- 3.1.2 Maori as the beneficial owners of land held under the MRLA have long claimed that the Crown established a legislative regime which permanently deprives owners of their full rights of ownership. Perpetual rights of renewal were introduced in legislation in 1887 without any or with inadequate consultation or consent of the Maori owners. In 1886, the beneficial Maori owners in Nelson and Westland offered leases of 126 years, being two periods of 63 years, on the understanding that if lessees were to be encouraged to develop the land that leases had to be long term. The Westland and Nelson Native Reserves Act 1887 nevertheless conferred perpetual rights of renewal on the leases.
- 3.1.3 Prior to the MRLA, all Maori Reserved land leases were arbitrated, as implemented by the Native Reserves Act 1882, but

many produced extremely low rentals. This was partly due to incorrect land valuation practise, as identified in the 1948 Royal Commission of Inquiry on the West Coast Settlement Reserves. A result of this Commission was the introduction of prescribed rents for rural lands set at 5% UV, which resulted in superior rents to those previously received. Urban rentals became prescribed at a later date, and the MRLA 1955 adopted these levels of prescribed rent.

4.0 Criticism of Maori Reserved Land Leases

4.1 The 1975 Commission of inquiry reported a number of strong criticisms, and made 66 recommendations.

4.1.1 Lessors (Maori) wanted to play a less passive role in the administration of their lands and the Commission recommended that the only statutory restriction should be to prohibit the granting of perpetually renewable leases on unalterable terms, but otherwise that Maori be free to lease under any terms and conditions they consider just and expedient, and that no new perpetually renewable leases be granted. (Note S42A of the MRLA as inserted by S6 of the Maori Purposes Act 1980 provides that on surrender of a lease the Maori Trustee may lease on such terms and conditions as thought fit. S29 provides that terms, covenants and conditions of any prescribed lease may be modified in such a manner as may be agreed upon between the Maori Trustee and any lessee (except as to rent).

4.1.2 Perpetual rights of renewal were criticised as being imposed upon Maori which was an effective alienation of their land, but the commission did not recommend legislative redress because of the cost of compensation. It suggested that lessors buy the lessee interest when it became available for sale, for re-leasing on more advantageous terms.

4.1.3 The infrequency of rent reviews and the method of rent fixation were also strongly criticised.

4.2 A consequence of the report, was the transfer of most of the reserve land from the Maori Trustee to incorporations and trusts represent-

ing the owners. Although the commission recommended against the cessation of perpetual rights of renewal it instead recommended a restoration of equity arising from perpetual renewal so that -

a) beneficial owners could participate in capital gains arising from changes in zoning or land use.

b) that S34 of the Act be amended to provide for a rent 1% above Government Stock for a term corresponding to the period between rent reviews, for both single unit residential land, and for farmland. The rate for income earning urban lands be 1% above this rate. Another recommendation was that at the lessors absolute discretion rentals be determined by the procedures laid down in the PBLA.

c) That upon next renewal, the lessor have the right to specify the period to next review, being not less than 5 years.

d) That new leases be related to the economic life of improvements, or to the span of human life.

4.2.1 The Commission stated that prescribing a rent level was unsatisfactory and that 4% for urban land unrealistically low. (op cit pp 490-492 1975 Report).

4.3 In the North Island Tenth's (1985) 88 Otaki MB 728 the Maori Land Court stated that the 1975 Commission did not recommend to end the right to perpetual renewal because of the position of the lessees and the substantial compensation payable; and re-iterated that the present leases weigh heavily in favour of lessees, being leases forced upon the owners by an enactment of Parliament and not contracted by the Maori owners themselves. This Court recommended amendment to the statute with respect to rent reviews and the question of rent. No legislative action was taken.

4.4 The 1991 Ngai Tahu claim, considered by the Waitangi Tribunal, considered

a) Did the Maori owners consent to perpetual leases?

b) Should Government have implemented the recommendations of the 1975 Commission?

c) Were the Crown-appointed trustees

negligent in the management of reserved lands?

4.4.1 On the first question, the Tribunal said

"In a few strokes of the pen, the legislature took away from the owners a valuable property right and gave it to the tenants. It was an action that deprived the owners of use and occupation as well as their property right. The Mawhera lands were reserved for individual occupation. The owners were known. They were entitled to have informed advice on the meaning and effect of such an important change to their title. They did not get it. The Tribunal considered it rather ironic that a little over 100 years later, when Maori are seeking to reverse the position, the present day tenants urged the Tribunal to respect their rights and their guaranteed land transfer title. The lessees indeed do have a valuable right and are entitled to be heard and to be compensated for any loss". (*Wai 27*, Vol 1 p 139)

4.4.2 On the second question the Tribunal found that the Crown failed to act on many of the recommendations. It commented that had it done so in respect of rent review and rental, there would possibly have been no grievance to address. It considered that when prescribed rents were fixed in 1955 at 4% and 5% they may not have been unreasonable but that rates should have been kept under review.

4.4.3 On the third question the Tribunal was critical of freeholding provisions under S 155 & 156 of The Maori Affairs Amendment Act 1967, which inserted clauses 9A and 9B into the Maori Reserved Land Act 1955. This was a unilateral step by the Crown in allowing purchase of private land at the lessees option. The Tribunal said "The owners have been separated from administration of their land since 1866. In 1887 they had 21 year perpetually renewable leases imposed on them without their proper consultation or consent. They had a fixed rental of four percent and five per cent imposed on them in 1955. In 1967 they stood to lose their freehold. That they did not lose all their reserved

- lands was possibly due only to the fact that the tenants had perpetual leases at low rentals and did not quickly move to freehold. Nevertheless land was sold". (*Wai* 27, Vol 1, p140)
- This right of purchase was repealed by S9D Maori Affairs Amendment Act 1975. [Freeholding has however been permitted under the MRLA Act -see note to 4.7]
- 4.4.4 The Tribunal also considered the Crown had failed to keep Treaty of Waitangi principles in respect of taking Maori land in perpetuity, not consulting with Maori over the legislation, and failure to implement the 1975 Commission recommendations.
- 4.5 The Tribunal recommended that the MRLA be changed so that leases converted to terminating leases; that all rentals become arbitrated rather than prescribed, and that rent review periods reduced to 5 years in the case of commercial and rural lands, and 7 years in the case of residential lands.
- 4.6 Leases do not provide for interest on overdue rents, or for payment of new rental during the period in which an arbitration takes place (S41 MRLA). (This is also a criticism of PBLA leases).
- 4.6.1 Inflation since the 1970's has meant that lessees subject to the arbitrated form of lease have paid higher rents than lessees subject to prescribed leases. Eg : Rental factors rose up to 9.0% until 1988 for commercial property.
- 4.6.2 S28 of the MRLA provides that a lessee may require the Maori Trustee to change the form of lease from arbitrated to prescribed. This has resulted in considerable economic loss to Maori owners. However, the Court decided in *Wheeler & Proprietors of Wakatu* (unreported decision Nelson 29/4/85) that while it is obligatory for the Maori Trustee to convert the type of lease to the prescribed form on request it is not so for an incorporation. *Wakatu Incorporation* have since declined to grant any such requests.
- 4.7 On transfer from the Maori Trustee to Incorporations, land was declared to be Maori freehold land
- once a declaration to that effect was made by the Court under S31(3) Maori Affairs Amendment Act 1967. Note that since this report, the Maori Land Act 1993 has allowed trustee incorporations to seek a Court order declaring the land general land, therefore allowing alienation without having to obtain consent of all beneficial owners pursuant to S10 or S86 of the MRLA. However it is important to note that freeholding has been allowable subject to Agreement.
- 5.0 Sanctity of Contract
- 5.1 There are numerous instances of legislative interference with private contracts regarding leases or mortgages of land.
- Eg: *Mortgages & Tenants Relief Act 1933*, *Mortgagors & Lessees Rehabilitation Act 1936* and *Land Acts 1970 and 1979*, *Rent Freeze and Rent Limitations Regulations 1983*. Judges have shown no great reluctance to interfere with parties contractual rights where this is seen as being necessary to redress an imbalance of power or confidence, or to prevent other unfair and unconscionable dealing. Likewise Government may see it socially desirable to overcome perceived injustices, and the arguments for sanctity of contract are therefore no impediment. In Britain, legislation conferring rights of freeholding was first passed in 1967 and has been progressively extended since.
- 6.0 The Lusk Report
- 6.1 Some submissions related to the rent reviews of commercial properties in which the rental was fixed at such a high level that it led to lessees electing not to renew and abandoning their improvements. The Committee found that the fact that the rental resulting from a review is higher than the lessee can afford is no reason in itself to question the system or recommend a change; and that none of the submissions detailed evidence of irregularities, unfairness or suspect valuation methodology. Commercial lessees are able to pass on rental increases one way or another, and the committee concluded that few commercial lessees chose to make submissions for this reason. Having considered this matter, the committee concentrated thereafter on residential lease issues.
- 6.2 Problems identified by lessees are summarised in Clauses 1.3.3-1.3.3.7
- 6.3 The recent high level of discord has been prompted by a reaction by lessees to ground rental increases of an unprecedented level, of up to 4000%. This compares with a CPI All Groups increase of 805% in the 20 year period between 1969 and 1989 and an average weekly wage increase of 1200%-1300% in the same period. The primary reason for most of the increase was the dramatic increase in land values in the Eastern Suburbs which is one of Auckland's most desirable localities. But this was compounded by high interest rates which resulted in increasing rental factors, at up to 8.5% in 1987. A period of economic stringency and declining incomes, especially for those on fixed incomes or national superannuitants, followed and lower inflation and interest rates resulting in reduced rental factors.
- 6.4 The Committee found that lessee groups were becoming increasingly vocal, and lessees were more ready to go to arbitration or a negotiated settlement. The level of discord is likely to remain a feature of future rental reviews.
- 6.5 There is considerable disparity in the bargaining power between the parties. Leasing authorities are institutions of permanence and financial strength, with full access to professional advice, and who conduct their business without personal contact with lessees who cannot make representations to the Boards. Lessors decline to recognise lessee associations as spokesmen for individual lessees, and adopt a take-it or leave it attitude to rent review and freeholding. To refuse to discuss the price and terms on which a lessee can purchase the freehold of the site on which his house stands was considered extraordinary. The lessee bears all the risks - his home and the improvements for which he had paid, and must continue to maintain but can never own so long as he remains a lessee. In default the lessor may regain possession of the

land and improvements at no cost. The lessee is captive, bound either to accept the rent or have to sell up. There is no right of compensation if he elects not to renew. The market for leasehold sales has diminished so that any sale would represent a significant loss of equity. However, it was noted that the one beneficial aspect to this point is that due to the current publicity, realistic prices will in future be paid for lessee interests. Valuers are appointed for the Board, but many lessees cannot afford a valuer's fee and the costs of arbitration to dispute rent.

6.6 Highest & Best Use Valuations

This aspect received considerable criticism from lessees, for those leases renewed under S7(1)(e) PBLA wherein the renewal provisions of Clause 3 of the First Schedule state: "The valuation is to take no account of the value of improvements on the land". Critics suggest that what the legislation required was that only the value of the improvements was to be disregarded, and not their existence; despite Court decisions to the contrary going back 80 years, (Ref. Reserves, Endowments, and Crown and Native Lands Exchange, Sale, Disposal and Enabling Act 1898 - gross value was to be ascertained, and a rental of 5% applied to the land value after deduction of the value of improvements). However, the relationship between lessor and lessee is not one created by the Act (c.f Maori leases), but which arises from the lease contract itself. The Act confers power on the leasing authority to issue the lease, but has few restrictions on the terms it may contain. Most leases are in fact drawn so that "the valuation is to take no account of improvements on the land". Some leases do contain use restrictions, and where there is express prohibition without consent on using the land for more than one house, clearly the highest and best use approach to value is precluded. Most leases provide that no subdivision or development take place without lessor consent, which may be arbitrarily refused for some leases, but which may not be unreasonably refused for others (this is a useful means by which lessors can consent subject to a

new lease containing shorter reviews etc). It is arguable that a lessee should not have to pay rental assessed on a development potential he is unable to realise. However, if market value includes some value for potential, this is the value that must be assigned, and nevertheless the rent renewal clauses of the lease take precedence over other restrictive provisions. The Committee suggested that lessors and lessees consider a variation to the terms of their contract to exclude a highest and best use approach to valuation for rent review purposes, and to provide that if the density of development is increased then the rent should be reviewed to take account of actual development but did not go as far as to recommend legislative action.

6.7 Prudent Lessee Concept

The Committee devotes a full section of its report (pp 71-95) on the ascertainment of fair annual rent, and covers case precedent as to prudent lessee v's fair rent, rental factor v's comparative rent approach, highest and best use valuations; citing extensive case precedents. It noted some disquiet as to whether the prudent lessee test is being progressively usurped by the test of what the prudent valuer calculates is a reasonable return to a lessor/investor, but concludes that the present method of assessing ground rents (of residential properties) is the most appropriate available.

6.8 Lessee's Lack of Understanding

The Committee was critical of the woeful ignorance by lessees as to the nature and terms of their leases, and noted that nothing had changed in this respect since the 1968 Beattie report, and that lessees continue to pay virtually freehold prices for leasehold land without seeking any professional advice. It proposes compulsory requirement for professional advice on purchase, but makes no recommendation for legislative requirement.

6.9 Rent Reviews

The Committee made no recommendation for legislation to reduce the period of rent reviews, due to the strong opposition of

lessees to such a change, and the unfortunate history of the failed S26(3) PBLA. It suggests that encouragement be given to lessees who want a shorter review period, and notes that inflated rentals are a factor of ground rents fixed many years before. It also noted the difficulty for valuers in assessing a fair rent to be uniform for the 21 year period, and commented that this had to be speculative. A problem with 21 year reviews is higher relative rents are payable at the beginning of the period and low returns received by lessors towards the end. One method of reducing the impact of hikes in rents upon review would be to increase the frequency of reviews. There was no request submissions from lessors to increase the frequency of reviews (p145).

