Boat Park Ltd v Hutchinson - [1999] 2 NZLR 74

Court of Appeal Wellington
27 August; 2 November 1998
Henry, Thomas and Tipping JJ

Contract -- Interpretation -- Literal compliance with contractual provision -- Intention of parties.

Valuation of land -- Market value -- Whether market value can vary according to purpose for which valuation obtained.

The parties entered into an agreement for the sale and purchase of land which included a vendor mortgage. The contract limited the vendor mortgage to 75 per cent of a ``registered valuer's valuation of the property", which valuation was to be obtained ``by and at the expense of the Purchaser."

The purchasers produced a valuation which was over twice the purchase price and which represented the developed value of the land assuming that subdivision was successfully carried out. The vendors referred the valuation to another valuer who assessed the value of the land as approximately the purchase price. The vendors rejected the purchasers' valuation on the ground that it did not reflect the current market value of the land and refused to settle. Eventually the parties agreed to complete settlement without prejudice to their rights under the agreement. The purchasers then issued proceedings against the vendors alleging that they had suffered a number of losses as a result of the delay. The vendors contended that the valuation did not comply with the requirements of the contract.

Held:

1 The principles by which contracts were to be interpreted were as follows:

(i) the meaning to be ascertained was that which the document would have conveyed to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract;

(ii) subject to the requirement that it should reasonably have been available to the parties, the background included absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable person, except for the previous negotiations of the parties and their declarations of subjective intent; and

(iii) the meaning of a document was not the same thing as the meaning of its words, but was what the parties using those words against the relevant background would reasonably have understood them to mean, even if this was to conclude that the parties must, for whatever reason,

have used the wrong words or syntax. The law did not require that the parties have attributed to them an intention they plainly could not have had (see page 81 line 35).

Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 WLR 896; [1998] 1 All ER 98 (HL) at pp 912 - 913/114 - 115 adopted.

2 The terms of the contract were not met by the production of a report simply because it purported to be a valuation. The word ``valuation" could not be construed to mean anything less than a valuation prepared in accordance with basic valuation principles and methods (see page 83 line 22).

3 In the absence of a legislative direction or instruction to the contrary, a valuation must assess the current market value of the property at the effective date. Market value remained the same irrespective of the purpose for which the valuation was obtained (see page 83 line 36, page 83 line 49).
Appeal dismissed.

Appeal

This was an appeal from a decision of the High Court (Auckland, CP 289/96, 26 November 1997, Laurenson J) on the interpretation of a contractual term.

Raynor Asher QC for the first and second appellants.

Robert Fardell and *Grant Nicholson* for the respondents.

Cur adv vult

The judgment of the Court was delivered by

THOMAS J.

The question in issue in this proceeding is whether the vendors to an agreement for sale and purchase of a block of land are in breach of contract in declining to accept a valuation (or valuations) submitted to them by the purchaser pursuant to a clause in the agreement.

In terms of cl 16 of the agreement, the vendors agreed to advance to the purchaser $500,000 to be secured by a registered second mortgage. Clause 16.1(g) provides that the sum secured under the first and second mortgage ``shall not exceed the nett sum of 75% of a registered valuer's valuation of the property". The valuation is to be obtained ``by and at the expense of the Purchaser." The vendors rejected the valuation (or valuations) submitted by the purchaser on the ground that it was not a proper valuation.

The more particular question, therefore, is whether the valuation (or valuations) submitted by the purchaser was a valuation within the meaning of the phrase ``registered valuer's valuation of the property" for the purposes of that subclause.

The agreement in cl 16

Under an agreement for sale and purchase dated 20 October 1995, Messrs Hutchinson and Findlay, the respondents in this appeal, agreed to sell, and Boat Park Ltd and **Licaka** Holdings Ltd, the first appellants, as trustees for a company to be formed, agreed to purchase, a block of land containing 49.0098 ha in two contiguous titles situated at One Tree Point north of Whangarei. Most of the property is zoned Residential. Within the centre of the residential zone is a ringed area zoned Commercial A. Another strip of land set back from the road frontage is zoned Rural B.

