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**Challenges Confronting Property Valuation
Practitioners in Australasia**



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*In memory of William N. Kinnard, Jr., 1926-2001
Beloved friend, colleague, mentor, dissertation examiner (2000), co-author, job & fellowship referee*

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Keywords: Professional Indemnity insurance; de-regulation; a global profession; competition; fee cutting.

Abstract: The future of valuation as a profession is being questioned. The professional bodies in both New Zealand and Australia are going through an unprecedented level of change. In the last five years we have experienced merging property-related professions (the recently formed API and NZPI: previously the AIVLE and NZIV) and competition for members from overseas organisations (for example, the Royal Institution of Chartered Surveyors). Further, competition has come from the passing of The Trans-Tasman Mutual Recognition Arrangement (TTMRA) in 1998 that permits valuers from each country to compete for business across the Tasman.

This paper provides an Australasian perspective of the issues confronting valuers in that region. The findings outlined herein are a result of consultative feedback provided by a number of key players in the valuation profession from both New Zealand and Australia.

The main findings from the investigation are that many of the challenges confronting the valuation profession in Australasia are interconnected. There are enormous pressures for valuers to produce more work but in less time and to meet increasingly complex and stringent standards of professional practice. This is in addition to competition for valuation work from related professions: banks, lawyers, and accountants, both nationally and internationally. Fee reductions to compete for work have become the norm.

The struggle to compete and produce more work, together with a failure to keep abreast of industry changes by attending Continuing Professional Development (CPD) courses has led to falling standards of valuation practice and greater exposure to risk. A consequence of this has been a greater number of claims made on professional indemnity insurance funds. Insurance companies are no longer prepared to underwrite valuers' professional indemnity (PI) cover. Without PI cover valuers cannot afford to take the risk of practicing at all. This puts the future of the valuation profession in doubt. The paper concludes with suggestions for dealing with the challenges outlined herein.

Introduction

As a valuation proponent and avid researcher of valuation issues Kinnard (Bill) was acutely aware of the rising number of issues facing valuers globally. This was a primary motivation for him to call together a panel of international valuation experts to present their findings of the issues facing valuers in their region at the AREUEA meeting in Cancun, Mexico in May 2000. The main aim of this panel was for the regional representatives to share the challenges their valuers are grappling with and to help raise the level of awareness amongst valuers that the issues faced are shared globally and that they need to be addressed in this way, that is, globally.

The author was the Australasian representative invited onto the panel. It was with great regret to hear of Bill's death just weeks before the conference but the panellists decided that Bill would have wanted the panel to continue. This was a particularly moving conference due to his noticeable absence.

This paper is a result of that presentation. The paper begins with a background to the valuation professions in New Zealand and Australia, and outlines the moves to globalise the profession. It then discusses the various issues valuers in Australasia are facing and how some of these are being addressed. For those issues remaining unaddressed solutions are suggested to help resolve them. A primary aim of this paper is to inform valuers from other countries about the Australasian experience so that they might learn from it to avoid similar issues and to garner ideas on how to address those currently faced.

Background

New Zealand

The New Zealand Property Institute (NZPI) was launched in 2000 following the overwhelming support for a new organisation by members of the New Zealand Institute of Valuers (NZIV), the Institute of Plant & Machinery Valuers (IPMV), and the Property & Land Economy Institute of New Zealand (PLEINZ). The new institute has a membership of some 3000 key property professionals who provide services in a number of property related areas. These include; property management, property consultancy, property development, property valuation, facilities management, plant and machinery valuation, financial analysis, real estate sales and leasing, project management, and others. The Institute has 17 branches across provincial and metropolitan New Zealand, a number of overseas members, and is affiliated to a number of other international property organisations, including the World Association of Valuation Organisations (WAVO), RICS, The Pacific Rim Real Estate Society (PRRES), etc.

The NZPI Registration Board provides registration in the following streams: Property Consultancy; Property Management; Facilities Management, and Plant and Machinery Valuation. Members who are Registered Valuers are administered by the Valuers Registration Board (VRB). The VRB's role is to ensure a minimum standard of entry for valuers becoming recognised by registration. Further, the VRB is responsible for keeping an up-to-date register of all registered valuers, and the issuing of Annual Practising Certificates. To obtain Registration applicants must have obtained the age of 23 years, completed an approved tertiary degree and have not less than 3 years practical experience in NZ within the 10 years immediately preceding applying for registration.