6.20 Hardship Cases

The committee concluded there is nothing that can be done to assist. What has happened in relation to rental increases is what is inherent in leasehold tenure - the rent has gone up and people can no longer afford it. That is one of the risks. It is not something that results from anything unfair in the Glasgow lease system. The committee pointed out that statutory and other powers allow flexibility and assistance in hardship cases may have been given insufficient attention by lessors:- ref S23 PBLA (flexibility is also allowed in Maori leases under S29, except as to rent).

6.11 Compensation for Improvements

The committee recommended compensation for residential lands as provided by the PBLA for farmland ie: every effort should be made to lease the land to another, and the incoming lessee pays the value of the improvements. Only after efforts to re-lease fail should the lessor pay the compensation. The committee noted that the value of the lessee interest in the land value would be forfeit. This recommendation was made because there are lessees who cannot afford new rentals, and cannot sell their interest and who are obliged to abandon their leases. This is not seen as giving encouragement for lessees to walk off

(Continues on Page 39)

LEGAL ISSUES

Caveat Emptor or Now Let the VENDOR Beware?

by S Espie

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Introduction

As Arthur Daley of the television series "Minder" would be quick to point out the maxim "caveat emptor", or let the buyer beware, has long been the golden rule governing contracts or agreements of sales and purchase.

In New Zealand in recent years, however, various legal protections for purchasers have whittled away at Arthur's golden rule. These include the Contractual Remedies Act 1979, the Contractual Mistakes Act 1977, the Fair Trading Act 1986, the Consumer Guarantees Act 1993 and a growth in the general law and equity in the notions of unfairness and unconscionable bargains. Such protections have application not only to situations involving the sale and purchase of goods, but firmly apply to sales and purchases of real property.

Most recently a decision of the High Court sitting at Christchurch has further eroded this golden rule in respect of property transactions. This decision has significant impact for vendors of real estate.

King v Wilkinson

The general rule for agreements for sale and purchase of land is that they are not contracts which require the utmost good faith on the part of the each party and the vendor is under no duty to disclose any particular details in respect of the property. The purchaser must rely on his or her own inspection and judgment. A vendor must, however, answer a purchaser's inquiries as to the property honestly and must not do or say anything misleading if asked.

These basic premises are embodied in the standard form REINZ/ NZLS Agreement for Sale and Purchase (Fifth Edition) in clause 5, which is entitled "Title, Boundaries, etc.". That clause

provides that the vendor shall not be bound to point out the boundaries of a property, excepting that he is required to ensure that the property is pegged as at possession in respect of a vacant residential lot not limited as to parcels.

The clause also contains the "objections or requisitions" procedure by which a purchaser is deemed to have accepted the vendor's title unless, relying on his own inspection and judgment, he makes an objection or requisition as to some aspect of the title.

Further, clause 5.6 provides "except as otherwise expressly set forth in this agreement, no error, omission or misdescription of the property or the title shall annul the sale but compensation, if demanded in writing before settlement but not otherwise, shall be made or given as the case may require".

The facts of the case of *King v Wilkinson* [(1994) 2 NZ ConvC 191, 828 - 29 March 1994 HC Christchurch, Holland, J.] are as follows:

- King bought an attractive house together with a substantial area of flat land from the Wilkinsons for \$410,000.00.
- King was shown over the property on a Sunday by the Wilkinson's real estate agent, and made an unconditional written offer for the property that same day, which was accepted by the Wilkinsons.
- During the course of the inspection of the property King asked the agent about the eastern boundary, and was told that the fence was on the boundary. This was correct in respect of the particular boundary in question.
- King did not ask any questions about the southern boundary,

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and the agent was not aware of any discrepancy with the southern boundary and neither King nor the agent had any other boundary in mind at the time of the inspection.

- A short time after the purchase had been settled, King found out that the southern boundary was in fact inside the southern fence line, and consequently a strip of land approximately 3.5 metres by 32.6 metres within the southern boundary fence line in fact belonged to King's neighbours.
- Furthermore, the Wilkinsons had leased this area of land from the neighbours (approximately 114 square metres) and this lease came to an end when the Wilkinsons sold the property.
- Up until this time King had no reason to doubt that the substantial and well maintained southern fence was on the boundary. Furthermore, a stone paved entrance way extended beyond the boundary, and a narrow formed garden approximately 1 metre in width inside the substantial and relatively

new paling fence, together with a lamp stand on the garden and paving of a carparking area also extended beyond the boundary of the property. This meant that the true position of the boundary would seriously inhibit the use of these facilities in terms of carparking and manoeuvring on the property.

- There was in fact a surveyor's mark on the paving at the entrance gate which was on the true boundary. This, however, was less than an inch square, and would not be noticed unless attention was drawn to it. The Court later found that this was not an obvious indication as to the true boundary.
- King consequently claimed damages from the Wilkinsons for misrepresentation as to the boundary, or alternatively for mistake. The purchasers claimed that they were induced to enter into the agreement for sale and purchase in respect of the property by material mistakes known to the vendors, or by a mutual mistake in that the purchasers believed the boundary was on the fence line while the vendors believed the boundary was the true boundary.

Mistake

This was the second claim made by King, and again for the purposes of this article is of minimal interest. The Court was satisfied that the elements of mistake as required by s6 of the Contractual Mistakes Act 1977 were satisfied in that King was influenced in the decision to enter into the agreement for sale and purchase by a material mistake; ie that he was purchasing the property "as fenced" and was further satisfied that the existence of this mistake must have been known to the Wilkinsons at the time the agreement was entered into.

These elements having been satisfied, the Court found that the purchasers were entitled to proceed on this cause of action.

Misrepresentation

Firstly, King pleaded that the oral representation by the Wilkinsons' real estate agent was a misrepresentation that the boundaries were the fences. On the evidence this claim was rejected by the Court.

King also pleaded that the Wilkinsons "further misrepresented the true boundary of the house property by erecting a southern fence along a line that was not the correct southern boundary line and not having the correct boundary line properly or sufficiently marked. They further misrepresented the true boundary of the house property by failing to reveal to the purchasers the existence and terms of a lease between them and their neighbour... as to the use and occupation of the land enclosed by the southern fence line, but otherwise outside the legal southern boundary".

The Court considered the general nature of the law of misrepresentation and its application to the facts of the case.

It was noted that a misrepresentation may arise from conduct, but in certain limited circumstances can arise from silence.

The Court was satisfied that the Wilkinsons "must have known that unless attention was drawn to the true factual situation, any purchaser would believe, because of the set up of the property, that the southern boundary of the property was as fenced. They presented the property without anything to indicate that the fence was not on the true boundary. This was not a case of whether there might be mere confusion as to the exact position of the boundary. No-one examining the property without prior knowledge of the true boundary would contemplate that the boundary was anywhere other than on the fence line".

This ruling was made recognising that there is no fiduciary relationship (ie a relationship of trust or utmost good faith) requiring disclosure between a vendor and purchaser as a general rule. The Court also gave express consideration to the terms of paragraph 5.1 of the REINZ/NZLS Agreement for Sale and Purchase relating to a vendor pointing out the boundaries. The Court found that the facts of the present case amounted to a great deal more than simply not pointing out the boundaries. The presentation of the property for sale in the particular manner in which it was presented was a positive representation as to the boundary. There was no discussion by the Court of paragraph 5.6 of the Agreement.

The Court also considered the real estate agent's role in this misrepresentation. The Court stated clearly that the finding of misrepresentation was made independently of the agent's representation as to the eastern boundary, but nevertheless the repre-

sentation also played a role. The Court found that the circumstances of the agent's statement required disclosure of the true position, and that a representation in contract may be entirely innocent and consequently the agent's lack of knowledge regarding the southern boundary was immaterial. Accordingly, a vendor will be liable for the representation of his real estate

agent even though such representation is innocent on the part of the agent.

The Court awarded King damages in the amount of \$38,000.00. This reflected the costs of re-fencing along the true boundary and consequential re-organisation of the property, the drop in value of the property, and finally stress caused to the purchasers.

Conclusion

In many cases, properties are bought and sold where fences are not quite on the boundary. Generally the discrepancy is minor, but nevertheless in these cases care will be needed when selling the property to ensure that purchasers are not misled.

In other cases where the problem is more acute, as in the case noted in this article, there are obvious dangers for both vendors and purchasers in assuming that a fence is on the boundary, and in particular great care must be taken in providing any professional information about properties and their boundaries and the issue should be investigated fully in order to be in a position to disclose the true situation.

If a rule is to be gleaned from the Wilkinsons' experience it is that you cannot simply let the buyer beware, and where there is a significant boundary discrepancy, and that discrepancy is not obvious, a vendor must inform the purchaser of the true position, or run a very real risk of facing an action for damages in misrepresentation.

As far as valuers are concerned the decision clearly has implications, and care will need to be taken as to the description of any property and the basis of its valuation.

Health and Safety and Accident Prevention in the Workplace

by O Buxton

Olly Buxton is a solicitor in the Kensington Swan Wellington Office. He practices in the Litigation department, primarily on employment law matters.

Health and Safety in Employment

Until 1992, occupational safety in New Zealand was regulated by up to 27 Acts and over 40 sets of regulations, administered variously by five different Government departments. Predictably enough, there was a lack of focus in the regime, some Acts being aimed at safety in the workplace generally, others were aimed at specific hazards. The Health and Safety in Employment Act 1992 arose from the ashes of the fourth Labour Government's Occupation Safety and Health Bill, which had lapsed following the defeat of that administration in the 1990 General Election.

The new Health and Safety in Employment Act was stated to have the following objects:

- To provide for the prevention of harm to employees at work;

- To promote excellence in health and safety management by employers;
- To prescribe and impose on employers and others duties in relation to the prevention of harm to employees; and
- To provide for the making of regulations and the development and approval of codes of practice relating to hazards to employees.

The Act sets out duties relating to health and safety in the workplace. Duties are owed by employers, building owners and lessees, the self-employed, principals, and employees.

The general duties owed by the Employer to employees are:

- (a) To take all practicable steps to ensure the safety of their employees at work. This includes:
- To provide a safe working environment
 - To provide facilities for safety and health
 - To ensure plant and equipment is safe to use
 - To ensure employees are not exposed to hazards near their place of work which are under the employer's control
 - To develop emergency procedures for when accidents occur
 - To identify, assess and, where accidents occur, investigate hazards arising in the workplace.
 - To eliminate, isolate or, where neither is practicable, minimise significant hazards which arise in the workplace.

The Act is wide in its coverage, extending to employees, agents, independent contractors and indeed the general public who may come in to a working environment.

It should be stressed that, while the majority of serious accidents will occur in an industrial environment, there is no reason for employers in office *type* environments to feel complacent. The notion of health and safety clearly includes repetitive strain injury, exposure to radiation from computer screens and may include intangibles such as the "sick building syndrome". These hazards are a good deal less visible than industrial ones but may require even greater vigilance to avoid conviction.

It will be of interest to all building owners, principal contractors and employers to note the penalties imposed on them by the Act for breaches. The penalties may be levied against companies and also against directors of companies personally.

It is an offence for any person to take (or fail to take) action in breach of the Act where that person knew that his or her conduct would be "reasonably likely" to cause serious harm to anyone. On conviction, the penalties are severe:

- (a) one year's imprisonment;
- (b) a fine up to \$100,000; or
- (c) both

The Act also provides for less serious offences. Any of the above persons, regardless of the likelihood of harm, who fail to comply with any of the duties imposed on them by the Act will be liable on conviction for:

- (a) a maximum \$50,000 fine if the failure did in fact cause serious harm; or

- (b) a maximum \$25,000 fine in any other case.

The Act specifically contemplates company officers, directors, and agents who participate in breaches of the Act being personally liable for fines and imprisonment.

Some recent examples will illustrate:

The Napier Port company was recently found guilty of a breach of offence of failing to identify or address an obviously hazardous state of affairs. A worker was killed when crushed between two forklift pallets on the waterside. The court found the pallets were of such a height and the forward visibility of the forklifts when loaded so poor that the circumstances were manifestly unsafe. The court noted the port company had "exerted great energies" to address its health and safety obligations. Nevertheless, it convicted the Company and imposed a \$20,000 fine.

An apprentice boiler maker at a New Zealand engineering firm was recently injured in the course of his employment. While arc welding, he suffered third degree burns when a steel drum on which he was working exploded when an arc was struck. The company for whom he worked was convicted and fined for failing to ensure its employees were not exposed to hazards arising in the course of employment. What is more, a director of the company was also convicted and fined \$2,500.

Statistics relating to Health and Safety in Employment Act prosecutions have been released by the Department of Labour which are current to 1 October. It is of interest to note which persons are being prosecuted. Of the 347 prosecutions under the Act, 85% of them have been against employers, 4% have been against employees, 2% against the self-employed, and 3% against Principals, 4% against persons in control (i.e. building owners) and 2% against workers and managers. This indicates that the authorities are well prepared to cast their net wider than just employers.

The highest fine yet imposed for a breach of the Act is that on the Napier Port Company of \$20,000.00. The total amount of fines levied between the inception of the Act and 1 October 1994 is \$345,300. Since its inception, injured employees have been awarded \$128,300 in compensation for injury.

There is an upward trend in compensation awarded to injured employees which appears to reflect an attitude that compensation payments under the Accident Compensation Regime are increasingly inadequate.

The developments in the area of Health and Safety prosecutions, along with the prosecutions under the Resource Management Act and the Building Act have resulted in a greater demand amongst employers and other affected parties for statutory liability insurance cover, which indemnifies against compensatory awards and fines imposed under these Acts.

