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VALUATIONS AT ISSUE: MARKET VALUE, WHAT IS IT?

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Abstract: *This paper aims to examine the definition of market value, and the duty of valuers in light of recent and widely publicised Fletcher Homes Limited (FHL) claims.*

In the mid-1990s numerous claims surfaced in New Zealand against FHL regarding the way it sold "new homes" between the mid-1980s and the early-1990s. One of the main allegations was that homes were overvalued so purchasers could borrow a large percentage of the purchase price, leading to many purchasers borrowing more than their homes would fetch on the open market if on-sold.

The paper traces the role of valuations in this process. It reviews explanations for variations that can occur between the initial purchase price/market valuation of a "new home", and its subsequent re-sale as "secondhand". With emphasis on these explanations it then presents a case study on segments of the New Zealand housing market. This leads to conclusions that are relevant to a range of property types.

Conclusions are that the reported market value of a property can vary, by reason of the market in which that property is traded. Valuers therefore need to have an understanding of what they are valuing, and know the specifics of the market in which they are valuing. In circumstances where market values of properties with similar physical features differ because of the markets in which they are traded, it is important that the valuer clearly states the valuation assumptions, standards and the respective value(s) that apply. Any party who is relying on the valuation will then be clearly aware of the risk factor, and the valuer will be protecting him or herself against potential criticism/claims.

1. Introduction

Fletcher's have been a major player in the New Zealand construction industry for many years. In the residential sector it has had a long-term involvement in "affordable" low cost housing. Originally, this encompassed State Housing and private housing built with the assistance of State finance. In more recent times it has included the marketing of "housing packages" under the FHL name.

The latter "housing packages" targeted market opportunities that developed through the latter half of the 1980s, as the State progressively withdrew from housing finance and trust legislation amendments increased lending flexibility. They were launched to meet a perceived demand for low cost housing from people with little or no deposit. The packages offered prospective buyers sections, house plans, fixed price construction, and low deposit mortgage finance options as required. On this basis FHL built some 10,000 homes in New Zealand before it left the market in the mid-1990s.

Under the mortgage finance option, mortgages were proposed and managed by a FHL associated finance company, Residential Mortgages Limited (RML). Outside Banks would make advances to a Residential Mortgage Trust, the trustee of which was AMP Perpetual Trustee Company NZ Limited, for onward lending guaranteed at various points by Housing Corporation of New Zealand and private insurers like "MGICA". Mortgage advances were based on valuations obtained by FHL from external valuers; often the advance would exceed 90% of the property's assessed market value.

FHL "housing package" deals therefore gave many people the opportunity to acquire a "first" or "new" home that they could otherwise not afford at the time. Through the middle and late 1980s buoyant property market conditions and value appreciation protected those with high mortgage gearing. However, by 1990 recessionary conditions were developing in New Zealand. Residential property markets slowed, and house values became static and even declined in some regions through the early-1990s. By 1992 the FHL "housing package" system began to falter. Economic downturn, static and declining property markets, personal problems making mortgage payments, and an inability to refinance caused many FHL "new home" buyers financial loss.

In the mid-1990s, with a burgeoning volume of properties being resold at lower prices than initial "new home" prices, a wave of claims surfaced against FHL. Through to mid-1998, 1,000 or so claims were lodged with the Commerce Commission and the Courts - alleging overpricing and misrepresentation amongst other things. Numerous other claims including overvaluing and negligence were made against valuers.

WD Gosper & TN Olsson & Ors v Re Licensing (NZ) Limited & Ors (HC 17/8/1998, Wellington, CP225/96), became a test case. The plaintiffs alleged FHL, the valuation providers, and RML the mortgage manager had lured them into overpriced FHL houses and excessive borrowings through improper and otherwise negligent conduct. With reference to valuers liability all plaintiffs claimed in negligence and in contract (one plaintiff also claimed in deceit). The plaintiffs referenced large disparities between original valuations on their properties and ultimate sale prices or revaluation levels evidenced only a few years later. Valuer defences included: (a) plaintiffs contributory negligence through failure to obtain a copy of the relevant valuation or to make enquiry as to its content, failure to obtain a second valuation, and borrowing in excess of the recommendation; (b) failure to obtain adequate prior advice, to maintain the property, and to mitigate damage; (c) disclaimer provisions in the relevant valuations limiting responsibility to the mortgagee and mortgage insurers.

The judgement of McGechan J found that the valuers, FHL and RML were not responsible for the homebuyers' losses, although he did find against FHL for misrepresentation as to promotions. He found there was no collusion between Fletchers and valuers to induce people into overpriced homes. On the valuations the judge said the plaintiffs assumed that the valuations should have been based on re-sales evidence, but that was not so and the valuations were prepared using acceptable methodology at the time that was not negligent or incorrect. He confirmed that the buyers losses were due to economic downturn, declining markets, and personal difficulties meeting mortgage payments and refinancing on reducing values; not because the homes were overpriced or overvalued in the first instance.

The principles of the test case were subsequently applied to all remaining claims. As at July 1999 there were no outstanding claims against FHL and only 40 against valuers, and for the latter terms of withdrawal negotiations were at an advanced stage. FHL "settled on" around 385 of the actions against it, the remainders were withdrawn.