The purchase price for the land is $1,050,000, including GST. The deposit is $50,000, to be paid on the agreement becoming unconditional. The

agreement is subject to the purchaser obtaining sufficient and suitable first mortgage finance by 21 December 1995. It is also subject to the Whangarei District Council approving a change of zoning in respect of the land zoned Rural B by 21 November 1995 and approving a subdivision plan by 21 December 1995 in terms acceptable to the purchaser. The balance of the purchase price is to be paid, as to $500,000 in accordance with cl 16 of the agreement, and as to the remaining $500,000 in one sum in cash on the possession date. Both the settlement date and possession date are 14 January 1996.

The trustees duly formed a company, One Tree Point Ltd, which is the second appellant.

Clause 16 relates to ``Vendor Finance''. It is set out in full in the judgment of the Court below [(High Court, Auckland, CP 289/96, 26 November 1997, Laurenson J)] and need not be repeated in toto. Clause 16.1, under the subheading, ``Priority'', requires the vendor to advance to the purchaser the sum of $500,000 for a term of five years from the possession date, such sum to carry interest at 7.5 per cent pa for the first two years and interest at a bank rate on comparable securities for the last three years. The security is to be a registered second mortgage over the property. Paragraph (g) is the pertinent provision. It reads as follows:

> ``The sums secured under the first and second mortgage including any priority under Section 80A of the Property Law Act shall not exceed the nett sum of 75% of a registered valuer's valuation of the property less an amount equivalent to the GST on such sum. Such valuation to be obtained by and at the expense of the Purchaser. The Purchaser shall have the right at all times to refinance or vary the existing first mortgage subject to the requirements in this subclause and the Vendor shall at the cost of the Purchaser execute all necessary documents to facilitate such refinancing.''

Background facts

One Tree Point's solicitors purported to submit a valuation pursuant to cl 16.1(g) to Messrs Hutchinson and Findlay's solicitors under cover of a letter dated 28 February 1996. The valuation had been completed by a registered valuer, Mr J F Kerr. It consisted of a letter to a Mr Tucker dated 28 November 1995 to which was annexed a valuation report dated 20 November 1995.

The valuation report of 20 November 1995 is addressed to One Tree Point's solicitors. The purpose of the valuation is stated to be to assess the ``current market value'' of the areas zoned Residential, Rural B, and Commercial A on a plan which is attached to the report, and to estimate the ``total current market value'' of the property, not as at the date of the report, 20 November 1995, but as at 31 December 1996. It recites that the prospective owners have had preliminary discussions with the chief planner of the Whangarei District Council and, ``with their verbal blessing intend to apply for total residential subdivision over the total area as well as maintaining the small commercial zoning''. It is noted that a ``scheme plan and form application'' is to be made within the next three months. Mr Kerr confirms that the property is adequate security for normal residential lending criteria based on his ``projected valuation''. Having assessed the estimated land value for the residential, rural and commercial zoning, he arrives at an estimated total gross current market

value ``on completion of subdivision approval, roading, surveying and issue of compliance certificate which is anticipated will be by the end of 1996'' of $19,210,000.

The letter dated 28 November which annexed this valuation report also purported to submit the ``current market value of the zoned residential land'' as at 28 November 1995 ``with the approved residential scheme of subdivision plan as attached to the report''. No details are provided, but Mr Kerr states that, on the basis of a net number of sections of approximately 292, the land has an estimated potential gross realisation of $16.9m. He fixes development costs and profit at $13.3m, leaving a balance of $3.6m. A reasonable current market value of the land, he states, with the current zoning and ``approved residential scheme plan'' would be in the vicinity of $3.5m.

Messrs Hutchinson and Findlay's solicitors replied by facsimile the following day. Not unexpectedly, they expressed themselves as being somewhat surprised at the valuation which had been submitted, particularly as it was grossly at variance with the valuation obtained by their clients the previous year and well in excess of the purchase price in the agreement for sale and purchase. The solicitors indicated that the valuation required by them and anticipated by the agreement would be one which set out the current market value of the property as at the date of settlement, not one incorporating some perceived benefits which may accrue to the property in the future. They advised that they were sending a copy of the valuation to another registered valuer, Mr Nicholls, with the request that he confirm his view of the current market value.

Unbeknown to Messrs Hutchinson and Findlay, or their solicitors, Mr Kerr had completed a valuation for a nominee trustee company managed by a law firm in Whangarei on 6 February 1996. The purpose of that valuation was stated to be to assess the current market value of the total property to be used as security and collateral for the client's financial application to the trustee company. In this valuation Mr Kerr assessed the current market value to be in the vicinity of $1,135,000, exclusive of GST.