(Continued from Page 34)

their land, but the Committee believes that inflationary factors and other changed social and economic developments have recently created a disadvantaged group of captive lessees, and that this change will help redress the imbalance of power upon renewal. S23(1) of the PBLA already provides

"A leasing authority may -

- a) Accept, on such terms and conditions as it thinks fit, a surrender of any lease, whether with respect to the whole or to any part of the land comprised in the lease.

The committee traversed the fact that improvements, while paid for by a lessee, are owned by the lessor. What a lessee owns is a contractual right to use the land and buildings for a term of 21 years subject to the terms of the lease. At the end of the term, he has the option to renew. If he elects not to renew, the lessors reversionary interest springs into full ownership. (Ref Sir Trevor Henry: Melanesian Mission Trust Board and St John's College Trust Board award 12 June 1975). The recommendation of compensation for improvements is recognition of changed circumstances which have created unfairness, and is not an attempt to change fundamental legal principles.

6.12 Freeholding

The committee disagrees with a statute based right to freehold, and this was a strong view of lessors. The relationship between the parties is based on contract, entered into voluntarily on terms which does not include the right to freehold, much less at a time to suit the lessee. There are benefits in retaining the present system:-

- 1) From the lessees perspective.
 - a) A 21 year fixed rental period is a real benefit, which is why lessees oppose more frequent rent reviews.
 - b) Leasehold enables people to afford better quality of improvements and/or location than freehold (in theory).
 - c) Rental factors are less than mortgage interest rates.

- 2) From the lessors perspective
 - a) Leasehold is a secure income source with little risk
 - b) The lessor attracts no liability for buildings, including refurbishment or replacement.
- 6.12.1 Many lessors already allow freeholding by policy. A statutory right would depreciate the value of the lessors interest, thereby reducing land value at time of rent review and in turn reducing rental returns. On the other hand it would increase the value of lessee interests.
- 6.12.2 The committee deals at length on the recent introduction of statute-based freeholding in Britain, known as "leasehold enfranchisement", but points out that lease terms there are quite different. Leases are mostly terminating leases, without right of provision for renewal or compensation. These terms have created undue benefits on lessors, and lessees have been disinclined to adequately maintain improvements. (See Government proposals Clause 11.2 for MRLA leases).
- 6.13 The Committee noted that provided that the market realises the true implications of leasehold and reflects this in paying prices that preserve a proper margin between freehold and leasehold prices, then there remains a very real place for Glasgow leases.
- 6.14 Offer-Back Recommendation
The Committee recommended that legislation be enacted giving lessee's prior right of purchase of the lessor's interest. In most instances they are the logical buyer of the freehold in respect of which they already paid in full for improvements. If the lessor is willing to sell then there is much to be said in favour of requiring that it be offered to a lessee before passing to a third party, especially where that third party is not itself a leasing authority of the type contemplated by the PBLA.
- 6.15 Arbitration and Alternatives
The Committee recommends that a review is made of the arbitration provisions in the lease forms so that less formal procedures are available as of right but does not recommend legislative change.

Many leasing authorities consent to a negotiated settlement between two valuers, one acting for each party, and where they cannot agree the parties have appointed a sole arbitrator. Few full scale arbitrations have been necessary, and they can be expensive. The committee favours this practical method of negotiated settlement, whereas the PBLA requires any contested rent to be by way of an arbitration comprising two arbitrators and an umpire.

- 6.16 At times the less formal procedures have led to confusion. It has not always been clear what authority the valuers have for reaching a decision. Some lessees have been surprised to find they have become bound by a joint award, when they understood their valuer was still negotiating. One leasing authority considered the award not binding. The Committee noted that valuers need to be careful to ensure the parties they represent understand the status of their discussions.

"... The legal member of the Commission ventures to think that, where it has been agreed by the parties or ordained by statute that there shall be a valuation, it is very doubtful if the amendment of the Arbitration Act was intended to have or in fact has the effect of letting in witnesses and other apparatus of judicial procedure in substitution for the knowledge and skill of the persons appointed to value. It is thought that by expressly providing for valuation the parties exclude those common-law incidents to an arbitration proper, but that, although they do so, the Arbitration Act is still left to operate as regards the filling of vacancies and suchlike matters. Necessity for Distinction

If, therefore, legislation dealing with the method of arriving at the rents and value of buildings is undertaken, care should be taken (according to what is determined to be done) either to convert the valuations into arbitrations to all intents and purposes, or to make it clear that while the Arbitration Act applies so far as it goes the valuation is nevertheless to be made according to the knowledge, skill, and experience of the valuers appointed."

- 6.17 Lease Forms
The lease form is not derived from any legislation, but is a contractual document. The Committee sees no reason for legislation to impose a form of lease to replace existing contracts, but recommends that leasing authorities produce a modern english version of lease to make them more easily understood.
- 6.18 Cross Lease Flats
Legislation is recommended to enable individual flat owners to freehold without the concurrence of all co-owners. It is noted that there are legal obstacles with this.
- 6.19 Other Matters
Leasing authorities should
- 1) Be more open and communicative with lessees
 - 2) Ensure lessees take professional advice before purchasing leasehold property
 - 3) Produce informative newsletters annually showing details of renewals resolved during the year including a resume of significant determinations of arbitrators. The purpose being to make lessees aware of current levels of increases and the lessors current practice in relation to renewals.
- 6.20 Perpetual Renewal
The report has little to say on this matter, and clearly lessees were not quick to criticise the right. No recommendation is made to remove perpetual right of renewal.
- 7.0 The Marshall Report
- 7.1 The Committee endorsed all the criticisms common to the 1975 Commission and the Waitangi Tribunal, and notes that lobbying for change has increased over the years. Society's attitudes and economic circumstances have changed; the understanding and importance placed on the application of the Treaty principles have increased; and the rental stream has decreased due to inflation.
- 7.2 There is no substitute for voluntary bargaining, and the committee prefers negotiated settlements in every case, but recognises the practical difficulties in achieving these.
- 7.3 Perpetual Renewal
- 7.3.1 Legislation should not be introduced to confer a benefit on one party at the expense of the other but unless the problem is settled with expedition the committee believes that values and rentals will be injuriously affected due to the prevailing uncertainties. It is recommended that perpetual right to renewal be proscribed, but that the Crown accept responsibility for compensating losses, both for the lessor and the lessee.
- 7.3.2 Maori owners have regularly stated that they have no wish to regain occupancy in all cases. Their objective is to regain the "normal" rights of owners and to gain market rents. Various transition periods for removing perpetual renewal rights are suggested, but made subordinate to the perceived urgent need to amend the frequency of rent reviews and the rent-setting mechanism.
- 7.3.3 The Committee recommended that legislation convert perpetual leases to terminating leases based on the expiry date of existing leases plus a further 21 year terminating period ie: from 22 to 41 years, but residential lessees and their spouses should have a license to occupy for life.
- 7.3.4 Maori owners should have right of first refusal during this transition period should lessees sell their interest. Otherwise the lease should be sold to a third party as a terminating lease.
- 7.4 Rentals
Prescribed rental levels at 4% urban and 5% rural is acknowledged as unrealistic over long review periods and is a major source of grievance for Maori. The low relative rentals and the impact of inflation have been beneficial to lessees, at the expense of Maori. The effect of S28 MRLA allowing lessees the choice to convert from arbitrated to prescribed rentals upon renewal has been to increase the inequity (Ibid 4.6.2).
- 7.41 The Committee recommends that
- a) Rent reviews be made at 7 year intervals
 - b) Rents be set by negotiated settlement, or failing that by arbitrations
 - c) The first review be made on the next 7 year anniversary of the lease ie: lease now in year 3 = Review Year 7. Lease now Year 8 = Review year 14 etc
 - d) The Crown accept responsibility for paying compensation to lessees for the difference between the renegotiated rent and the current rent, for a period of 14 years certain from the commencement date of the new rent.
 - e) The Crown should pay for the cost of setting the new initial rent and the Lessee and Maori owner should share the cost of the next succeeding rent reviews during the first new lease period.
 - f) The Crown consider compensation for past losses to Maori.
- 8.0 Lease Contracts
On completion of the transition period, MRLA leases become leases without legislative prescription.
- 9.0 Compensation
The Committee recommended that:
- 9.1 Lessees be compensated by the Crown for the loss of lessee interest in the land as a result of the proscribing of perpetual right of renewal.
 - 9.2 Lessees be compensated for any improvements at the time of transfer of the lease, or termination. The Crown should pay Maori 50% of the cost of such purchase, and pay the cost of any special valuation needed to reach settlement.
 - 9.3 Lessees be compensated for the difference between current rent and new rents payable under amended legislation, for a period of 14 years certain from the commencement date of the new rent (Ibid 8.4.1.d)
 - 9.4 The Crown should pay the lessor compensation for past losses. It is noted that this, among other claims, is the subject of a separate claim before the Waitangi Tribunal.
 - 9.5 The Crown forego taxing compensation payments.
 - 9.6 Total compensation costs are estimated at PV \$300m.
- 10.0 Mortgages
The Crown should consider the provision of a mortgage guarantee scheme, to offset reduced lessee

- interests. It is noted that payment of compensation would negate this requirement.
- 11.0 The Government Position on the Marshall Report
 - 11.1 The Marshall report was made available to the government on November 29, 1991, although not released to the public until 28 April 1993. The government, instead of adopting the recommendations, produced its own proposals detailed in a booklet "A Framework for Negotiation - Proposals for a Solution to Maori Reserved Land Issues". This is a very short booklet and all lessees were invited to consider the alternatives and make submissions at public meetings held during August-October 1993 conducted by Judge Peter Trapski, former Maori Womens Welfare league president Georgina Kirby and Valuer Robert Cooper. A copy of the alternative recommendations (pp 10 & 11) are alongside at 11.2.
 - 11.3 Judge Trapski stunned all parties when he announced during a meeting in Motueka on 8 October 1993 that the panel could only discuss issues relating to prescribed leases because arbitrated leases did not come under the Maori Reserve Land Act 1955 and were therefore outside his terms of reference.
 - 11.3.1 Wakatu Incorporation immediately contacted then Maori Affairs Minister Doug Kidd for clarification on the matter, saying "We believe the approach taken is inconsistent with historical or legal facts concerning the establishment of perpetual leases affecting Maori ownersthe essential criteria for any inquiry was that the owners of the land were Maori, the leases were perpetual in nature, and that there was 21 years between rent reviews. Those essential points are the major issues which are causing the injustice difficulties both for Maori and the lessee".
 - 11.4 Judge Trapski has made his report to caucus, which has yet to be made public, but it is understood that the Minister of Maori Affairs has required that all leases of Maori Reserved Land be included in the terms of reference.
 - 11.5 As noted in Capital Letter Vol 17 No 6 (758) from the Replies Supplement 31/3/94 "Hon John

11.2 RRYIEW 'IAIYI

Termination of Leases

The period of transition to terminating leases to extend between 21 and 42 years,

based on the *expiry* date of *existing* leases a further 21 year

terminating lease period.

Rental and Rent Review

That the period of rent review during e transition period be set 4 7 years for all leases.

That the rent payable during the transi-tiosr period be established by a process of agreed market rent setting, supported by arbitration.

That the first rent review under *the new* system, should take place on the next 7 year anniversary of the commencement of the existing lease (*i.e* 7, 14 it years).

Compensation

Residential tenants or their estate should be compensated for any difference in market value resulting from the sale of a terminating lease as distinct from a perpetual lease.

Tenants be entitled to compensation for Improvements left on the land at the time of sale or transfer,

Crown to assist Maori owners to purchase improvements (minimum 50% of purchase price).

Crown to accept responsibility; for compensating provable loss with respect to difference between the rent fixed in the *current* lease and the new rent payable.

Right of Refusal

Maori owners have right of first refusal during the transition period in the event that a tenant wishes to sell or transfer his leasehold interest.

Residential Leases

Rent levels and review periods to apply as for all other leases.

Existing tenants to have lifetime occupancy rights.

The surviving spouse of the existing tenant to have lifetime occupancy rights.

in the event of the proposed sale or transfer (other than to a surviving spouse) of a residential lease the Maori owner, the lease should be transferred only as a terminating lease as distinct from a perpetual lease.

The Crown should accept responsibility for negotiating the purchase of residential land with the encumbrance of existing leases if such is sought by the Maori owner. The principle of land for land is recommended as the appropriate approach. The final choice to rest with the Maori owners.

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Termination of Leases

Leases should terminate at the end of their existing term, plus two further

periods of 21 years (this will provide existing tenants with between 42 and 63 years further tenure under like leases depending on the date at which leases were last renewed).

Rental and Rent Review

Rent for all leases to be reviewed in 14 years time to market rent. In the meantime the existing rental rate, subject to the normal review at the commencement of each 21 year terms, should remain as currently set.

Rent reviews thereafter would occur at the end of year 7, and year 14, of each lease term, and at renewal (that is, at the end of each rent review period).

Compensation

Nil compensation would be payable to residential tenants in view of lifetime tenancy rights.

in view of the extra transition period no compensation be payable by the Crown, to the tenants.

At termination of the two 21 year lease periods, instead of assistance being made available to Maori owners, owners would be given the opportunity either purchase the improvements at valuation, or grant an additional 21 year lease and own the improvements at the end of that time.

BY mutual agreement, owners and tenants be able to come to a different arrangement to that suggested by the Government

Right of Refusal

Owners should be granted the first right of refusal to purchase leasehold interests if offered for sale.

In addition, tenants should be granted the first right of refusal to purchase the land if offered for sale

Residential Leases

Rent levels and review periods to apply as for all other leases.