This paper provides an overview of the concept of market value and the vital role valuers have to play in its assessment. This overview draws on lessons to be learnt from "new home" housing markets (in particular, the FHL saga). The paper begins by summarising the main features of residential housing markets – based on a review of housing markets literature, and

providing a list of factors that are likely to influence house prices. The paper reviews explanations for variations that can occur between the initial purchase price/market valuation of a "new home", and its subsequent re-sale as "secondhand", and then provide a case study on segments of the New Zealand housing market. Finally, valuation standards and the duty of valuers in the provision of "new home" valuations is reviewed.

2. The Residential Housing Market

Internationally, econometric housing market literature is extensive. A common theme is the complexity of markets (Savage, 1996):

- Housing is both a consumption good (for owner occupation) and an investment good (for income stream returns). Therefore market activity/prices are influenced by a mix of consumption factors (e.g. demographic changes) and investment factors (e.g. rate of return on housing relative to other asset classes).

- Housing is a heterogeneous good. Every property has a unique set of characteristics (i.e. size, quality, location etc.). This implies that changes in the market value of certain properties may vary from median or average price movements, and at times there may be significant differences between construction costs and re-sale value.

- House prices are known to exhibit strong cyclical patterns and volatility.

An understanding of housing markets requires consideration of the following (Peters and Savage, 1996):

- Supply factors – includes changes in the availability of land and skilled construction labour. As supply of these factors declines (increases), there is upward (downward) pressure on house prices. There is evidence that construction activity is relatively slow to respond to changes in housing market conditions. New construction is slow to put downward pressure on prices during high demand periods. Therefore, higher prices can lead to overbuilding which ultimately could result in excessive price falls.

- Institutional factors – include changes in the regulations affecting lending institutions, changes in the behaviour of those institutions (e.g. lending criteria), and changes in fiscal (e.g. home owner subsidies) and monetary policies (e.g. interest rates).

- Location factors – there is evidence that differences in the behaviour of house prices can persist between regions and between price tiers (e.g. the lower and upper ends of a market) within regions.

- Financial factors – includes changes in tax rates, inflation, share prices and interest rates.

- Demographic factors – changes in the growth rate and composition of the population. Amongst these the growth of the house buying "age-cohorts" and immigration are important.

- Industrial factors – changes in industrial activity can be exaggerated in regions or locations that rely on a small range of industries for employment.

- Speculative price bubbles – for periods of time prices may be inconsistent with the fundamental forces of supply and demand (i.e. current price movement may simply reflect past price movements). Research on the behaviour of market participants indicates house buyers and sellers often have price expectations (current and future) that are inconsistent with the way markets actually work. Case and Shiller (1988) survey of house buyers in four United States cities found that the "popular model" employed by most participants varied significantly from the true "economic model" of housing markets. The results of their survey showed:

  - None of the respondents noted fundamental factors related to current or future supply or demand trends as determining prices.
  - There was a strong speculative motive behind house prices in some regions.
  - There appeared to be a view that in boom cities prices could not fall. Most respondents anticipated little or no risk in buying a house.
  - There was evidence of "shortage illusion" i.e. the belief that price changes will not tend to restore equilibrium. Respondents in boom cities tended to believe that house price increase would continue indefinitely.
  - Housing markets are strongly influenced by recent local experience, with price expectations almost entirely based on past price movements.

In New Zealand house prices over the past quarter century have been found to have the following important features (O'Donovan and Rae, 1996):

- Strong cycles – historically, there has been a "minor" cycle every two years, and a "large" cycle every seven to eight years (on average).

- Volatility – house prices are much more volatile than the general price level.

- A boom-bust nature – the housing market can jump from bust to boom (and back again) very quickly.

- Booms are different from busts – booms tend to be short and sharp, with rapid price growth. Busts tend to be more mild but last longer.

- Regional differences – in the short term the regions follow each other closely. Over the longer term, house prices in different regions (even regions that are geographically close) follow their own individual trends.

- Regional house prices depend on – the region's economic performance (its gross regional product and unemployment rate), on agricultural commodity prices, and on the region's population.

Research on house price movements in the Auckland, Wellington, and Christchurch markets 1980-1995 reveals that for (Peters and Savage, 1996):

- Long-run determinants of house prices – equilibrium real house prices are mainly determined by population and real incomes.

- Short-run determinants of house prices – speculative pressures push prices out of line with supply and demand fundamentals i.e. price rises in one period are to some extent simply a function of the fact that prices had risen in a previous period, rather than some change in supply or demand.

Further research on the Auckland, Wellington, and Christchurch housing markets 1986-1996 indicates (Bourassa and de Bruin, 1996) that employment, real wages, population growth, the impact of first-home buyer subsidies, and boom-bust bubbles are significant factors affecting house price variations. They observe that:

- Employment appears as the primary factor affecting changes in house prices over the past ten years.

- The relative impact of the different factors changes quite dramatically over time, with overseas immigration becoming as important as employment growth in Auckland during the three years up to 1996.