Mr Nicholls's valuation is dated 29 February 1996. It is an updated report of a valuation provided by him to Mr Hutchinson in March 1995. Mr Nicholls assessed the current market value of the property to be $1m. He considered this figure to be a realistic assessment. He was aware that the block had been on the market for some time and expressed the view that the market had been fully tested. Mr Nicholls had some pointed comments to make about Mr Kerr's valuation. After describing the methodology of the valuation he expressed the view that it would be most unwise and imprudent to lend to normal lending criteria on his valuation of $3.6m. He noted that, while the subdivision plan of the residential land might be approved by the district council, intensive subdivision of the Rural B land could be difficult. There were abundant residential sites to sell before ``moving'' to this land. Mr Kerr's valuation, he said, took no account of the demand and spread of sales for the sections in this particular locality having regard to section sales over the previous years. He concluded that 300-odd sections would take many years to sell and that Mr Kerr was remiss in not applying a discount factor to allow for this reality. Mr Nicholls added that, in fact, discounting a subdivision by 20 years generally results in a meaningless answer.

Extended negotiations followed between the parties. In general terms both parties wished to complete settlement with One Tree Point holding to the view

that the original valuation of Mr Kerr complied with cl 16.1(g) and Messrs Hutchinson and Findlay's solicitors remaining adamant that it did not. The settlement date was postponed.

On 8 March 1996, One Tree Point's solicitors passed on to Messrs Hutchinson and Findlay's solicitors a letter from the Whangarei District Council confirming that the first stage of the company's proposed subdivision conformed to the subdivision standards of the residential A zone and had been approved in principle. The council expected to issue formal approval incorporating its conditions within the next few weeks.

During the course of the negotiations One Tree Point's solicitors submitted a further updated valuation report by Mr Kerr dated 19 March 1996. This valuation purported to assess the current market value of the land zoned Residential in accordance with an attached plan which had been approved in principle by the Whangarei District Council, the current market value of the balance of the land as at 14 March 1996, and to update development administration and legal costs of the first stage of the subdivision. The total current market value was assessed at $3,236,000.

Messrs Findlay and Hutchinson's solicitors continued to reject the valuation. By letter dated 20 March they asserted that Mr Kerr's reports overlooked the clear intention of the parties that the valuation to be supplied was to establish the market value of the land. The material supplied, they said, was inadequate to establish that value. He had not established that the value represented the market value as he did not appear to have taken account of the demand for or likely delay in disposing of the properties, he had made no allowance for the risks associated with subdivision, his valuation did not seem to be based upon any significant market research, he did not include any analysis of the direct or indirect costs of subdivision, and he did not even proclaim the feasibility of the subdivision. It followed, the solicitors said, that until One Tree Point had met its contractual obligation to establish the market value, Messrs Hutchinson and Findlay were not in a position to settle or to demand settlement.

One Tree Point's solicitors responded by letter dated 21 March 1996. They claimed that the intention of the parties had been set out in cl 16.1(g) and no reference had been made to market value in that subclause. If the parties required the valuation to be market value then, they said, the parties would have inserted those words in the contract. But, in any event, they asserted, the valuation had been prepared on the basis of market value. Later in the letter they reiterated that their client did not have a contractual obligation to establish the market value, but again added that it had, in fact, provided that value.

During the course of further exchanges between the solicitors, One Tree Point's solicitors tendered yet a further valuation addressed to them by another registered valuer, Mr Burgess. Mr Burgess expressed the view that, based on a proposed staged subdivision creating a maximum of 400 residential and commercial sections together with two rural residential blocks, the property had a current market value of $2.4m. Later in the report he stated that his valuation had been assessed on the premise that a residential subdivision would be undertaken in the near future, and he noted that approval had been gained from the Whangarei District Council, subject to the District Land Registrar's approval on right of way access to some sections, for a 48-lot development. He concluded that the valuation arrived at fairly reflected the current market value

of the property but with the qualification that it was ``subject to the proposed residential subdivisions proceeding as outlined''.