Existing tenants and their surviving spouses (including common law spouses) would be granted lifetime occupancy rights with the lease expiring 3 months after the death of the tenant or his/her spouse, whichever is the later.

Owners to be granted the first right of refusal to purchase leasehold interests if offered for sale. Landowners would be empowered to sell their interest in land, on a voluntary basis.

Luxton (Minister of Maori Affairs); The Government intends to introduce legislation reforming reserved land leases during the current parliamentary session. The timing is conditional on the time it takes for a proper analysis of the report of the Reserved Lands Panel and for subsequent decisions to be made".

12.0 Conclusion

- 12.1 The recommendations contained in the Marshall report boil down to the fact that Maori perceive the past actions of the Crown via the MRLA as being a nimious state interference requiring a dismantling of major provisions of the Act and compensation therefore.
- 12.2 The effect of such extensive change may put right perceived Maori grievances, although the Government proposals contained within the "Framework For Negotiation (ibid 11.2) are an effort to avoid compensation, and the results of the Trapski report are as yet unknown.

12.3 The effect on lessees is barely addressed in the Marshall report, except as to fiscal compensation. A conversion from the privileged terms currently enjoyed by lessees to leases terminating at periods up to 63 years, on market rents reviewed 7 yearly would be such a disincentive to lease that I doubt the attraction to incoming lessees unless values declined to a fraction of replacement value of improvements. There would be little encouragement for investment, and the problem as faced (and recently statutorily redressed) in the U.K. (Ibid 6.12.2) with improvements left to fall into disrepair; unless compensation were to be paid on lease termination in terms of the Public Works Act, ie: as though the Statutory Amendments as proposed had not occurred. The government proposals are to exclude this compensatory provision. Note that one of the few recommendations of the Lusk report on PBLA leases is to include a compensatory provi-

lion for urban lands, but that such provision already exists for rural land (Ibid 6.11).

12.4 Many of the lessee criticisms of leases considered in the Lusk report would spring onto new Maori leases unless new lease contracts provide for the problems. The lessee bears all the risks: his home and improvements for which he has paid and under lease terms must continue to maintain but can never own so long as he remains a lessee. In default the lessor may regain possession at no cost. The lessee is bound to accept reviewed rents or sell up. Without compensatory rights his interest will diminish over time towards termination. Unless he renews he will forfeit the value of improvements, unless there are compensatory rights (Ibid 6.5) However, there will remain a place for new leases of Maori Reserved land provided that the market gives appropriate recognition to the differences between freehold and leasehold land.

Local Authority Development Management:

Is A Pro-Active Approach Appropriate?

by M J Wright

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Introduction

The propensity for Local Authorities to engage to varying degrees in property development, has over many years provided for a wealth of press comment. This has at times fuelled emotive public responses, in some cases strong enough to force the abandonment of the offending project or the demise of the politicians involved. This paper considers this practice of Local Authority Development Management (LADM), the motivation for such, its effects, and its future. The experiences of the Christchurch City Council (CCC) in adopting LADM in the city of Christchurch, New Zealand are evaluated specifically as a case study, and the effects of this practice appraised in the Christchurch context.

What Is LADM

Development is defined in the Oxford dictionary as the "Act or an instance of developing" and to develop is to "Convert (land) to a new purpose so as to use its resources more fully". Management is "the process or an instance of managing or being managed" and to manage, is to "organise; regulate; be in charge of (Oxford Dictionary, s.v.)

Development Management is a descriptive term coined by Christiansen and defined by him as "the professional role of

coordinating and managing a project through all its phases from inception to completion" ... "the total organisation and shepherding of a development project from the inception of an idea to completion and beyond" (Christiansen, 1988, 138-139). This definition could be further expanded in the context of this paper to incorporate regulation ("regulate" from the definition of manage) in the context of town planning, and encompassing the use of district plans and zoning regulations etc.

Local Authority Development Management (LADM) is therefore the adoption of Development Management by Local Authorities, or borough or city councils. It is the undertaking of property development, or involvement in such by Local Authorities, mainly, but often not entirely for community purposes. Research for this paper has revealed that LADM is undertaken to varying degrees

throughout the developed world. Examples covering the spectrum of LADM include public place developments (for example, parks), amenity developments such as public car parking, administration and town hall buildings etc. Other developments sold to the public as beneficial to a city or district from an economic perspective perhaps, but which are often perceived to be more of a private sector

development function, may also be included. An example would be Local Authority involvement in a tourist related facility such as a hotel. The Local Authority's involvement can range from full, sole participation (conception, development and operation) to being a partner or undertaking a joint venture with private sector interests.

Motivation For LADM

Motivation for the adoption of LADM is wide and varied. The mayor of Lower Hutt City, in commenting on Local Authority's role in development, has stated that "the council has a central role to play in fostering and directing development in the city, even to the extent of engaging in commercial development" (*Dominion*, 29 September 1993) a view which supports the use of pro-active LADM. Addressing the Public Sector Property Conference in 1991, the Director of Property for Manakau City Council, Mr Bob Lang stated;

"I believe it is a legitimate function of a local authority to manage and develop property for the purpose of achieving planning and city development objectives. It is another level of land use control being used more frequently by local authorities to boost economic growth and for employment creation in a district. The acquisition, development and management of property .." (pro-active LADM) "... in all these circumstances must include risk assessment and be aligned to the goals and priorities of the local authority. Opportunities exist for joint ventures with private sector in this category" (Lang, 1991).

LADM is therefore perceived by many Local Authority employees and politicians alike to be an important tool or function necessarily undertaken to achieve ideal and well balanced community property development. Zoning appears to be inadequate as the sole means to achieving this level of development. This may be a result of the inflexibility that exists within the current New Zealand zoning system to expedite change in the short to medium term under a completely open and public operation. Alternatively, the complexity that would be required to be accommodated within the system to permit such change, whilst continuing to maintain adequate controls over private sector development would be unmanageable.

Conflicts of interest would probably be unavoidable under this latter approach to zoning control. LADM therefore appears to be a necessary supplement to zoning and other town planning controls but may not be the only option available to achieve their desired level of community development.

Local Authority roles in New Zealand have expanded markedly in recent years and continue to expand, this being partially the result of a shift in the responsibility for many social functions from central government to local government level as a result of central government initiative. The poor, and at times declining economic performance of most local districts through the late 1980's and early 1990's has also spurred many Local Authorities to become involved in a wide variety of local development functions (including LADM) and other pro-active activities in order to stimulate the local economy and perhaps improve community morale and status. Local Authority involvement in such developments is not without criticism from ratepayers, who question their authority to undertake such. Whether such activities fall within the bounds of normal Local Authority activity is also questionable. Where property is concerned, the question of whether Local Authorities have sufficient expertise to operate in what is agreed by most to be a risky area of activity is also asked.

In order to identify specific motivation for CCC involvement or initiation of development, which indicates a pro-active LADM approach, unstructured interviews were conducted with two key council employees. These revealed that to date the council has not had specific goals or objectives as part of its strategic plan to actively seek out appropriate development options. The practice appears to be undertaken in an ad hoc manner, although some councillors appear to recognise its importance as an augmentation to town planning as was reported during the council's recent bid for two key inner city properties. "Ownership of the sites would

give the council more influence over the design of any developments that went on them, than it could achieve through town planning" (*Press*, 26 August 1993). The council's Property unit, which is responsible for the management of all council property as well as having disposal and acquisition functions, does have the following objective recorded however; "Completing the purchase of property for civic purposes and assessing and carrying out authorised strategic property investments" (CCC, 1993, 65).

Developments are introduced to the CCC from internal sources, by number, approximately equally between council employees and elected politicians, and also from external sources, usually developers. A common facet of these external proposals is the request for financial backing or bankrolling by council. The council is not averse to such requests. Development options are evaluated both internally and externally utilising a diverse range of specialist consultants. Recently the CCC employed the services of an expert Australian consultant to advise on a proposed entertainment/conference centre development. More than one opinion can be sought when dealing with exceptional projects such as this. In reality, most council development projects could be classified as exceptional projects.

Even with favourable external consultants reports backing internal recommendations on projects, those of seemingly sound economic sense, but sensitive socially, may not be accepted by the politicians. Proposed (CBD) developments are evaluated relative to a number of issues. These include tourism, employment, maintenance of the status of CBD retailing against the impact of competition from the increasingly sophisticated suburban retail centres, and the somewhat subjective issue of social importance or impact. Council does not currently consider development options from the perspective of providing a means of offsetting any decline in rating revenue, or to boost city revenue in any

other way. Concerning the maintenance or stimulation of the CBD retail sector, this has clearly been recognised as a priority of council for some years, as noted in a council publication "a major objective was to support the centre (CBD) against increased competition from new suburban shopping centres" (CCC, 1987, 1). In the strategic policies of the operative district plan the following objectives are also stated; to "limit(ed) further substantial growth" (of the suburban centres) and "the formulation of proposals for the city centre to achieve environmental improvements including pedestrian malls..... car parking facilities to encourage greater shopper attraction" and to "retain the Central Commercial District as the principal commercial administration and retail focus of the region".

An interesting observation with respect to the CBD retail area and these policies specifically, was the effect that upgrading of a large area of industrial zoned land, some 6 blocks south of, and well away from the CBD retail area, had on that area following the change in zoning in 1990. Three large shopping centre developments were undertaken in this area following the zoning change, and although it was perceived by council that these would be a drawcard for the CBD retail area, this perception was ill conceived. Instead, these centres have established more as a close by suburban type shopping development in competition with CBD retailers. This has somewhat negated the council's strategic policies to protect the CBD as discussed above.

The practice of pro-active LADM by the CCC does not appear to be undertaken as a conscious augmentation to conventional town planning and the use of zoning as a control and development stimulant. "Perfect" planning if such a scenario was possible, would not it appears alleviate the requirement for pro-active LADM as there would still be a need for the provision of uneconomic public amenities that could not, or would not be effectively provided by the private sector, at least when social issues are involved.

The following comment has some relevance in the New Zealand context prior to the enactment of the Resource Management Act 1991 (RMA).

"The essential point about local planning authorities is that they have no 'positive' powers to ensure that the developments (Industrial estates) set out in a plan will take place. Their powers are 'negative' powers - they

have the ability to refuse permission for development which does not conform to the plan" (Pickvance, 1982,70).

Palmer noted that:

"zoning techniques have been developed considerably to meet the changes in urban demands and to achieve the goals which a community may recognise. However, zoning systems per se cannot provide the means to achieving all planning goals. As a form of negative regulation the impetus for development must be provided by private and public action" (Palmer, 1977, 2).

In Australia recently it was reported by a representative of the Blacktown City Council, commenting on the acquisition of a parcel of CBD land, that it

"was part of a programme which provides the council with strategic long-term land holdings which can be used in conjunction with planning guidelines to achieve balanced development of the central business district" (*Australian Financial review*, 12 August 1993).

In summary the concept of pro-active LADM can be readily identified from these examples and writings, and appears to be widely, albeit somewhat subconsciously, practised by many Local Authorities. Some Local Authorities, as highlighted by the Blacktown City Council example, do however specifically recognise the need to implement practices, such as pro-active LADM in conjunction with town planning to achieve desired results. Ratcliffe's comments on the benefits of joint developments, which encompasses pro-active LADM effectively sums up this facet of motivation. This (proactive LADM) permits the -

"authority to exercise positive planning by initiating development;..... to receive a share in future development profits; enable them as landlord to exercise more effective control over the nature, use, design, and management of the scheme (district plan) than would otherwise be available under town planning control; provide a greater opportunity to include civic and amenity use on valuable central area land;..... give the chance to introduce outside expertise particularly in complex central area redevelopment structures; shed many of the financial risks inherent in property development and more readily secure private contributions towards high infrastructure costs" (Ratcliffe, 1976, 107-10).

Case Studies

LADM as undertaken or proposed to be undertaken by the CCC in their city has encompassed a wide range and scale of activities with varying degrees of council participation. This ranges from full or 100% council conceived, designed, built and managed projects, through the complete spectrum of mixed public and private enterprise projects. Some are initiated by council, either by the politicians (elected councillors) or by council staff, and others by members of the public, usually developers. Somewhat regardless of the level of participation, council involvement in property development, or with persons undertaking such, is almost without exception heavily reported on by the media. The information imparted to the public about this process is either sourced by the media through formal channels (press releases) or obtained by informal means (leaked).

In the ensuing paragraphs, three significant projects undertaken by the CCC in recent years, and subject to intensive press coverage, are evaluated. A brief descriptive overview will be provided for the case studies, following the evolution of the project and providing an indication as to the context within which it was appraised and undertaken by council. This section will be followed by an appraisal of some of the effects of these cases of LADM and the council's formative decisions.

City Mall

One of the city's early "modern" development projects was the pedestrianisation of three linked blocks of inner city roadway, which after much public discussion and debate was opened in its original state in August 1982. It has since been remodelled to suit perceived 1990's and beyond demand and usage.

Parkroyal Hotel Site

In the mid 1980's the council notified its intent to close part of the inner city road of Victoria Street. This was done to improve traffic flows in the inner city, and to amalgamate part of the former road reserve with other adjoining land acquired over the years to provide a site for new civic buildings adjacent to the city's existing town hall. Closing off part of Victoria Street in this manner would also allow for the comprehensive redevelopment of an important inner city park, Victoria Square, which had been dissected by Victoria Street, prior to redevelopment. Following the announcement of its plans, the council was approached by representa-

tives of a major hotel chain with a proposal to secure the land earmarked for the new civic buildings for an international standard hotel. The council recognised, firstly the need for another such hotel within the city to cater for increasing tourist numbers, and secondly the likely economic advantages of implementing such a proposal to CBD retail businesses. Consequently an agreement to lease the land to the hotel chain on a long term basis was struck. This has resulted in the completion of what many believe is one of the most significant and influential developments undertaken in Christchurch for many years. Public concern has surrounded the terms for the ground lease to the hotel which is thought to have contained incentives for the hotel developers.