3. " New Home" Markets

The supply of a "new home" involves the builder/developer and the client/purchaser negotiating a contract price subject to agreed terms and conditions, typically confirmation of finance before the contract becomes unconditional, provision of building warranties etc.

In the case of "housing packages" the contract will sometimes include land; other times the cost of construction only, on land already owned by the client or on land being purchased from a third party. At first glance most people assume that the contract price relates to the actual real estate being purchased or supplied. However, this is not always the case. Depending upon the deal the price may incorporate "incentives" offered by the builder/developer such as: plans, trade or swap deals, builder "gifts", rebates on settlement, vendor finance, mortgage guarantees, rent guarantees etc.

The provision of "incentives" frequently results in "new home" buyers paying a "premium", compared to the price of equivalent real estate marketed under "traditional" (non-incentive based) conditions. For "new home" builders/developers the motivation behind offering purchase "incentives" is higher sales volumes. The "incentives" are typically designed to make purchasing easier, and thus entice people into homes that they could otherwise not afford. However, there are costs in providing such incentives, and these are passed-on or recovered from the purchaser through an inflated purchase price.

In New Zealand "housing package" offerings are not a recent occurrence. This form of property marketing is synonymous with the New Zealand "group housing" phenomenon that commenced in the 1950s, shortly after the abolition of property sale controls previously implemented under the Servicemen's Settlement and Land Sales Act 1943. During the 1950s an acute shortage of housing stemming from the end of the Second World War, new designs,

new interior fittings and a reasonably prosperous economy all combined to give the New Zealand house building industry impetus.

Originally “group home” building companies were in competition with property speculators who were marketing early 1900s inner city homes on easy purchase terms. Typically the speculator acquired properties with cash and then on-sold at inflated prices, under low deposit sale and purchase agreements or with the provision of vendor finance. “Group home” building companies were commonly involved in “greenfields” (suburban) subdivision development, and competed on price and quality via cost savings associated with semi-mass production economies of scale, and promotion of quality control standards and workmanship guarantees.

“Group home” new house markets became well established in New Zealand in the 1970s; around the country there are now numerous examples of large scale “group home” developed subdivisions and neighbourhoods dating from that era. By the 1980s “packaged” house property developments offered by “group home” building companies had created two-tiered housing markets. The situation developed where “new home” price packages were commonly observed to exceed the price of comparable standard “secondhand homes”; particularly in the low cost or first home buyer markets, with the disappearance of Home Ownership Savings Account Schemes and after the Housing Corporation largely withdrew from home mortgage funding. To this time the Corporation had held tight Government control on the price structure of homes for which funding was sought, and similarly control of low interest mortgages. At the same time the “old” low deposit alternatives disappeared through the advent of increased demand for “inner” city infill housing and tax disincentives for property speculators.

Goods and Services Tax (GST) as introduced from 1 October 1986 (initially at 10% and then 12.5% in July 1989) represented a significant cost increase on new home construction and further contributed to the price differential between new and secondhand home prices. The majority of vendors of the latter home types tend to be unregistered for GST. Therefore, GST did not directly increase secondhand home prices.

Other conceivable reasons for the purchase price of a “new home” package exceeding valuation or market expectations as “secondhand” include:

- An oversupply of secondhand houses on the market.
- Property damage.
- Location, and economic changes.

4. New Zealand Housing Market – Case Study 1990 - 1998

Housing activity in New Zealand has increased significantly through the 1990s. From an average of 26,000 freehold open market house sales per six months during 1991, national sales increased strongly through 1993/94, to peak at an average 40,000 per six months in 1994. This resulted from improved household confidence levels flowing through to increased spending and investment activity. Rising employment and real disposable income,

favourable demographic trends and low interest borrowing rates initiated improved confidence.

After the 1994 peak, annual national sale volumes stabilised somewhat through to the end of 1997. Within this period though quarterly sale volumes fluctuated, resulting from confidence shifts associated with various economic and financial uncertainties (including rises in interest rates). In the face of the aforementioned sales activity trends, house prices showed positive growth. Quotable Value New Zealand's (QVNZ) National House Price Index grew some 52% from the half-year ended June 1991 through to the half-year ended December 1997. Their statistics show the national average house price for the December 1997 half year was $184,000 compared to $114,000 in the half year ended June 1991.

Long-term residential property market trends in New Zealand show that house prices have typically matched or exceeded the level of general inflation. The experience for many low deposit "new home" buyers through the 1970/80s was for any "premium" price associated with the initial sale and purchase agreement to be absorbed by high market value appreciation.

Focusing on nationwide figures alone, disguises important differences in trends that have been occurring at a regional level. In recent years the Auckland region has experienced rapid house price appreciation. Population and overall economic growth have been major determinants. Generally, above national average price appreciation has been confined to Auckland and the upper North Island; regions further south fall short of the national trend, and indeed of late there is evidence of price decline in various areas (Figure A1). Therefore, in more recent times, in those regions with stable (and falling) property prices the price differentials between new and secondhand houses have remained. Under New Zealand's current low inflation environment as driven by Reserve Bank of New Zealand monetary policy, this situation is likely to prevail in the medium term.