It may be helpful to recapitulate at this point the various valuations relating to the property which had been completed:

Valuer	Date	Valuation
J F Kerr	20 November 1995	$19,210,000 (gross)
J F Kerr	28 November 1995	$3,500,000
J F Kerr	6 February 1996	$1,135,000*
A C Nicholls	29 February 1996	$1,000,000
J F Kerr (update)	19 March 1996	$3,236,000
W A F Burgess	10 April 1996	$2,400,000

*Not available to Messrs Hutchinson and Findlay.

After further negotiations the parties agreed to complete settlement on 17 May 1996 without prejudice to their rights under the agreement. One Tree Point issued proceedings against Messrs Hutchinson and Findlay alleging that, as a consequence of having to arrange alternative finance, they had lost the first mortgage finance which had previously been arranged and suffered a number of particular losses. They claimed judgment in the sum of $523,382.24.

The proceeding was heard before Laurenson J between 11 and 18 November last year. Extensive valuation evidence was adduced by both parties, although Mr Kerr was not called to give evidence. The learned Judge reserved his decision and delivered judgment on 26 November 1997. He rejected One Tree Point's claim and entered judgment for Messrs Hutchinson and Findlay.

The judgment in the Court below

Laurenson J concluded that the valuations proffered by One Tree Point did not comply with the terms of cl 16.1(g). He held that the intention of the parties when they agreed to the inclusion of the subclause was clear. It was to provide the vendor with protection for the second mortgage by limiting the extent of advances under the first and second mortgages against the property. The Judge observed that, when a mortgagee lends money on a mortgage, the ultimate concern to be satisfied is that there will be a sufficient margin of security to ensure that the mortgage advanced, plus costs, is recovered in the event of a mortgagee sale following default by the mortgagor. Consideration of this factor, he added, necessarily involves an acceptance that default could occur at any time.

The learned Judge referred to the purchase price paid for the property and reviewed the various valuations. He concluded that, in reality and practice, a very distinct difference exists between the value of property for mortgage lending purposes and its value assessed on the basis of a hypothetical subdivisional development. Whatever might be the case in theory the two values do not coincide in practice. Stated simply, he said, a valuation for mortgage lending purposes seeks to provide an assessment of what the value of the property will achieve in the event of a forced sale. On the other hand, valuations based on a hypothetical subdivision development seek to predict what will be received in the future following a development and allowing for

development costs, profit and risk, and discounting back to present value. The Judge then drew a further distinction. He claimed that it is necessary when assessing the value of land prior to subdivision to calculate the current market value of the land taking into account that it has subdivisional potential. In other words it is the value which a potential subdivider will pay for the raw land. On the other hand, he said, the hypothetical subdivisional basis starts by taking the value of the raw land which would be paid by a subdivider and then grafting on to that value a calculation designed to show what ultimately would be achieved. Such an approach is designed to determine the value of what a landowner has been deprived of, namely, the opportunity to achieve the subdivisional potential. Thus, the Judge held, the purpose of the valuation is quite different from the purpose sought to be achieved by valuing the land prior to subdivision when it is the land in that state which is being assessed for the purpose of present mortgage lending.

Accepting that in practice there is a difference between a valuation for mortgage purposes and a valuation based on a hypothetical subdivision or calculation, Laurenson J expressed little doubt that the valuation intended by cl 16.1(g) was a valuation for mortgage lending purposes, that is, a calculation of a value which the land would be likely to produce at any time during the currency of a mortgage in the event of a mortgagee sale. This conclusion was reinforced, in the Judge's view, when regard is had to the price paid under the agreement for sale and purchase, the obligations of the vendors as trustees, and the financial circumstances of One Tree Point. Such considerations necessarily imply that the valuation referred to in the subclause was a valuation for mortgage lending purposes. The Judge pointed out that, if this was not the case, then, in effect, One Tree Point was asking Messrs Hutchinson and Findlay to accept a significant de-

gree of risk in advancing $500,000; a risk which no normal lender in the circumstances would ever accept. The value suggested in the valuations, he said, was never going to materialise until the subdivision and development was completed and, in his view, it is quite specious to say that overnight the ``raw'' value of the property had increased significantly beyond the sale price simply because a scheme plan had been approved and there was a subdivider ready and willing to carry out the development.