Tramway

The tramway is similar in concept to the City Mall. It involves predominantly public land and has, like the City Mall, a potentially large effect on private property values. It was approved by council in its

original form for staged construction in 1991.

In August 1992 council voted in favour of an external consultants opinion that the Tramway be extended, and to involve private enterprise in its operation. In October 1993 a local entrepreneur proposed a further extension to the route, to take in a relatively depressed area of the north eastern side of the CBD. Council has since given approval to this proposal.

Other Examples

Similar in some respects to the rumoured Parkroyal lease incentive, recent *Press* reports have stated that the council is considering offering "incentives to encourage the development of a new international-class hotel" in the city including "a direct grant..... or assistance with the provision of land" (*Press*, 23 June 1993).

Perhaps the most reported New Zealand example of pro-active LADM in recent years has been that of the Lower Hutt Council's ill conceived car parking building development, which has contributed significantly to Lower Hutt becoming

New Zealand's most indebted city on a per capita basis (*Dominion*, 29 September 1993).

Pro-active LADM is clearly not just a Christchurch, or indeed New Zealand phenomenon. For example the Melbourne City Council in Australia, in formulating the redevelopment of the city square, the plans including "the restoration of the Regent theatre, private apartments and the construction of an International hotel on the city square site", has entered into an agreement "for the developer to contribute \$1.5 million toward improvements in the city square in return for an undertaking from council not to carry out any major works there for 50 years" (*Sunday Age*, 23 May 1993).

In the USA "in their agreements with private developers, city officials..... promised to build parking garages, skyway, parks, even department stores, as publicly owned elements of private real estate projects", and "when cities financed downtown projects in the 1980's they were acting as developers as well as lenders and investors" (Sagalyn, 1990, 429).

Results Of LADM

Prior to the implementation of any development project, the potential effects need to be thoroughly evaluated. From a Local Authority's perspective, priorities for evaluation should concentrate on the all important social issues, - as well as on economic issues. With respect to social issues, considering the CCC experience, effects evaluated cover the full range of possible and probable positives and negatives. Concerning economic issues, positive effects are given priority and emphasis. However, probable/possible negative economic effects, such as consideration of the economic impact a particular council development could have on the businesses and property of ratepayers (such as the resultant draw-off of clientele), are not, it appears, readily identified or given much priority in the evaluation process.

Considering the development projects outlined above it is possible in hindsight to appraise both the social and economic effects of these developments since completion.

City Mall

The City Mall development of the early 1980's has been hailed as a tremendous success by many commentators. Doeksen

Cashel Street (pre Mall development (approx 1980) (Provided by Christchurch Star))

recently commented in a *Press* article that "The City Mall, despite strong resistance by retailers when the concept was launched, is now a success for everyone" (*Press*, 7 May 1992). Certainly from a social perspective this comment would be refuted by few, but what of the economic ramifications of the council's decision to pedestrianise such a significant portion of the CBD retail area. It is perceived that the positive effect of the improved aesthetic environment of the City Mall coupled with a positive effect on pedestrian movement in the vicinity has rewarded local business with increased turnover, and landlords with increased rental returns and property values. Considering changes in pedestrian movement in

Cashel Mall (following remodelling (1993))

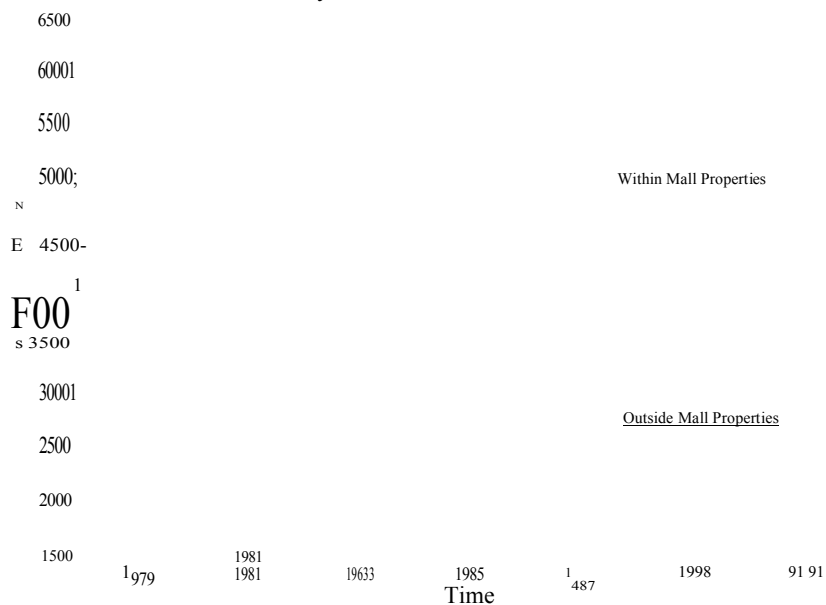
the mall since inception is a relatively simple task, and some data is available on rental levels. Measurement of effective changes in property values or obtaining turnover data as a measurement tool has proven difficult however.

Focusing on rentals, a sample of rentals pertaining to a range of premises from within the City Mall was compared to a range of rentals for retail premises outside the mall over the eight year period 1981 to 1989. This time period was chosen to capture the settling in period of the mall which was opened in 1982, and the end point was determined to some extent by the rental review periods of the properties analysed. 1989 was also recognised as the significant turning point for rentals

Cumulative % Rental Change 1981-1988
City Mall vs Outside Mall Areas

1981 1982 1983 1984 1985
Time

Pedestrian Count Levels 1979-1991
City Mall vs Outside Mall Areas



following the flow on effects of the share and property market collapses of late 1987. Graph I shows the cumulative change in rental levels over this period for six properties chosen from both within mall and outside mall localities. Somewhat surprisingly, this reveals no significant difference in the percentage increase in rental levels within the mall, in comparison to those benchmark properties analysed outside the mall. It is recognised that this analysis is constrained by data availability. Enquiry of local property professionals has revealed that key money is still being achieved within the mall, this being a

particularly rare practice in virtually all other inner city retail localities currently. Of course, one perspective of key money is that it represents the present value of perceived future rental benefits, if it is considered that the current rental levels are below market, and this may in part explain the inconclusive results of the analysis. Another indicator of the City Mall's success reflecting the prevalence of key money payments, has been the low level of vacancies in the mall in recent years compared to other retail areas within the CBD.

The mall is considered the most "populous area of the city" (CCC, 1993, 103), and

analysing New Zealand Institute of Valuers (NZIV) pedestrian count data over the same period has revealed one period of significant difference for mall data compared to outside benchmark data in the early years of the mall's establishment. Graph 2 clearly demonstrates this differential. Interpreting this graph, the initial sharp rise in pedestrian numbers is largely erroneous as it results from the change in data measurement. Pedestrian numbers in malls are measured right across the mall whereas traffic street measurement encompasses one side of the road only. This sharp rise therefore only reflects the transition of Cashel Street to the City Mall. Following on from this period, the data does differ however. Between 1983 and 1985, a clear falloff in benchmark out of mall pedestrian levels was evident whilst inner mall levels continued to rise. Comparing the combined count for two prime out of mall points (on Colombo Street north of Cathedral Square) indicated a fall of 9.3% between 1983 and 1985, whilst within the mall, two prime points recorded 1.4% and 7.3% increases respectively, before following the general citywide trend thereafter of decline through to 1987 (appendix 3). As was succinctly put by Christiansen "location is a movable feast" (1991, 10). One explanation for the rise in pedestrian numbers in the mall against the general city trend through 1983 to 1985, is the affect of a shift in retail locality emphasis the development of the City Mall had on the CBD retail area during this period. Graph 2 could also be interpreted as reflecting an inner city retail trend lead role taken by the City Mall. These shift effects should have led to a fall in yield rates for properties within the mall and therefore a corresponding rise in real property values since the mall's conception. If this perceived shift is a "real" effect, then it is probable that the council's pro-active development (pro-active LADM) of the mall could be perceived to have redistributed economic wealth within the CBD, by improving property values or providing "betterment" to those properties within the mall. Offsetting this would be a reduction in some property values outside the mall ('worsenment'). This effect has been noted before (Hajdu et al.), although the data analysed in this study does not readily support this effect. Hajdu, in his appraisal of pedestrian mall evolution in Germany, did note other characteristics similar to those perceived

to have occurred in Christchurch as a result of the City Mall development. "Commercial success increasingly became linked to changes in the types of shops within the malls and to a widening gap between retail rents and property values within the mall and those outside it"; and prevalent was "a decline of small shops, especially those providing basic services, and a concurrent increase in department stores, retail chain stores, and luxury specialty shops"; with the effect that "rising rents pushed out the types of business less able to pay the increased rates" (Hajdu, 1988, 320). This describes a kind of evolution or economic progression. Reflecting Hajdu's observations in readily defensible terms, the heart of the City Mall has progressed to a point where today it is characterised by predominantly specialty and chain type retailers, a contrast to the type of retailers occupying premises on formerly comparable streets away from the mall, where mainly locally based retailers have positioned. It is not suggested that the council attempt to recover betterment or compensate for 'worsenment' resulting from its development projects, given that since 1953 there has not been the legal mechanism allowing such in New Zealand, except with cases involving compulsory acquisitions (Christiansen, 1991, 316). However, with respect to 'worsenment' all efforts should be made to avoid such when council development options are evaluated.

Another of Hajdu's observations was that "The falloff in retail turnover in the adjacent streets was highly detrimental to the shopkeepers there" (1988, 330). This alerts to the possible conclusion that a refocussing of the CBD retail has occurred as a result of the mall's development. Although any significant negative financial effects are difficult to fathom, the council, by undertaking this mall development, could have severely reduced the potential success of any private entities plans for a substantial retail development on nearby streets for some years following the opening of the mall. At the same time the development has improved the potential of properties within the mall to capitalise on the betterment provided, and this latter effect is readily appraised. A number of substantial arcades have been developed within the mall since it was opened, but development to this extent is not obvious

in any other part of the CBD retail area. Examples of arcades opened since the mall's completion include; the Triangle Centre, late 1982 (34 shops) Cashfields Arcade, 1984 - refurbished and renamed Cashel Plaza 1993 (25 shops), The Canterbury Centre, 1983 (13 shops) Shades Arcade stage 3 which fronts Hereford Street but links to sections fronting the City Mall, 1984 (20 shops), and the Guthrie Centre 1987 (26 shops) (*Christchurch Cityscope*, 1992). Whether these arcade developments would have progressed or succeeded without the council's mall development is unknown. Most commentators would surmise that at least some may not have.

Parkroyal

Opening in 1989 the Parkroyal Hotel development has been influential in promoting a substantial shift in the emphasis of retail activity on the northern side of the CBD. The number of tourist oriented businesses occupying retail premises along Colombo Street between Cathedral Square and Armagh Street (adjacent to Victoria Square) has increased by some 900%, up to a level of 72% of the entire stock of retail premises along this stretch of Colombo Street since the hotel opened.

The redevelopment of Victoria Square which accompanied the Parkroyal hotel development provided a strong link between the hotel and Town Hall complex and the city's main street and core. This has contributed to this change in retail perspective. Although together, the Parkroyal and Victoria Square developments are recognised as contributing significantly to the aesthetics and economy of the north west corner of the CBD, the development has effectively

segregated the north western end of Victoria Street from the central city. This initially reduced the quality and scope of retail activity along this section of Victoria Street. Examination of the district scheme and restrictions on uses stated within reveals that this was desired by council (CCC, 1986). However the restrictions on retail uses had failed somewhat to curb the prevalence of these uses along Victoria Street, as a large number of properties enjoyed existing use rights (i.e. were established uses) for retailing. By undertaking the closure of part of Victoria Street in the manner described above and negotiating the said hotel lease, the council was able to achieve through the erection of this imposing structure, a significant visual separation of the north western part of Victoria Street from the central city. This appears to have contributed initially to the stifling of some retail businesses along the street and this was probably not achievable by zoning alone. The effect may have now reversed however, as over the last twelve to eighteen months a number of tourist oriented business have begun to locate in Victoria Street no doubt as a result of the economic influence the Parkroyal Hotel has exerted on the area. In an interesting conclusion to these comments on the effects of both the City Mall and Parkroyal developments on the CBD retail area, the CCC, in a recent planning discussion document, stated its observations that -

"within the central city the location of commercial activities has been changing. Specific concentrations of activities have emerged as precincts within the central commercial zones. North of Cathedral Square has evolved as a tourist and Hotel area.....retail activity has reduced in peripheral areas of the central city and is concentrating in the Cashel Street-City Mall area" (CCC, 1991,95).

No reasons were offered in the document for these noted concentrations or shifts.

Victoria Street prior to Parkroyal Victoria Square redevelopment. (Provided by the Christchurch Star) (town hall LHS)

Parkroyal Hotel (1993)

Tramway

The potential positive or betterment effects of the tram route on adjoining property values along much of the proposed route are similar to those discussed with reference to the City Mall. Already there is some evidence of this along part of the initial section of the route, known as the Worcester Boulevard. The substantial postal centre building which lies on a site with frontage to both the Boulevard and Hereford Street, but which is presently orientated towards the Hereford Street frontage, is being marketed for sale currently for hotel conversion which will involve reorientation of the building towards the Boulevard. Land in this commercially zoned area which for many years has remained fairly static in a development sense, will no doubt come under pressure for the inclusion of retail type uses once the Tram is up and running.