4.1 Manawatu District Housing Market

Throughout the 1990s the Manawatu residential housing market has been representative of a market that has fallen short of national trends. QVNZ House Price Index for Manawatu District only grew some 5% from the half-year ended June 1991 through to the half-year ended December 1997.

Manawatu District Freehold Open Market House Sales (Figure A2) shows six monthly freehold open market house sale volumes and average prices for Manawatu District. The figure shows the Manawatu residential house market experienced positive growth through 1991/94, both in terms of sale volumes and prices. Price levels remained relatively stable through 1995/96, then declined in 1997. Sales volumes fell through 1995/96, then recovered again in 1997.

Overall, the average house price for Manawatu District increased from $85,000 in June 1991 to $99,000 in December 1997.

Housing Affordability

Home Mortgage Affordability (Figure A3) for the Manawatu-Wanganui Region shows that through the period 1990 to 1994 housing affordability improved, underpinned by lower mortgage rates. Affordability then declined in the mid-1990s, on the back of rising mortgage rates. Most recently during 1997/98 affordability has again improved, initially influenced by easing house prices then easing interest rates.

Regional Economic Performance

Regional Economic Activity by Annual Average Growth Rate (Figure A4) shows differences between growth trends for the region and the national economy. Manawatu-Wanganui almost invariably has a growth rate less than the average for total New Zealand. Since 1992, the Manawatu-Wanganui regional economy experienced positive economic growth, although the rate of growth has been slowing down.

NB One drawback of both the Home Mortgage Affordability and the Regional Economic Growth data is that they do not measure Manawatu District performance separately. Some of the data used to compute the indexes are not available at Local Authority level. Despite the fact that Manawatu-Wanganui home mortgage affordability and economic activity levels, as separately portrayed by the indexes, are not necessarily representative of Manawatu District levels, it is important to recognise the performance of the region as a whole. There are strong linkages between the District and surrounding areas.

The population of the Manawatu-Wanganui Region increased 1.2% between the 1986 and 1991 Census. During that period Manawatu District's population increase was 5.2%. Population increases through to the 1996 Census for the Manawatu-Wanganui Region and Manawatu District, were 1.8% and 3.5% respectively.

4.2 Fletcher Homes Valuations

A study of a volume of valuation reports prepared by defendant valuers on FHL "new homes" reveal the following trends:

- The valuers appear to have followed reasonable principles and practices in deriving their valuations.
- For residential house properties the basic valuation approaches used are the sales comparison approach and the replacement cost approach. Of these two the sales comparison approach is widely recognised as the most applicable approach for the determination of value. The replacement cost approach is accepted as a useful check method.
- From the work papers the valuers have attempted to analyse their comparables to derive net rates (market value per square metre). The range of derived net rates are then adjusted to the subject property allowing for size, quality etc.

- The valuers variously viewed the Building Economist and/or New Zealand Institute of Valuers (NZIV) regional pricing (two different NZIV Modal House Costs, and a separate New Zealand Building Economist sourced Regional House Cost were consistently being published in the *NZIV Statscom* over the period of the subject valuations).

- The valuer's assessments of value appear to have been influenced by the contract prices of the homes, and sales of other Fletcher Homes.

- The valuation reports conform to the basic minimum of generally accepted valuation practice at the time of valuation (it is understood the valuers were under strict instructions from the mortgagee as to the form and content of their reports). The general format of the valuation reports was common at the time, and found some acceptance with other lenders and valuers.

- The reports are clearly addressed to the lending institution, and contain standard "riders" as to: the valuations being based on plans and specifications, contingent upon proper completion in accordance with the plans, building, engineering surveys; certification of the valuer's professional qualifications; liability to other parties' etc. From 1992 most reports include a list of comparable sales and also include CUAMIC/MGICA certification.

In an overall context it appears the valuers have relied on the last "new home" transaction in the area (and the subject contract price) when completing their valuation. It is ethical to incorporate the sale price (if known) of a property being valued into the valuation analysis, but it must be viewed in the context of the wider market evidence. It seems the problem in many cases is that the valuers have not thought beyond the current sale, whom was likely to purchase the property next and what they would conceivably pay.

The FHL saga suggests the home buyers, valuers and lending institutions had all been raised on a diet of high inflation i.e. past indiscretions had over the years been concealed by value appreciation. It appears that no one really thought that property values could fall. From a valuer prospective it points to a profession that has focussed on looking backwards and not considered what is around the corner, or understood market dynamics.

5. Valuation Standards and the Duty of Valuers

What then is market value? Surely the NZIV Valuation Standards definition must apply:

"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".

Valuation is the process of assessing the price at which a property interest might reasonably be expected to sell for, at a specific date assuming normal market conditions under the principle of a willing buyer-willing seller.

The role of the valuer and methods of valuing residential property are clear, as set out in the New Zealand valuation Jefferies text, *Urban Valuation in New Zealand - Volume One* the first edition of which was published in 1978.

The valuer's assessment of value is a professional opinion as to the most probable price a property interest should sell for in the marketplace, **at the date of valuation**. For residential house properties the basic valuation approaches are the sales comparison approach and the replacement cost approach.