Thus, the Judge concluded that the intention of the parties in agreeing to cl 16.1(g) was that the valuation was to be supplied for mortgage lending purposes and the valuations submitted by Messrs Kerr and Burgess could not be said to be valuations for that purpose. One Tree Point had therefore failed to provide a ``registered valuer's valuation of the property'' in terms of the subclause. As a result, Messrs Hutchinson and Findlay were not in breach of the contract in rejecting the valuations. Judgment was entered for them.

Counsel's submissions

Mr Asher QC, who appeared for One Tree Point, submitted that the Judge appeared to have decided that the valuation had to be acceptable to the vendors. Such a subjective approach was in error. Nor was the Judge correct in implying a term or adding the words ``suitable for mortgage lending purposes''. The requirements of cl 16.1(g) are unambiguous, and should be applied without reference to the factual matrix. Assuming, however, that it was legitimate for the Judge to go behind the wording of the valuations and consider their substance, Mr Asher contended that they were nevertheless valuations for mortgage lending purposes.

Mr Asher strongly refuted the Judge's suggestion that a valuation based on the notional subdivisional basis was not appropriate for mortgage lending purposes. There were, he claimed, no comparable sales of blocks of land with subdivisional potential in the area, so that the comparable sales approach to the valuation could not be used. He pointed out that all valuers involved used, at least as an essential element of their consideration, the hypothetical subdivision method. He suggested that it was the only sensible method or approach when the land was subdivisible and there was a market for the subdivided lots. Where the valuers differed markedly, he argued, was in their assessment of that market. The real difference between them was the extent to which they used the notional subdivisional approach to the various blocks of land and the ``inputs'' applied by them in the course of carrying out that exercise.

Mr Fardell, who appeared for Messrs Hutchinson and Findlay, sought to uphold the judgment in the Court below, essentially for the reasons given by Laurenson J. He argued that the purpose of cl 16.1(g) was to limit the amount One Tree Point could borrow so as to provide a minimum equity level of security for Messrs Hutchinson and Findlay when advancing funds secured by way of second mortgage. For this reason the intention of the parties was that the valuation supplied by One Tree Point was to be at current market value and thus able to be relied upon for mortgage lending purposes to provide security to Messrs Hutchinson and Findlay. The learned Judge had correctly held that cl 16.1(g) required a market valuation of the property suitable for mortgage lending purposes.

Counsel's arguments can be considered, in addressing the question in issue, by first considering Mr Asher's argument that One Tree Point literally complied with cl 16.1(g), then examining the learned Judge's views relating to the valuation of the property in the course of considering the correct valuation approach and, finally, applying that approach to the facts of this case.

Literal compliance?

We reject, as did Laurenson J, the submission that One Tree Point complied with cl 16.1(g) simply because it tendered to Messrs Hutchinson and Findlay a valuation which was in the plain terms of that clause ``a registered valuer's valuation of the property . . . obtained by and at the expense of the Purchaser.''

Such an argument is based on an outdated approach to contractual interpretation. It is worth reiterating in full what Lord Hoffmann felt it necessary to spell out when delivering the judgment of the majority in the recent decision of the House of Lords in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98 at pp 114 - 115. The learned Law Lord stated:

``My Lords, . . . I think I should preface my explanation of my reasons with some general remarks about the principles by which contractual documents are nowadays construed. I do not think that the fundamental change which has overtaken this branch of the law, particularly as a result of the speeches of Lord Wilberforce in *Prenn v Simmonds* [1971] 3 All ER 237 at 240 - 242, [1971] 1 WLR 1381 at 1384 - 1386 and *Reardon Smith Line Ltd v Hansen-Tangen, Hansen-Tangen v Sanko Steamship Co* [1976] 3 All ER 570, [1976] 1 WLR 989, is always sufficiently appreciated. The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary

life. Almost all the old intellectual baggage of `legal' interpretation has been discarded. The principles may be summarised as follows.

(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

(2) The background was famously referred to by Lord Wilberforce as the `matrix of fact', but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax (see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 3 All ER 352, [1997] 2 WLR 945).

(5) The `rule' that words should be given their `natural and ordinary meaning' reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Cia Naviera SA v Salen Rederierna AB, The Antaios* [1984] 3 All ER 229 at 233, [1985] AC 191 at 201:

> `. . . if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.'"