Commercially, likely negative economic effects of a potential shift in the retail emphasis within the CBD as a result of the Tram route development may also occur. This effect is more probable following the council's recent approval to allow extension of the tram route through the north western sector of the CBD, and away from the city's main street, Colombo Street. Certainly a shift in the tourist emphasis that has established in Colombo Street since the Parkroyal was developed, as noted above, is highly probable in the medium term given the fundamentally tourist driven nature of the Tram proposal. Another perceived negative effect that has been revealed since the CCC's approval of the first extension to the route, is that of the impact of the tram on residential properties fronting a relatively small section of the new route on the western side of the CBD. Newspaper reporting on the matter indicates that council does not appear to have considered the potential negative (economic) effect on private property as part of the overall evaluation process, again indicating a weakness in the evaluation process.

Worcester Street (prior to tram route development)

General

The question of confidentiality of negotiations in other council property dealings has been identified as a contentious issue on more than one occasion. This is highlighted by a reported council comment during recent negotiations through which the council was attempting to secure a large inner city property; "The ability to conduct sensitive negotiations without prejudice outweighed the public's right to know" (*NZ Property*, January 1992). The opposite view was also expressed at the time of these negotiations, when one or more councillors took the advocates stance and leaked details of the proposed deal to the *Press* which duly published such. What followed culminated in a council threat of legal action against the newspaper, which was also duly published in full by the *Press*, and suggestions by some councillors that those caught offending be financially punished. A fiasco as it appears, this episode portrays one clear problem with the council's ability to embark upon effective pro-active LADM within the confines of

Conclusions

Local Authority's by their very nature, can exert considerable influence on their administered environment through property dealings, arguably significantly more so than private developers. Aside from the impact on private land values, there can be other consequences. Examples such as the ratepayer indebtedness that has resulted from the Lower Hutt Council's abortive car park building development, are widely reported. These should be avoidable if initial studies on such proposals are correctly structured. Pickvance commenting on the effectiveness of Local Authority development projects (pro-active LADM) noted the following- "Local authority development is constrained by a variety of economic, political and financial pressures which frequently hinder its success." (1982, 80).

Worcester Street - now Worcester Boulevard (1994) following laying of tram tracks.

its current business or corporate structure. Property professionals would agree that where property development proposals are concerned, some level of secrecy is paramount in the evaluative and formative stages, to maintain a competitive advantage in the market. Although it could be argued that Local Authorities operate in a non competitive environment, when it comes to property dealings this is invariably not the case. Depending on market conditions at the time, their involvement will almost without exception attract the interest of private entrepreneurs. Also, depending on the circumstances, these competitors could choose to bid up the price of the property being considered. Offsetting the case for the desirability of some degree of secrecy in council property negotiations, is the strong argument for transparency, or the public's right to know about what its elected local body is doing on its behalf. As one councillor commented towards the end of the above fiasco, "the ratepayers think we are a joke, business people think we are a disaster..." (*Press*, 26 November 1991)

The observations noted above go some way to support this view, and in the light of the difficulty a Local Authority can experience in negotiating property matters confidentially, the future of effective pro-active LADM requiring the acquisition of private land is not bright under the current system. There is clearly some scope for improvement within the existing framework in the CCC case, and perhaps even some justification for changing the framework, or system under which the council currently deals with property development proposals, itself. Whatever the choice, "community input should be sought when setting program ... options" (Dowall 1990).

Commencing on the CCC case, clear goals and strategies aiding the identification of key or strategic properties and ground rules for the evaluation of development options for those identified, are lacking in the council's current strategic plan. The necessity for such strategies and guidelines is paramount in the interests of ratepayers. This is particularly important given the elements of risk associated with any property dealings and the potentially large amounts of ratepayer or city revenue that is invariably exposed in such developments. The council needs to decide on if, or where, property development fits into its function, and given the potential scale of the activity, acknowledge the risks and perceived benefits formally. Hein Doeksen recently commenting on the need for a strategy for the city centre, went so far as to state that

the councils "ad hoc decisions (were) caused by the lack of a coherent over-all vision". (*Press*, 7 May 1993). A more structured system would not necessarily impact detrimentally on the councils current negotiating ability, given that it is undertaken in the public arena, but it would go some way to improving the councils professional standing and reputation with respect to property dealings. The option to change the present system has been considered by other New Zealand Local Authorities, effected by the recent changes to Local Authority legislation (Local Authority Amendment Act [NO 2] 1989) which brought about significant Local Authority amalgamations. An important part of this legislation [s.34 (2)] permits Local Authorities to set up Business Units and Local Authority Trading Enterprises (LATEs). Most Local Authorities have chosen to restructure in the business unit manner "an intermediate step between a departmental structure and a full public company" (McKenzie, 1993, 2). Hamilton City Council appears to be the only Local Authority to date which has set aside its property functions as a LATE, "a private company 100% owned by council" (McKenzie, 1993, 2) although the Dunedin City Council appears to be structuring towards this goal. It is too early to accurately evaluate the success of Hamilton City's LATE relative to the business units of other Local Authorities such as the CCC.

There is however overseas experience of structures similar to those of LATEs. In the USA it is recognised as a common and widely accepted procedure for Local Authorities to set up separate entities or companies to engage in public real estate development, usually in a joint venture context. It has been said of these entities that "perhaps the main reason (for) setting up an independent organisation to engage in joint development is that it insulates delicate negotiations from the constant scrutiny of the public" (Dowall, 1987, 23). The two primary purposes for these agencies undertaking or seeking to undertake this type of development initiative are the generation of new sources of public revenues and promotion of economic development. Certainly the second purpose would be a priority for all New Zealand Local Authorities but most would at this time deny any desire to strive for the first.

The adoption of the LATE format for Local Authority property dealings appears to have some merit therefore, especially if the companies objectives are clear and unambiguous, and its personnel competent. A clear economic advantage would be the minimising of political interference. According to McKenzie "By clearly

defining the role of the property unit, you can minimise senior management and political interference" (McKenzie, 1993, 6) in a business unit structure as well. There are however a number of potential problems with both types of structure, but more so with LATEs. The most significant is that of accountability. Certainly with respect to council operation in the Christchurch environment, there appears to be a strong public desire for transparency in all council matters, particularly with respect to property dealings. There is also the all important factor of risk. Powell stated on this topic that 'Local Authorities "are not structured and prepared to bear all risk like private developers shareholders in private companies and financial institutions expect their money to be at risk, ratepayers do not" (Quote Ratcliffe, 1976, 108). Analysing risk, associated with development proposals should go beyond similar private considerations for Local Authorities to encompass wide ranging social issues as well as economic issues, both positive and negative, as discussed.

The question also arises as to "how does the public's financial interest affect land use decisions? ... can the city serve as both a partner (or developer) and a regulator at the same time?" (Sagalyn, 1990, 438), or "what happens to the objectivity of public planning and zoning when one of its (the Local Authorities) own projects is under review?" (Dowall, 1987, 23) questions pertaining to the conflict of interest faced by Local Authorities in undertaking development projects individually or in joint venture situations.

The question of competition with private enterprise is also worthy of consideration - "If it (the Local Authority) has a financial stake in a project and stands to earn a share of the profits, will it investigate the project's impact on traffic and neighbourhoods with the same care it applies to proposals from other developers:" (Sagalyn, 1990, 438).

Other economic factors could also be included for evaluation. Some of the developments undertaken by Local Authorities could be seen to be more in the private developers arena. If Local Authorities ultimately choose to undertake developments to boost city income or augment rating revenue, then the economic emphasis of proposed developments may change and put the Local Authority in direct competition with private developers. Is this an appropriate function for Local Authorities?

Some of the benefits seen to stem from Local Authorities adoption of either the business unit or LATE structure is that

greater autonomy of the property sections of Local Authorities could provide the impetus for attracting more skilled workers into Local Authority property positions, and traditional evaluation procedures, which often involve numerous disinterested sections of Local Authority, can be streamlined. It is imperative that Local Authorities seek the right advice before embarking on development projects, and part of this clearly requires honest evaluation of the Local Authorities resources. Local Authorities must also be prepared to seek outside advice when internal resources in a particular area are identified as weak, and also as a source of verification of internal opinion. In evaluating some projects it will be important that "Civic chauvinism should not overwhelm common sense" (McGuinness, 1982, 424), or indeed the personal agenda of the politicians in the evaluation process. Finally, the need to honestly and impartially evaluate the possible/probable negative effects of proposed Local Authority development projects is of paramount importance in this process. Gauging the scope for continued adoption or expansion of pro-active LADM under the Resource Management Act 1991 is a difficult task complicated by a number of issues. Although in the first few months following the introduction of the RMA, many commentators and analysts concluded that "rigid zoning classification and restrictive categorisation of activities should find little place in the new District Plans" (Donner, 1993, 2), it appears that in many areas the old system of zoning will remain, albeit in a somewhat different form. In a recent Planning Tribunal hearing, the Tribunal commented that the RMA is not necessarily concerned with zoning and arbitrary boundary limits but that zoning was nevertheless a permitted technique (*Quinn v. Lower Hutt City Council*). Investigations in Christchurch have revealed that the CCC proposes to broaden the current zone boundaries, and replace statements concerning permitted and restricted or prohibited uses with performance standards.

Section 75 of the RMA deals directly with "Contents of district plans" and the need for Local Authorities to identify the resource management "issues" of the district and state policies with regard to those issues. Certainly identification of these issues will be a difficult enough task, given that 'significant' which is used to qualify their scale, is not presented in any particular context with which the scale can be identified. Section 32 which requires that Local Authorities in adopting rules, shall "have regard to other, means in addition to or in place of such objective, policy rule... etc" which additionally

requires Local Authorities to justify their adoption of any rules etc under the Act and in accordance with section 5, the purpose of the act, "to promote sustainable management of natural and physical resources". The task is considered by most commentators to be enormous. Many consider that zoning will be challenged as a control perhaps on the basis that the resource that is sought to be sustained or protected, is not 'significant', or that the 'significance' identified by Local Authorities is unsupportable, let alone the arguments expected on how 'sustainability' can or should be measured.

In conclusion, pro-active LADM can have a significant effect on the value of private property, as has been demonstrated by the examples discussed above. It's application by Local Authorities appears to be an important augmentation to traditional town planning regulation to assist in shaping the future direction of town/city growth.

In the New Zealand context, initial considerations of the place for pro-active LADM under the RMA are positive. Certainly if zoning is successfully challenged Local Authority's current powers to control land use by zoning may be lost. At the other end of the scale it is likely that zoning could survive but in a somewhat watered down state and thus pro-active LADM may in fact take on a more important role as a planning tool in the future. In this respect however Local Authorities will have to become more professional in their appraisal and instigation of development proposals, and the business unit or LATE structure if skillfully developed, should provide them with the wherewithal to achieve this.

Internationally, as noted, pro-active LADM is already widely practised and is well established in some countries. The need for a properly structured entity with clear unambiguous public interest strategies is paramount to the long term success of this planning tool.

Whether a pro-active approach to LADM is appropriate or not would appear to depend on the circumstances under which it is to be applied. Certainly there is evidence to suggest that unless the process of zoning can be perfected, which is an unrealistic expectation, under circumstances where social issues are involved a pro-active approach to property development is perhaps the only option available to Local Authorities. However, the question as to the applicability of the practice to more straight forward or conventional property development functions is perhaps too far into the political arena to be answerable in this paper.

For LADM to be undertaken effectively and equitably however, and thus be accepted by the public (ratepayers), its operation must be focused upon publicly formulated goals and objectives. These goals must be formulated with public input to ensure that the tide of new responsibilities taken on by Local Authorities is both desired and acceptable to

ratepayers. The goals and objectives must also encompass a template or set of guidelines, for the evaluation of all positive and negative social and economic issues associated with any development proposal. This evaluation process must place sufficient weighting on the potential negative economic impacts of a proposal relative to those of a positive nature.

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TUOHROIOSY

Compiled by Ian Mitchell

FORum

Computer and information technology continues to effect our lives and this is attracting increasing comment in the media, particularly overseas in the USA. The article by Professor R V Hargreaves discusses how some of these technological advances could impact on the property markets in New Zealand. I would encourage those of you who have an opinion on this topic to respond to his article.

If you have a particular skill or knowledge in a technology related field, I would be interested in hearing from you or receiving any articles you wish to submit for publication in technology forum. I can be contacted at Darroch & Co Ltd, PO Box 27-133, Wellington (04) 384-5747 or through the NZIV National Office.

Ian Mitchell

The Information Superhighway

by R V Hargreaves

Bob Hargreaves is Professor in the Department of Property Studies at Massey University, Palmerston North. He is an Associate of the New Zealand Institute of Valuers and is Councillor for the Central Districts Branch. He has recently been appointed Chairman of the NZIV Editorial Board. Bob Hargreaves has contributed numerous articles to the New Zealand Valuers' Journal particularly on computer based valuation methods.

Hidden inside our advance to a new production system is a potential for social change so breathtaking in scope that few among us have been willing to face its meaning. For we are about to revolutionise our homes as well.

Alvin Toffler (1980)

According to Toffler the first great wave of change that swept the world was the agricultural revolution, followed by the second great wave, being the industrial revolution. The third great wave is the electronic revolution, based on the silicon chip. Toffler envisaged that the electronic revolution would enable people to work, shop, and be entertained in their own homes. He coined the term 'electronic cottage' to describe the future family home - where personal computers and other electronic communication devices would link the home to the rest of world. This communication system has recently become known as the Information Superhighway or Internet.

Toffler went on to predict that a new generation of workers would emerge. This group of "telecommuters" would be attracted to working from home, by time and money saved through avoiding physically commuting to downtown offices. Like all sensible futurists, Toffler did not put a specific time frame on his predictions. This has allowed his critics to argue that, because telecommuting has not really eventuated, it will not be a major factor in social change. Other arguments commonly advanced against telecommuting include-

Many business dealings require face to face contact. Most people are gregarious by nature and enjoy many of the social aspects of their work. Working

from home can reduce significantly the amount of social interaction. Upward striving executives may feel too far away from the seat of the power. There is still a work ethic which essentially says that unless the boss can see you working, maybe you are not working.