In the instance of a secondhand home, or newly built previously unoccupied home the appraisal process involves a property inspection, and valuation of the property as it exists at valuation date. In the instance of a proposed new house development, the appraisal process involves a property inspection (typically of a vacant allotment), a perusal of plans and specifications for the proposed house etc., and provision of a valuation envisaging completion of the development. The provision of a valuation based on plans and specifications should always clearly note that it is subject to satisfactory building completion at a later date, and final property inspection and confirmation of value on completion of development works. For a partially built house, the appraisal process would again involve the valuer undertaking a property inspection, and provision of the valuation subject to the same proviso of satisfactory completion (i.e. dwelling construction in compliance with relevant Local Authority and National Building Standards, issue of Code Compliance Certificate).

Historically, and through to the present day the sales comparison approach has remained the most applicable approach in New Zealand to the valuation of houses. Property prices are influenced by a variety of factors; this requires the valuer to have a good knowledge of land economics when interpreting and applying market data during the valuation process. The sales comparison approach is most applicable, in that economic factors etc. are recognised by the market and reflected in individual property prices.

Valuers using the replacement cost approach to assess value have to take market evidence into account. **Cost does not necessarily equal value** is a fundamental principle in valuation.

Depending upon the circumstances behind a property sale it may be that the indication of true market value lies above or below the actual price noted in the sale and purchase agreement, and the memorandum of transfer for a property. The foregoing has been a definite problem area for valuers over time. Jefferies, in his standard valuation textbook *Urban Valuation in New Zealand - Volume One 2nd Ed. (1991)*, notes that little consensus of approach has been established/accepted by valuers over the years as to what is truly a willing seller-willing buyer sale, under conditions such as low deposit selling.

At various points in time valuation determinations of "new homes" have been seen to reference a combination of sales of new properties, as well as sales of secondhand homes and replacement cost considerations. In more recent times many valuers have now adopted sales of secondhand properties only as comparable when assessing "new home" values.

In undertaking a valuation instruction the valuer now has a professional duty to apply best valuation practises, in accord with NZIV mandatory Valuation Standards or non-mandatory

Guidance Notes of the time, and to comply with mandatory statutory and/or regulatory requirements relating to the valuation.

The NZIV initially began developing Valuation Standards in 1980 when the NZIV addressed the needs of the accounting profession, and with assistance from the Royal Institution of Chartered Surveyors (United Kingdom) produced Guidance Notes on the Valuation of Fixed Assets for financial statements. In 1985 as members of The International Assets Valuation Standards Committee (TIAVSC) the NZIV then adopted TIAVSC published Valuation Standards and Procedural Guidance Notes, as relating to fixed asset and financial statements. The NZIV revised the Asset Valuation Standards again in 1988. These Standards contained market value definitions that became widely used by Institute members in their everyday valuations.

It was not until mid-1990 that the NZIV issued any form of Guidance Note for valuers on the inspection and valuation of residential property. It was in the form of an exposure draft of a proposed Guidance Note. The Institute issued a Provisional Practice Standard No 1 "The Valuation of Residential Properties" in January 1991 and it came into effect as Practice Standard No.1 from 1 January 1992.

In July 1991 the NZIV issued a discussion draft on the Valuation of Residential Properties for Mortgage Purposes; a Provisional Practice Standard No 2 for the same was issued in January 1992, and this came into full effect as Practice Standard No.2 on 1 January 1993.

In 1995 the NZIV reviewed and reissued its Valuation Standards, Practice Standards, and Guidance Notes in a new format.

NZIV did not have any form of guidelines for valuing "new homes" from plans and specifications until 1996. Practice Standard No.2 did have general provisions on the valuer's role in Section 2, and on work in progress in Section 5. Chronologically, the NZIV issued an exposure draft "Guidance Note No.7: Valuation of Houses Under Construction and Houses to be Built or Previously Unoccupied New Houses" in May 1996, for members' consideration and comment (the Council of the NZIV issues Guidance Notes as statements of recommended "best practice"). The exposure draft was elevated to provisional status for a further 12 months from 1 March 1997. Following the passing of that period the provisional Guidance Note was reviewed and upgraded to Full Guidance Note status, issued 1 March 1998.

Practice Standards No.1 and No.2 together with Guidance Note No.7 now provide NZIV members with clear "best practice" principles and specific requirement for the valuation of all residential properties. The valuer's minimum reporting requirements should include a statement of the purposes and functions of the valuation, and the source of the valuer's instruction. Where the market value of a "new home" is likely to be significantly different from achievable resale value in its same condition, then NZIV Guidance Note No.7 recommends the valuation report should clearly state this and show both the previously unoccupied new property value and the value on resale. It further recommends that where a mortgage recommendation is provided, that recommendation should be based on the resale value of the property.

The NZIV introduction of the latter Guidance Note No.7 was obviously prompted by the growing evidence of inconsistencies in approach used by valuers in regard to the determination of values in two-tiered housing markets; the majority of these valuations prepared for mortgage purposes. It now makes it clear to the prospective mortgagee what additional risk may exist in the event of non payment of the mortgage, and to the prospective purchaser the price premium that may be attached to a "new home" package.