Applying these principles, we do not consider that the parties intended that the word ``valuation" would include any document simply because it purported to be a valuation prepared by a registered valuer. Mr Asher himself accepted that, by ``valuation", something that is recognisable as a bona fide commercial attempt to value the property is contemplated. We accept that it must be prepared in good faith. But more is required. In our view the valuation contemplated by the clause must be a proper valuation in the sense that it has

been prepared by a registered valuer in accordance with basic valuation principles and basic valuation methods. (See the seminal valuation text by Rodney L Jefferies, *Urban Valuation in New Zealand* (2nd ed, 1991), vol 1, esp ch 5 and ch 6.) So, too, it would not be acceptable as a valuation if it disclosed patent and material errors in the calculations contained in the valuer's report. By and large, it can also be assumed that the parties intended the valuation to comply with the requirements of the New Zealand Institute of Valuers' *Valuation Standards*. Paragraph 7.4 of Standard 4 requires the valuer, in reporting a market value estimate for loan security, mortgages, and debentures, to:

> ``7.4.1 Completely and clearly set forth the valuation and the valuation report in a manner that will not be misleading.
>
> 7.4.2 Provide sufficient information to permit those who read and rely on the report to fully understand the data, reasoning, analysis and conclusions underlying the Valuer's findings, opinions and conclusions.
>
> 7.4.3 State any assumptions or limiting conditions upon which the valuation is based.
>
> . . .
>
> 7.4.7 Fully and completely explain the valuation bases applied and the reasons for their applications and conclusions."

Consequently, we are satisfied that cl 16.1(g) is not met by the production of a report simply because it purports to be a valuation. Literal compliance of this kind is not enough. Applying the principles of contractual interpretation spelt out by Lord Hoffmann, the word ``valuation'' in cl 16.1(g) cannot be construed to mean anything less than a valuation prepared in accordance with basic valuation principles and basic valuation methods.

The correct approach . . .

While we are able to agree with the general thrust of Laurenson J's decision, we are not able to accept certain aspects of his judgment which appear to depart from valuation orthodoxy. The first is the distinction which he draws between a valuation of market value for mortgage lending purposes and a valuation of market value based on a hypothetical subdivision development. The second aspect is the notion that the hypothetical subdivision approach cannot be utilised when valuing land for ``mortgage lending purposes''.

In the absence of a legislative direction or qualifying instruction to the contrary, the objective of a valuation is to assess the market value of the subject property at the effective date. The market value, or fair market value, is arrived at by determining what price the property would sell for on the open market under the normal conditions applicable in the market for the type and location of the property being valued. (See Jefferies (supra), ch 2-2.) Fundamental to this task is the willing seller/willing buyer principle. Thus, ``market value'' is defined in the New Zealand Institute of Valuers', Valuation Standard 1, in these terms:

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

It follows that there cannot be a market value for one purpose and a market value for another purpose. The price for which the willing seller would sell the

property to a willing but not over-anxious purchaser cannot vary depending on the purpose of the valuation. Market value remains the same irrespective of whether the valuation is required for mortgage lending purposes or for selling purposes or for buying purposes. Recognition of the mortgagee's interest (or any other interest) when valuing for mortgage lending purposes is properly made in the margin allowed, that is, the percentage of the market value recommended as the maximum limit for the advance, and not in an attempt to deflate (or inflate) the market value of the property. Of course, it is always open to a person requesting a valuation to expressly seek a valuation of the property at a value other than the market value. But, if that is the case, that specific purpose should be stated. Similarly, a valuer can, and in many cases will wish to, draw attention in his or her report to those features which may bear on the prudence and security of the investment. But the market value remains the market value.

The second aspect of the learned Judge's judgment which must attract comment is the notion that the hypothetical subdivisional approach is not appropriate when valuing for mortgage lending purposes. It has long been recognised that valuers should select the most reliable method of valuing the property in question and, to the extent that it is sensibly and practicably possible, should then verify the value arrived at by reference to other methods. No one method is generally regarded as conclusive, and for that reason prudent valuers check the valuation which they have arrived at following the most reliable method, by any other method which is appropriate in the circumstances. At times the valuation may represent a collage of approaches. Two or more methods may properly be applied in respect of the subject property and the correct market value be determined by a critical comparison of the results obtained by the application of those various methods. Hence, various valuation approaches are available and none should be necessarily excluded unless, for a particular reason, they are inapplicable to the subject property.