- Most homes are not set up to cope with an electronic office. For example, in New Zealand, the typical three bedroom bungalow does not have space for an electronic office when two children are also living at home.
- Having Mum and Dad at home all day long for seven days a week may create more stress on a relationship than when one or both partners goes out to work.

What has changed since 1980 when Toffler published his book 'The Third Wave'. Firstly, there have been dramatic improvements in telephone systems with the introduction of both satellites and fibre optic cabling. Secondly, computer systems have become much better at compressing information to be sent down telephone lines and pushing this information down the lines more rapidly than was previously possible. Thirdly computing costs keep reducing and this increases participation. Finally, cable television provides an additional connection to the Internet and a potential competitor to the phone companies.

In the last United States presidential election the Democratic Vice Presidential candidate Al Gore made a major feature of the "Information SuperHighway", and since then Internet has received enormous media attention.

The Internet is the world's largest network of interconnected computers and it is growing rapidly. The interconnection is achieved by installing a device called a modem to the computer. The modem enables a computer to be linked to the telephone system. Local area networks (LANS) allow computers to be interconnected with in a business or building.

This is relevant to valuers because the Internet is starting to change the way valuers do business. Furthermore, the Internet is likely to have a profound effect on both residential and commercial property values. Although most property data bases are not yet connected to the Internet it is only a matter of time before this happens.

Some examples of present computerised data bases that are available to valuers include:

1. VNZ Link

This system has been established by Valuation New Zealand and allows remote users to use the telephone system to search the Valuation New Zealand database. Users are able to obtain access both to Property Sales information and to the Government Rating valuations on all properties in New Zealand. This data base is likely to become one of the important first strands of the property Internet.

2. Land Information System - LIS

For a number of years central Government has been developing a LIS system that will ultimately contain much of the property information used by valuers in their day to day work. More recently local government has also begun working towards the development of

land data systems. The basic building blocks of the LIS system are a computerised land transfer system, and a geographic information system that will include the cadastral database. The existing VNZ Link system is also one of the important first strands of the central Government system. Central Government has a major part to play in establishing uniform protocols so that the various components of this part of the Internet are compatible. The local Government part of the database will include plans of streets, drainage systems, utilities, and Land Information Memorandum and a Project Information Memorandum. The LIS system is not yet connected to the Internet, but this will be achieved relatively soon.

3. Electronic Mail

Electronic mail is a very low cost way of communicating with other users around the world. It is analogous in some ways to using facsimile machines to communicate but has a major advantage in that the amount of telephone time is dramatically reduced and it is not necessary to print out a paper copy of the information. In the academic community electronic mail is used extensively by researchers to communicate around the world.

4. On-line Library and Research facilities

When valuers are faced with a type of valuation that they have not done before then they have to do some research. In some cases this will involve looking through the library for articles on the topic in question. The Internet now allows users to communicate with libraries across the world. In the case of Massey University, virtually all staff offices are now connected to the campus network by a fibre optic cable which includes the library. In practical terms this allows the user to sit in a building quite remote from the library and communicate with the library catalogue system. More sophisticated systems allow communication with outside catalogues and abstracts, similar to the present standalone CD ROM systems which access the major property journals. Statistics New Zealand offer a database facility called PCINFOS.

5. Real Estate Applications

Several residential areas of New Zealand now have fibre optic cabling in the street. This allows cable television to be received in the homes. In most cases the capacity of the fibre optic cable far exceeds the present number of television channels available in New Zealand, and thus there

is a lot of spare capacity. Some innovative entrepreneurs have seen the opportunity to start up a real estate channel. Their idea is that the real estate channel would show listings of homes in the area. Viewers would be able to select a particular home and enjoy a conducted tour of the home from the comfort of their armchair. This system would have major advantages to the consumer by reducing the time taken going to see properties which perhaps don't have the street appeal necessary to even entice them out of their car. The existing real estate agents obviously see this new system as a potential threat to their present way of doing business, and will seek ways to retain control over the information available for electronic listing. Areas that do not have access to fibre optic cables will find it more difficult to utilise this technology, because sending moving pictures over the existing telephone system is more complicated. However, the technology to send television pictures down a phone line is already available and the cost keeps reducing. Wireless connection using cell phone technology is another option when fibre optic cabling is not available.

Implications For Valuers

The changes in technology that have been discussed above will inevitably have major consequences for the way that valuers work. A hint of what might be to come is seen in the way that the United Parcel Service Company (UPS) in the United States conduct their business. The UPS vandrivers have an electronic tablet that tracks parcels and produces an invoice that the customer signs when receiving the parcel. We are now not too far away from the situation where a similar electronic tablet could contain the basic headings for a valuation report. The valuer would fill in the blanks by writing on the electronic tablet. The intelligence of the tablet would be such that it could translate handwriting and ultimately voice communications, into digital form. The digital tablet could be linked to a larger computer when the valuer returned to the home office. All the information, could simply be downloaded over the telephone system from the valuers car to the office printer by cell phone technology. It is also not too futuristic to imagine that many corporate clients will probably no longer continue to require a paper copy of a valuation report. Paper copies take up a lot of space in the filing system, and the electronic medium allows both colour photographs and moving pictures to be stored electronically.

The Electronic Cottage

The 1994 version of the Kiwi electronic cottage is typically a 3 bedroom bungalow. One room will be converted to an office. This might be a bedroom but is often the dining room. An extra phone line will be put in to cope with the conflicting demands of fax machines, answering machines, computers, as well as business and teenage extended phone calls. When both partners are telecommuters the electronic cottage may require two rooms to be dedicated as offices.

It is certain that telecommuters will want larger houses to cope with the space requirements of living and working from home. If existing homes do not have enough capacity, then people will want the capacity to add rooms.

Telecommuting will also result in valuers having to redefine residential location criteria. Transportation costs play a major part in traditional location models.

However, if overall transportation costs are significantly reduced, then aggregate values will tend to become more dispersed. It is likely that serious telecommuters will now be able to seek out those more remote locations with special amenity values.

The advent of the portable laptop computer means that people can work in a variety of remote locations that are not hardwired into the telephone system. For example, wireless communication can be used to link a portable computer in a valuer's car to the home office.

Downtown Dinosaurs?

As the number of telecommuters increases it seems likely that the number of physical commuters will decrease, and this will release office space in downtown locations. Illingworth (1994) has examined the effect of the 'virtual office' on worker satisfaction and company productivity. He concluded that telecommuting generally resulted in increased productivity and worker satisfaction. Rosen (1993) has

reported that an estimated 5.5 million corporate employees in the United States work at home at least one day a week, and that this sector will grow by 6 per cent per year, compared with an overall growth rate of 2 percent per year in the office-sector employment. A further point is that telecommuters require less downtown office space per worker. Brian Pollock from National Mutual was recently reported to have told BOMA Brisbane members that these changes in the workplace make the outlook for second and third ranking properties "cloudy". Perhaps these will be the buildings that become the 'downtown dinosaurs'. Valuers will also need to redefine commercial office location criteria, since modern telecommunications enables large corporates to take advantage of wage differentials across state and national boundaries. For example, one US based airline has part of their data input operation located in Mexico.

The above average white collar job growth in the state of Utah, USA is attributed to the language skills, productivity, and stability of a largely Mormon work force. Utah is quite remote from the major population centres, but this is no impediment to third wave industries such as computer software support services. **Online Interactive Retailing**

In a thought provoking article Roulac (1994) argues that it is no longer sufficient to consider retail real estate as just point-of-sale shops. According to Roulac more than half of the United States adult population shops by mail order catalogue, buying nearly \$90 billion worth of products. Roulac classifies traditional shopping malls as high risk investments and suggests that changes in retail technology will result in a high rate of attrition in this sector by the year 2000.

The Economist magazine (1994) recently described a new strand of the Internet that is known as the Commerce Net. The Commerce Net uses the user friendly MOSAIC software package to enable

users to browse through the electronic yellow pages and then select particular product directories. Currently, various computer products, games, and clothing items are sold via the Commerce Net. Home banking is another early application of the Commerce Net.

In the United States a number of cable television channels are dedicated to online shopping. These channels provide electronic shopping catalogues with 0800 numbers for people to call when they make a decision to purchase by credit card. Wilson (1994) reports that a virtual store in Greenwich Connecticut offers 250,000 brand-name products to an estimated 30 million potential shoppers. There is ongoing debate about the likely effects of electronic shopping on conventional shopping centres. Currently, the volume of electronic shopping is a very small percentage of total retail sales. Most shoppers do like to be able to try a product before they buy. Also, visiting shopping centres is an important recreational activity for many people.

Electronic shops offer major cost savings to retailers since there are no real estate or shop assistant components, and goods can be shipped directly from the factory or warehouse to the consumer. Traditional retailers simply can't match the prices in the electronic supermarkets. This means electronic shopping is likely to grow at a much faster rate than conventional shopping. Once again valuers will need to redefine commercial location to take account of the impact of the Internet.

Summary And Conclusion

The first strands of electronic communication have already changed the way that valuers operate their businesses. Instead of having to visit the local VNZ office to obtain roll information or sales data we can simply dial up the information from the VNZ computer. As additional electronic pathways to Local Authority and LINZ computers become available, more of the valuation task will be able to be completed in front of a computer screen. There is no fundamental reason why the

Electronic Publishing

NZIV is considering the provision of NewsLine and the NZ Valuers' Journal material on computer disc in Ascii text format. Indications as to Member interest and comments on the most appropriate format for the information are invited by posting or faxing this form to: The Chief Executive Officer, NZIV, PO Box 27-146, Wellington. Fax (04) 382 9214.

I would be interested in receiving the following Journal material on computer disc: (tick boxes)

Feature Articles Legal Issues Legal Decisions

My computer system is able to read Ascii text

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computer screen needs to be at a central city location. The nature of the valuation tasks means that most valuers could operate from their 'electronic cottages'. Corporate clients will be set up to receive and store valuation reports in electronic format.

The Internet will force us to redefine the traditional concept of work. It will also have a major impact on the present patterns of urban property values. The substantial reduction in the cost of long distance telephone calls is a good illustration of how electronic linkages have reduced the "message transportation costs" for telecommuters to a point where distance is now almost irrelevant. This means that the locational advantages of

living near the centre of the city will become less important for significant groups of workers. Similarly, forecasts of the demand for downtown office space will need to take into consideration the

fact that telecommuters require less space than conventional workers. The challenge for valuers will be in learning to navigate the Internet so that they can meet the needs of their clients.

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Legal Decisions

Lease - Construction of lease terms - Operating expenses - Plaintiff operated supermarket at shopping centre owned by defendant - Whether operating expenses of the centre were adequately identified Whether defendant required to provide details of salaries and wages paid to employees of the centre's managing agent - Judicature Act 1908. S24C(4).

In The High Court Of New Zealand

Auckland Registry

Commercial List

C.L. 13/93

Between Woolworths (NZ) Limited
Plaintiff

AND AMP Perpetual Trustee Company
NZ Limited
Defendant

Hearin : 22 July 1993

Counsel: L. McEntegart for plaintiff
D.H. Abbott for defendant

Judgment:

22 July 1993

(Oral) Judgment of Barker J

This is a proceeding under S.24C(4) of the Judicature Act 1908 for the determination by a Commercial List Judge of questions of construction in a deed of lease.

The matter has already been before the Court; in a judgment dated 22 April 1992, I refused the application by the defendant for a stay on the grounds of an arbitration clause. The basis for that decision was that the matter at issue between the parties was purely a question of law; with the accelerated procedure under S.24C, the

parties would obtain an early resolution of this point of construction. The affidavits are somewhat extensive, more so than one might have expected on a matter of construction. They have been of relatively little assistance in deciding the matters at issue.

The plaintiff operates a supermarket at the Lynmall Shopping Centre which was owned by Australian Mutual Provident Society ('AMP') but is now owned by a subsidiary of the defendant, AMP Perpetual Trustee Company NZ Limited ('Perpetual'). By consent, the name of the defendant is changed to that entity.

The plaintiff executed a lease of the supermarket on 5 March 1990 for a term of 20 years commencing 1 October 1986. As is usual in leases for shopping centres, the plaintiff, as lessee, is required, in addition to paying rent as determined by the lease, to pay the lessee's proportion of the "operating expenses of the centre". The plaintiff is one of the largest retailers in the centre and has a liability to pay approximately 15% of the operating expenses.