An alternative consideration

The "new home" market is a recognisable sub-market within most New Zealand residential property markets. It is logical that the value of a "new home" will reflect its condition in a previously unoccupied state. The price and value of a "new home" may not necessarily equate. However, one would expect both to be influenced by terms and conditions associated with the sale of "new homes". Given normal market conditions a "new home" is likely to sell at a premium to a secondhand property, on the basis that the home is new. The purchaser of a "new home" has the opportunity to select fittings, decoration etc. to taste.

The introduction of Guidance Note No.7 now gives valuers considerable guidance in specific regard to two-tiered home markets. However, it does not prevent a valid valuation based on "new home" price comparisons.

Where two-tiered markets exist through the influence of low-deposit purchase incentives, the alternative form of sales analysis would be on a market "cash equivalent" basis. On such a basis the nominal sale price would be adjusted to reflect the real transaction, or effective market price on an uninduced basis. Similar forms of analyses are now commonplace in commercial property markets when considering the impact of lessor provided rental incentives on market rent.

6. Conclusions

The reported market value of a property can vary, by reason of the market in which that property is traded. Valuers therefore need to have an understanding of what they are valuing, and know the specifics of the market in which they are valuing. In circumstances where market values of properties with similar physical features differ because of the markets in which they are traded, it is important that the valuer clearly states the valuation assumptions, standards and the respective value(s) that apply. Any party who is relying on the valuation will then be clearly aware of the risk factor, and the valuer will be protecting him or herself against potential criticism/claims.

The market value report is intended to help a client make an informed decision. Valuers are expected to report an objective value based on a factual account of the market. To provide the same the valuer needs to be **qualified** – experienced to do the job; **independent** – have no association with the parties or the property being valued; **have market knowledge** – of sales, income streams, where the property "fits", and the econometric indicators affecting the market.

Clients should now expect detailed reporting from their valuer, particularly in reference to market conditions and forecasts of value movements. Where positive or negative aspects of a property are evident these should be reported. Reflecting risk addresses optimism (or pessimism) and gives certainty. Do not let the valuer be a scapegoat with no defence for not being proactive or displaying professionalism. By adopting proactive and impartial standards the valuer will benefit the client and help enhance the valuation profession's public profile.

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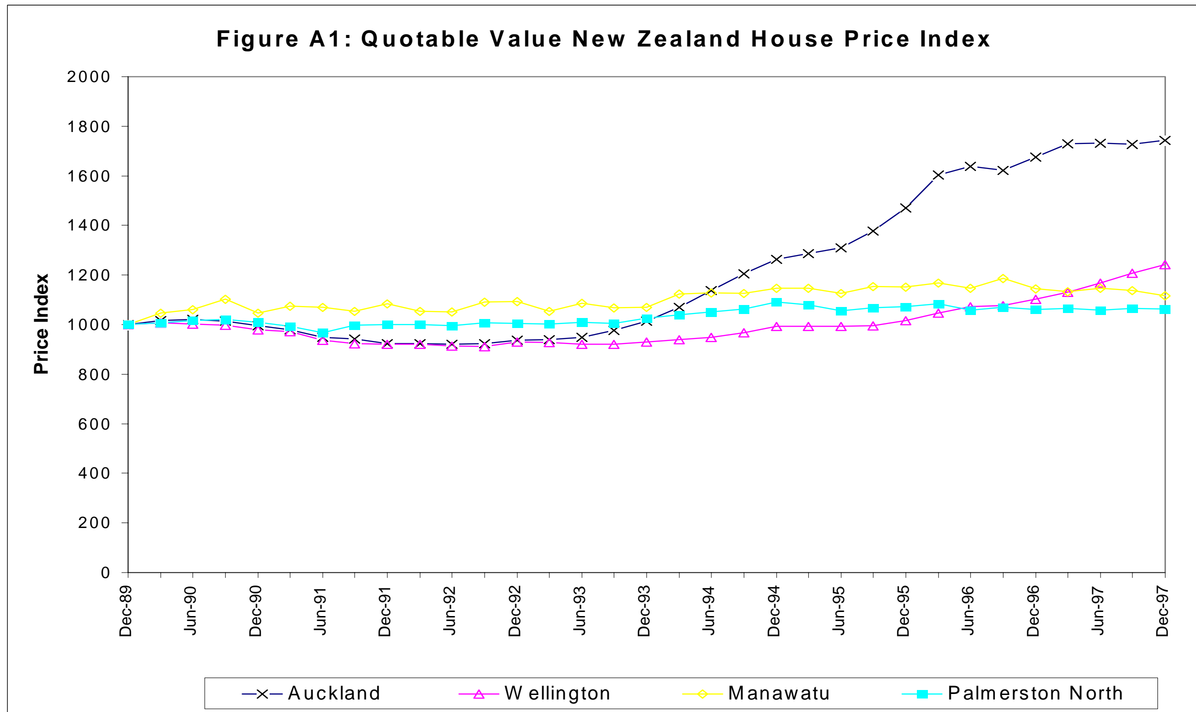
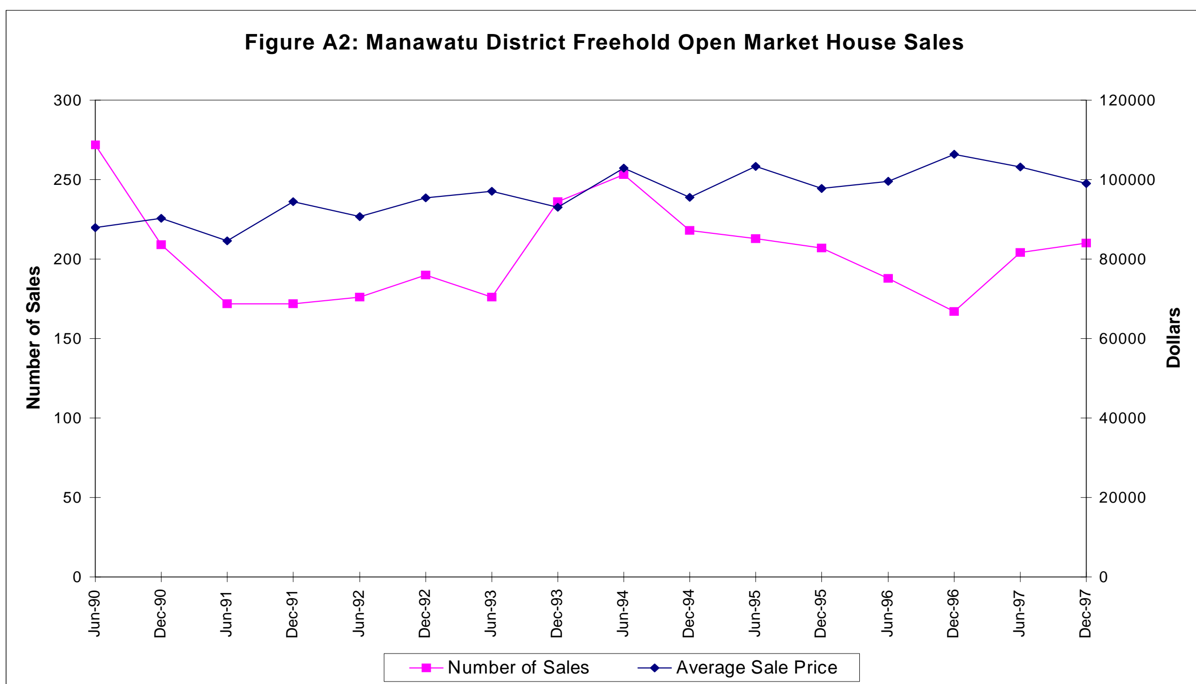
Data Appendix