Certainly, the sales comparison approach is the preferred approach. The valuer analyses evidence of past and current sales transactions of comparable properties making appropriate adjustments for the subject property in order to arrive at the market value. But such evidence may not be conclusive - or even available. Reference to other approaches is the only way to either verify an indicated market value or, if there is no comparable sales evidence, arrive at a market value. In respect of land, such as farm land, valuers may refer to what is known as the capitalisation or productive valuation

method whereby the valuer converts or capitalises the productive income to be received from the property into a present capital sum or net present value. Where the land has potential for subdivision and the sale of smaller lots, the hypothetical subdivision approach is likely to be of assistance. It is acknowledged, however, that this approach requires the valuer to make a number of assumptions and estimates, many or most of which defy infallibility. Thus, the valuer must estimate the gross realisation of the property based on assumptions about market demand and the period required for the development and sale of the sections, estimate selling expenses, including legal fees and agents' commissions, make an allowance for profit and risk, and estimate the direct engineering and development costs and the indirect holding and financial costs and costs of purchase. An error in any premise or step in this extensive exercise can have a cumulative or multiplying effect and seriously impair the reliability of the ultimate figure arrived at. It is for this reason that the hypothetical

subdivisional approach is most often used as a check on other methods. But it is a legitimate valuation tool and cannot be arbitrarily excluded from the valuer's task in arriving at the market value of a property.

In a case such as the present it would be accepted that the land has potential for subdivision and development. The market will presumably (but not necessarily) include potential developers. This development potential is therefore a relevant consideration to the extent that a willing seller would require, and a willing but not over-anxious purchaser would be prepared to pay, a premium for the benefit of that potential. The premium or benefit of the potential becomes embedded in the market value.

The most reliable valuation approach in the present circumstances would undoubtedly be to have regard to such comparable sales evidence as is available, and to interpret that evidence so as to relate it to the subject property. It would not be irrelevant that the land had been on the market for a significant time and that the owners had received only two offers for the purchase of the land, both at $1,050,000, and that neither of the offers had become unconditional and proceeded. Nor is the sale of the property to One Tree Point at the same figure of $1,050,000 to be discarded unless there is some indication that the price agreed was an aberration or represented a distortion of the open market. If, on the basis of comparable sales evidence, and the market history of the subject property, the valuer is able to arrive at an assessment of the market value, he or she could properly undertake the hypothetical subdivision exercise in order to verify or check the indicated value. If comparable sales evidence is not available or, for one reason or another, is not appropriate, this method may be the only means of arriving at the market value. In utilising this approach, of course, caution will be required lest an erroneous assumption or estimate warp or vitiate the resulting figure. Having arrived at his or her assessment of the market value, the valuer would then advise on the margin to allow for the purposes of the loan and draw attention to any special features which might affect the property as security or the interests of the proposed mortgagee.

. . . applied in this case

We consider that Messrs Hutchinson and Findlay were entitled to reject Mr Kerr's report and valuation. It did not represent the current market value of the property.

We do not doubt that the valuation referred to in cl 16.1(g) means an assessment of the market value as at the effective date. In the absence of an express indication that some other value is required, a bare reference to a valuation must be construed as a reference to the current market value. Any other conclusion would defy both common sense and valuation theory and practice. Moreover, it is only market value which would achieve the purpose of the subclause, which is to protect the vendor's security in the event of the purchasers defaulting in repayment of the loan. Clause 16.1(g) was designed to limit the amount which Messrs Hutchinson and Findlay were obliged to lend One Tree Point as at the date of settlement, and to limit the amount which that company could borrow and secure against the property by way of first mortgage from time to time. It is to be recollected that the subclause provides that One Tree Point can refinance its first mortgage from time to time and so increase the level of borrowings, but it can only do so to the extent that the total secured indebtedness of the first and second mortgages remains less than 75 per cent of the value of the property. In the event of default by One Tree Point there will then be adequate security to ensure that, on a sale, both the first

and second mortgages are repaid. It is only if this 75 per cent limitation is based on the current market value that this objective will be achieved.