The lease document is very comprehensive and includes a lengthy definition of

"operating expenses of the centre" which definition needs to be reproduced -

"The operating Expenses of the Centre" means the total sum of all rates, taxes (excluding the income tax of the Lessor but including tax payable or collectable under the Goods and Services Tax Act 1985 and all amendments thereto), costs and expenses (including the said Goods and Services Tax on such costs and expenses) of the Lessor properly or reasonably assessed or assessable, paid or payable or otherwise incurred in respect of the Land and the Centre and in relation to the control, management, maintenance and administration of the Land and the Centre or in the use or occupation of the same (but not otherwise the direct responsibility of the Lessor or of the Lessee or of any other lessee within the Centre) and without limiting the generality of the foregoing (except as hereafter provided) shall include:

- (i) That proportion of the total land tax payable by the Lessor as is equivalent to the proportion between the unimproved value of the land and the unimproved value of all the land owned by the Lessor and all other taxes which are or at any other time during the Term charged or levied upon the Land or Centre or upon the Lessor on account thereof but excluding the Lessor's income tax;
- (ii) All rates, charges, assessment, duties, impositions and fees at any time or from time to time payable to any Authority in respect of the

- Land and Centre irrespective of the ownership thereof or paid or payable by the Lessor in consequence of the receipt of rent or other moneys pursuant to these presents, or in consequence of the Lessor having any estate or interest in the Centre or the Land but excluding the Lessor's income tax;
- (iii) All charges for and costs in relation to the supply of water, sewerage, and drainage and not otherwise included in any other charges or assessments made by an Authority;
 - (iv) All insurance premiums, excess payments and valuation fees payable by the Lessor in respect of all policies of insurance effected on the Centre and the fittings and fixtures therein (including plate glass in the Common Areas of the Centre) for sums to be insured by the Lessor to full reinstatement value against fire, earthquake, fire consequent upon earthquake, flood, lightning, storm and tempest, water damage, electric fusion, boiler explosion and machinery breakdown and against such other risks as the Lessor may deem necessary or desirable (including consequential loss and loss of rent, public risk, in respect of the Common Areas of the Centre, public liability cover generally and accident compensation levies or any other levies in the nature thereof);
 - (v) The cost of providing, operating, maintaining, inspecting, testing, repairing and replacing all services from time to time provided by the Lessor for tenants and occupiers of the Centre including fire protection, emergency or other alarm services or systems and the plant and equipment required for any such services which shall be deemed to include the supplying of all parts and materials required for the purposes of operation, maintenance and repair as aforesaid;
 - (vi) All charges for energy, lighting, power, heating and ventilation incurred by the Lessor in connection with the Centre;
 - (vii) All charges for air conditioning incurred by the lessor in connection with the Common Areas of the Centre;
 - (viii) The cost of cleaning and maintenance of the Centre and Common
- Areas of the Centre including the cost of repairs and the removal of all waste and garbage from the Centre and Common Areas of the Centre and the Land and the costs of having the Centre treated by professional pest control agents for the control of all rodents and vermin of whatsoever nature;
 - (ix) The expenses of the Lessor in supplying paper towels, soap and other toilet requisites for wash-rooms and lavatories of the Centre;
 - (x) All costs for the rental of music amplification or public address equipment if installed;
 - (xi) All costs for the maintenance and hire of indoor and outdoor plants, potted shrubs, gardens, planted areas, fountains and artificial water courses and associated plant in or about the Common Areas of the Centre, seating, rubbish bins, tables and promotional stage or stages;
 - (xii) All costs for the provision of security services to the Centre;
 - (xiii) All reasonable costs (inclusive of wages, emoluments, allowances, superannuation contributions and administrative charges) associated with the effective operation and maintenance of the Common Areas of the Centre and the management, administration and control of the Centre;
 - (xiv) Without limiting the generality of the foregoing provision all fees payable to the managing agents for the general management of the Centre including the cost of the provision of channelled music including royalties relating thereto, expenses associated with the running of any children's play area, childminding centre, mothers' room and other facilities for customers of the Centre, the cost of policing and regulating traffic in the common parking area, the driveways therein and roads giving access thereto, fees and all premiums payable to specialist contractors and/or the wages paid (including sick-leave, holiday and long-service pay) to permanent and temporary staff employed and the cost of materials used by the landlord and/or the managing agents in or about the maintenance and servicing of the air-conditioning equipment and fire equipment
- or any other aspect of maintenance in the Centre;
- (xv) Such other costs and expenses including professional fees as may from time to time arise and be properly and reasonably assessed charged, chargeable, paid, payable or otherwise incurred by against or upon the Lessor in relation to the ownership management and maintenance of the Centre and the Common Areas of the Centre;
 - (xvi) Such sum in each Lease Year as the Lessor may reasonably decide to set aside as a fund to recover repairs and maintenance of a substantial but infrequent or irregular nature of the Centre PROVIDED ALWAYS that any expenditure of the nature aforesaid shall only be deemed to be an operating expense as otherwise herein provided to the extent to which the fund shall not be sufficient at the time when such expenditure is actually made.
- PROVIDED THAT in assessing the amount of any outgoing, cost or expense of which any Lessee is required to pay a percentage the Lessor may allocate to particular lessees' outgoings, costs or expenses reasonably identifiable in the Lessor's opinion as incurred in respect of such lessees and exclude the same from the operating Expenses of the Centre for which other lessees are liable."
- Under clause 3.07 of the lease, a lessee's proportion of the operating expenses is payable annually after the lessor has provided an estimate of the operating expenses. As soon as practicable in every year, the lessor is to provide a statement of the actual operating expenses of the centre in the previous year and compare them with the estimate; an adjustment is then made.
- The plaintiff for some time has been concerned at the operating expenses levied against it, particularly an item under the heading "management and administration". Initially, the defendant refused to disclose a "management fee structure", even though tenants were being asked to pay in the region of \$500,000 under this heading. A more reasonable approach was taken later in 1992 and a greater breakdown eventually supplied. On 20 November 1992, the plaintiff was advised by AMP Shopping Centres Pty

Limited ('AMPSC'), an Australian subsidiary of AMP that, under the heading "management and administration", the lessor paid to the managing agent of the centre \$535,000; of this sum \$20,000 was for research and traffic studies; the balance was subdivided into staff costs on site \$322,000, office space \$37,500 and the balance as contributions to operating costs of various AMP interests; e.g. a pro-rata apportionment of salaries and costs including travel expenses for executives from Australia, accounting and management costs and computer costs. The total of the projected expenses came to \$508,500 which was not far from the balance of the fee (after allowing for the \$20,000) of \$516,000. The plaintiff is still unhappy with what it sees as the lack of specificity in the information provided by the defendant about the operating expenses and it brought proceedings asking whether the defendant is required, if requested, to provide it with a breakdown of the charges levied under the heading "operating expenses of the centre"; if necessary it sought to be able to enquire down to the detail of the salaries and wages paid to employees of the managing agent which runs the centre on behalf of the defendant.

I pause here to interpolate that the managing agent is AMP Investments Limited ('AMPI') which is another wholly owned subsidiary of AMP Society. AMPI administers the shopping centre on behalf of AMPSL and AMP.

The first point to determine is what information should be supplied to lessees by the lessor in terms of its obligations at the end of each financial year to supply "a statement" of the actual operating expenses of the centre for the lease year. Although there is reference in some parts of the definition to the word "reasonable" as applied to "operating expenses", e.g. clause (xiii), I have little hesitation in accepting the submission of Mr McEntegart that the term "operating expenses of the centre" must mean the reasonable operating expenses of the centre. I should have thought this a fairly obvious implied term; in the context of a multiple-tenanted property, there is the authority of the English Court of Appeal in *Finchbourne Ltd v Rodrigues* (1976) All ER 581; there the plaintiffs were the owners of a block of flats and the tenants had the responsibility to pay certain running costs as certified. Cairns LJ said at 586 -

"However, I will express my opinion briefly on the second point. Is there an implication that the costs claimed are to be "fair and reasonable"? It is contended that no such implication is necessary to give business efficacy to the contract. Passages from the speeches in the House of Lords in the recently decided case of *Liverpool City Council v. Irwin* (1976) 2 All ER 30 are referred to as the most recent statement of the principles on which terms can be implied. Taking the strictest of tests on that matter, I am of opinion that such an implication must be made here. It cannot be supposed that the plaintiffs were entitled to be as extravagant as they chose in the standards of repair, the appointment of porters etc. Counsel for the plaintiffs said that there would come to a point without any implied term where the costs might be so outlandish as not to come within the description of the seventh schedule at all. In my opinion, the parties cannot have intended that the landlords should have an unfettered discretion to adopt the highest conceivable standard and to charge the tenant with it. Stress is laid on the provision that, insofar as the fees payable to the managing agents were included, it was expressly provided that it was to be a "reasonable and proper fee". There was a special reason for drawing attention to this, seeing that the agents themselves were to be the certifiers. It is not, in my view, a case where the expression of one amounts to an exclusion of the other. In my opinion, the Judge arrived at the right conclusion on both points. I would dismiss the appeal."

There is also an arbitration clause in the lease. Counsel were agreed that, if a tenant contended that the lessor was charging too much under "operating expenses of the centre", then there would be ability for the tenant to go to arbitration to have this contention examined. In the context of the lease of a shopping centre with a large number of outgoings, the question comes down to deciding what detail of those expenses is a tenant entitled to seek from the landlord. I add also that in this case there is practice, not required by the lease but one which the landlord has freely taken on, for an auditor to provide a certificate each year at the time when the demand for the actual operating expenses is made. The auditor certifies that the amounts claimed for various operating expenses are correct; that they are within the named general categories of expenses and that the

payments have been made. The auditor cannot decide as to whether the quantum certified as paid is in fact a reasonable quantum. However, I should have thought that the existence of the auditors would be a safeguard to the tenants for most of the items under the definition about which there can be little argument, such as the bare costs of occupation; i.e. rates, insurance, land tax etc.

Also, one would have thought there could be little argument about the numerous other items required for running the centre, such as the cost of music, air conditioning, even going to such mundane items as the cost of supplying paper towels and soap in the centre washrooms. It would be unreasonable for the Court to specify in great detail the sort of information that should be supplied. A tenant is clearly entitled to something more than just a sterile statement of the amount of the operating expenses. This has been recognised by the defendant in providing a breakdown. One would have thought that over most items in the breakdown there cannot be much argument; but when there is a rather bland item for a large amount, such as "management and administration" that is almost an invitation to any tenant, on the lookout to keep down costs, to make some enquiry.

As a guide to the parties, I consider that a tenant is entitled to have detail of all the various items which are specified as "operating expenses of the centre" in the lease. For many of them no reasonable tenant would want to make an enquiry; for major items one would think there could be justification for doing so. There can be, as the cases show, occasions of some kinds of expenditure by a landlord which are not recoverable from the tenant, such as the legal expenses incurred in pursuing a defaulting tenant.

Sella House Ltd v Mears (1989) 1 EGLR 65 shows that, in the absence of an express provision in the lease, a landlord cannot pass on to other tenants his costs in pursuing a defaulting tenant. Likewise, in *Boldmark Ltd v Cohen & Anor* [1986] 1 EGLR 47, a landlord of a block of flats could not pass on his interest charges incurred in providing money for various service items, which items were subsequently recoverable from the tenants. There has to be some mechanism to enable a tenant to decide whether it is going to be worthwhile to go to the bother of arbitration to challenge the claim for operating expenses or whether the costs claimed are reasonable.

A complication arises in this case which really triggered the second question. As I indicated AMPI as the managing agent is paid a fee by Perpetual for managing the centre; that fee includes a number of items which might otherwise be the subject of a separate charge under the definition clauses in the lease. I cannot see that a landlord should be prevented from making an arrangement such as this whereby some items of "operating expenses of the centre" are included in a global sum paid to the managing agent and not listed for subsequent reimbursement by the tenants. Of course, there cannot be any duplication of items. It does mean that the manager and other staff of the centre, including office and marketing staff, are employees of the managing agent and not of the lessor. However, the test from the point of view of the lessor, is whether the fee paid to the managing agent is such as should be reasonable, bearing in mind its constituent parts.

Mr McEntegart submitted that the lessee was entitled to know the exact salaries paid by the managing agent to its staff; but, as Mr Abbott submitted, the managing agent may decide to pay a high salary to a particular person for perceived ability in a particular sphere; this may be included or subsumed by the managing agents' fee. The test is whether the managing agent's fee is reasonable, presumably compared with fees paid in other shopping centres of similar size and whether all the "operating expenses of the centre" are reasonable. Provided there is no duplication within the managing agent's fee of items outside that fee, then I cannot see that the lessee is necessarily entitled to know such details, as the quantum of individual salaries. Obviously, there will be some profit component which in this case covered the items relating to reimbursement of the various AMP interests for costs of travel and computers.

The evidence suggested the management fee was reasonable. I have no way of knowing whether that was so, nor is it appropriate for me to express a view in an interpretation proceeding such as this. It was said that the fee charged by AMPI is comparable to that charged by real estate agents in an earlier year and to that charged by managing agents in other centres. It will be for the plaintiff to assess whether that is so and whether the charges in toto, including the managing agents' fee which includes the items mentioned, is reasonable. If it is not so reasonable, then

the plaintiff may wish to go to arbitration. I deal with the point made by Mr McEntegart, based on the *Finchbourne* case, that because AMPI is a wholly owned subsidiary of AMP which controls the defendant as well, that it is not a true "managing agent" and that a "managing agent" as envisaged by the lease document had to be somebody entirely independent. The *Finchbourne* case covers a totally different set of facts. There the landlord called himself a firm and purported to act as agent as a separate individual. In fact he was one and the same person. Both the trial Judge and the Court of Appeal were hardly impressed with that conduct. Here, the evidence suggests that although the defendant and AMPI are both subsidiaries of the same organisation, there is nothing to suggest any unprofessional conduct of the sort indicated in the *Finchbourne* case; nor that the management fee being charged is anything other than what the market would stand and would be paid to anyone else.

There was evidence by affidavit of the operating expenses of another shopping centre. There the agents were more forthcoming about the salaries paid to the staff; in addition they charged a management fee in addition to their staff salaries.

So it may well be there is little difference, other than in the method of calculating the charges.

One can understand the attitude of the plaintiff which is saying that it is paying for outgoings and should be entitled to know for what it is paying. I hope that this litigation and the judgment may assist the parties in having some reasonable understanding of the problems of each of them. It is good to note that the rather intransigent attitude shown by earlier persons associated with the defendant has now ceased; there has been supplied the information indicated in this judgment. I do not know whether in view of this indication the parties wish me to make formal declarations. I shall do so if requested. Counsel are at liberty to provide memoranda as to form of judgment.

In the circumstances, particularly in view of the fact that the parties have a continuing working relationship, I make no order as to costs.

Solicitors: Simpson Grierson Butler
White, Auckland, for plaintiff
Shieff Angland, Auckland, for defendant

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