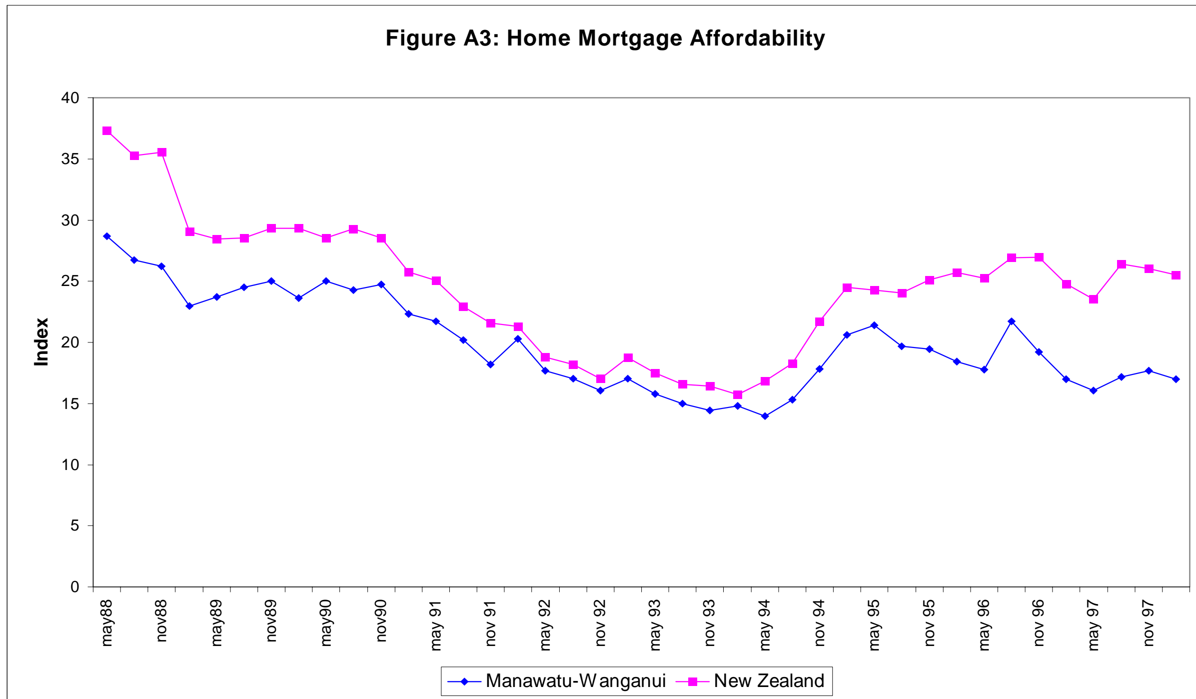


Source: Quotable Value New Zealand

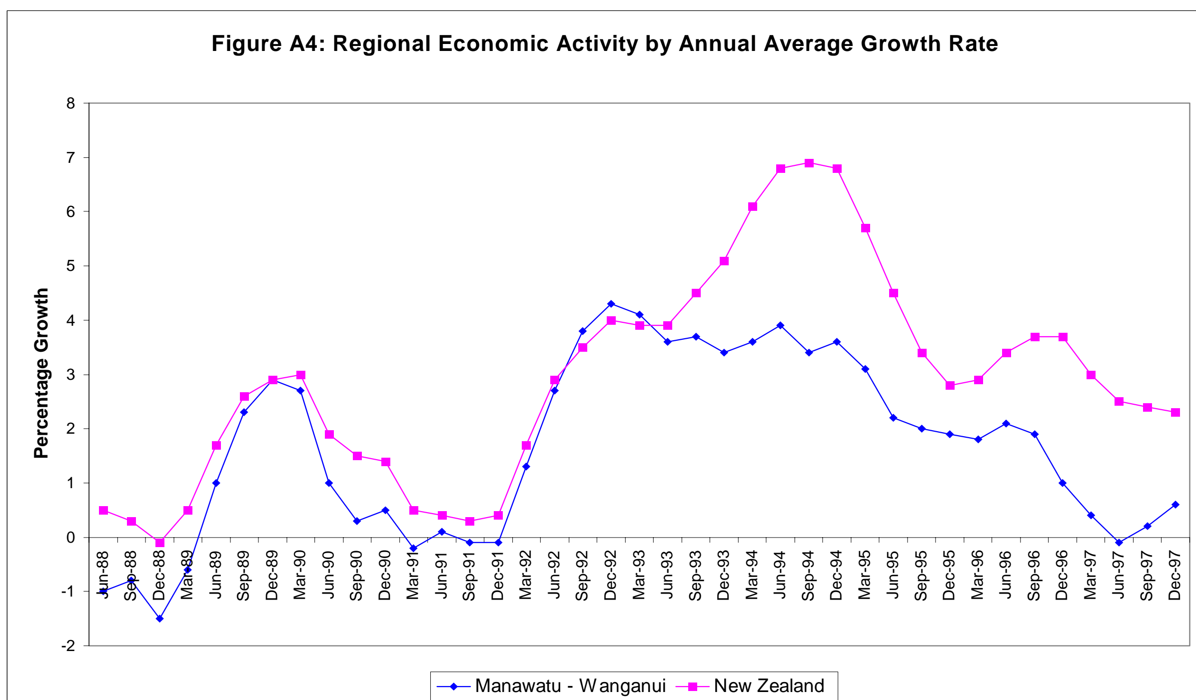


Source: Quotable Value New Zealand

Data Appendix



Source: Massey University Real Estate Analysis Unit



Source: National Bank of New Zealand Ltd.

Data Appendix

1. Quotable Value New Zealand (QVNZ)

Freehold Open Market – Figures A1 and A2 are produced from figures that include only freehold open market sales. Sales such as forced sales, sales between family members with a gift element and sales of leasehold and mixed tenure properties are excluded. Freehold open market sales were 73% of all sales advised to QVNZ during the second six months of 1997.

Timing – The statistics are compiled on the basis of the date notification was received by QVNZ, not on the date of contract or settlement.

Prices – All prices listed or shown are net sales prices (they exclude chattels).

Average Prices – A change in an average sale price does not indicate whether prices paid for the same type of property are higher or lower, or whether there is a change in the proportion of high to low quality properties sold.

Price Indexes – QVNZ developed its Price Indexes to offset some of the limitations of average sale prices. The Price Indexes reflect the average movements of sale prices related to the Rating Valuation of the properties concerned, to assist comparisons over time, and thereby introducing a quality measurement into the calculation. Each Price Index has a base of 1000 as at December 1989.

2. Massey University Real Estate Analysis Unit (MUREAU)

Figure A3: Home Mortgage Affordability index for Manawatu-Wanganui Region is produced by the MUREAU. Mortgage affordability is assessed by comparing average weekly earnings, mortgage interest rates (drawn from Statistics New Zealand data) and median house prices (released by the Real Estate Institute of New Zealand). The earnings figure represents the money available to the family, or household unit, and the median dwelling price combined with mortgage interest rates provides an indication of the expense involved. The lower the index the more affordable is housing. This is a result of the following factors, occurring independently or simultaneously:

- Higher household real incomes.
- Falling mortgage rates.
- Lower house prices.

3. National Bank of New Zealand Ltd.

Figure A4: Regional Economic Activity by Annual Average Growth Rate is produced from National Bank Regional Economic Activity Review data. It compares performance in economic growth of the Manawatu-Wanganui region against the average growth rate for New Zealand. The National Bank uses 34 series to calculate the composite indices of regional economic activity including gross regional product, registered unemployment, business and consumer confidence, real estate turnover etc. Regional results are measured independently from other regions.