Quite clearly, however, Mr Kerr's valuations are not assessments of the current market value of the land. Notwithstanding that the purpose of his valuation dated 20 November 1995 of $19,210,000 is stated to be to assess the ``current market value'' of the property, it is no more than a summation of three individual appraisals of differently zoned parts of the

land, each of which is itself a summation of gross realisations from a future subdivision in respect of those areas. Moreover, it openly anticipates a state of affairs as at the end of 1996 - 12 months later. Reference is made to the fact that the owners have had preliminary discussions with the chief planner of the Whangarei District Council and that, with its ``verbal blessing'', it is intended to apply for ``a total residential subdivision over the total area'' as well as maintaining a small commercial zoning. Indeed, Mr Kerr himself uses the phrase ``projected valuation''. The report falls far short of a proper valuation of the current market value of the property.

Mr Kerr purports to have had regard to comparable sales, but they are the sales of past and present vacant sections analysed for the purpose of the hypothetical subdivision exercise. No sales evidence of comparable rural blocks of land which have potential for subdivision and development is put forward, and no explanation is proffered as to why any such sales have not been referred to. If it is thought that no sales evidence exists or is applicable, no explanation is suggested to justify that conclusion. Yet some such explanation might have been thought reasonable before proceeding to a valuation using a hypothetical subdivision approach based on the purchaser's proposed scheme plan.

The valuation of 20 November is then used as the basis for the brief report dated 28 November 1995, although the gross realisation of the estimated potential of the land is reduced, without explanation, to $16.9m. Development costs and profit are then stated to be $13.3m. There is no indication as to how this calculation was made. The balance of $3.6m is reduced to $3.5m as the ``reasonable current market value'' of the land with its current zoning ``and approved residential scheme plan''. Read together with the valuation of 20 November, any detached reader would be disturbed at the highly speculative basis adopted for assessing the current market value of the land, especially having regard to the magnitude of the contemplated subdivision.

The basic flaw in the valuation tendered, therefore, is that it is unduly dependent on the least reliable method of valuation which is in turn unduly dependent on a number of assumptions and estimates which are either not disclosed or are highly suspect. As such, it cannot be said to represent the market value of the land and therefore a valuation in terms of cl 16.1(g). At best, it represents a projected valuation if and when a proposed scheme plan is approved and the contemplated development is completed in accordance with the assumptions and estimates made in the course of the exercise.

We do not need to enter upon the dispute as to whether Mr Burgess's valuation, which was obtained during the course of negotiations in an effort to see whether the parties could reach agreement as to an appropriate value, can be said to be a valuation tendered to Messrs Findlay and Hutchinson in terms of cl 16.1(g), as we consider that it also suffers from much the same shortcomings as beset Mr Kerr's valuation. It, too, is unduly dependent on a particular subdivision scheme plan of subdivision being completed. Indeed,

Mr Burgess is careful to qualify his valuation. When referring to the subdivision proposal he makes it clear that his valuation has been assessed on the premise that a residential subdivision will be undertaken ``in the near future''. He then concludes by affirming that his valuation of $2.4m is ``subject to the proposed residential subdivision proceeding as outlined'' by him. No doubt this qualification was the basis of Mr Burgess's recommendation of a 50 per cent margin for first mortgage finance.

Consequently, neither Mr Kerr's nor Mr Burgess's valuations seem to heed the need to arrive at a valuation which reflects the market value of the land as at the effective date. Too great a regard has been had to the prospective value of the land on the basis that it is developed as proposed. Yet, the land may fall to be sold prior to any subdivision or development being commenced or, indeed, during the course of the subdivision or development. The current market value is what the land would realise on the open market in its present state, that state including its development potential. But it remains the land and not the proposed development which is to be valued.

For the above reasons, we consider that Messrs Hutchinson and Findlay were wholly justified under cl 16.1(g) in rejecting the valuations submitted by One Tree Point. As they are not in breach of contract, they were entitled to the judgment entered in their favour in the Court below.

The appeal is therefore dismissed. The respondents are awarded costs which are fixed at $7500, together with disbursements, including travelling and accommodation expenses, which if not agreed, are to be settled by the Registrar.Appeal dismissed.

Solicitors for the first and second appellants: *Blackwell & Co* (Auckland).
Solicitors for the respondents: *Russell McVeagh McKenzie Bartleet & Co* (Auckland).

Reported by: Bernard Robertson, *Barrister*