Australia

The Australian Institute of Valuers and Land Economists (AIVLE) was repositioned in 1998 in response to the changing needs of, and influences on, the property profession and renamed **The Australian Property Institute (API)**.

The API is a national body with over 7,500 members who are experts professionally involved in the valuation, administration and use of land, property, and plant and machinery. The Institute has eight divisions including the National Office that are generally determined by the state boundaries of Australia. Membership entry to the API is based upon tertiary education standards, accompanied by recognised practical experience, similar to the requirements of the NZPI.

Closer Links: The Trans Tasman Mutual Recognition Act 1997 and the 2001 MOU¹

The Trans-Tasman Mutual Recognition (TTMR) Act between New Zealand and Australia came into effect on 1 May 1998. Its objective is to reduce regulatory barriers to the movement of goods and services between New Zealand and Australia. For valuers, it means that if a person is registered to practise as a valuer in New Zealand, then they will be entitled to practise an equivalent occupation in an Australian jurisdiction (and vice versa).

This arrangement has a similar outcome to reciprocity agreements being instigated by various valuation bodies around the world. For example, the NZPI has reciprocity agreements with similar bodies in Singapore, Canada, Malaysia and the UK. These agreements aim to bring the profession closer, allowing valuers to practice globally.

A Memorandum of Understanding (MOU) between the NZPI and API was signed in 2001. The aim of this was to establish a closer working relationship in order to develop a cross border common membership for each Institute's members in recognition of each other's equivalent occupation status and to give effect to the TTMR Act 1997. The two bodies aim to put in place mirror rules of each Institute, establish and publish a common Professional Practice Manual, and develop and introduce a common set of valuation standards, etc.

¹ MOU is the Memorandum of Understanding signed in 2001 by the NZPI and API.

Issues & Challenges Facing Property Valuers in Australasia

A Global Profession: RICS and WAVO

The Royal Institution of Chartered Surveyors (RICS) is an international organisation with some 108,000 members working in over 120 countries (Armstrong, 2000). The importance of establishing a truly global profession was identified as a key part of the 'status agenda' in the *Harris report* of 1998. According to the RICS Chief Executive Louis Armstrong: "From July 2001, the Institute will become more recognisably international with the advent of a governing council made up of representatives from all world regions. The governing council will make policy for the whole profession," p. 12. Globalisation of business has become a reality and the Internet is forcing the pace of change. The overall mission of the RICS is 'to elevate the status of the RICS qualifications worldwide...' Key strategic objectives are to:

- Increase the profession's influence and business potential worldwide
- Promote the qualification
- Attract top quality entrants, qualifying indigenously
- Create a global brand.

Priority areas for the next three years are Europe, USA, Australasia and China. The RICS was established in Australia, with an office in Sydney, in December 1999. However, RICS is yet to negotiate reciprocity arrangements with both the API and NZPI.²

The World Association of Valuation Organisations (WAVO) was established in 2002 at the United States Appraisal Institute's conference in Honolulu, where delegates from Australia, Brazil, Canada, France, New Zealand, South Korea, Turkey, the United Kingdom, and the United States agreed that WAVO would establish a global voice for the property valuation, consulting and advisory profession (Eades, 2002).

The inaugural meeting of WAVO was held in Kuala Lumpur, Malaysia on 12 October 2002. Current member organisations include: the American Society of Appraisal (ASA); American Institute (AI); Australian Property Institute (API); Appraisal Institute of Canada (AIC); International Valuation Standards Committee (IVSC); Singapore Institute of Surveyors and Valuers (SISV); NZPI, and RICS.

The objectives of WAVO include:

1. Supporting the consistent application of valuation standards and methodologies
2. Encouraging standard terminology and worldwide transparency
3. Improving educational and training opportunities
4. Providing a quality assured WAVO accreditation to member organisations
5. Working in parallel with IVSC³

The members of WAVO are determined to accelerate the work of identifying and adopting international best practices for the benefit of their members, clients and the communities they serve.

"It's significant to note that two Australians, are taking leadership roles on WAVO - Grant Warner, who is the API's Director of Policy and Research has been invited to be interim secretary, and Brian Ellerbeck, a past National President and current chair of API's International Committee, has been appointed to the interim board," Eades (2002).

² The original AIVLE and NZIV organisations had reciprocal agreements with RICS but these arrangements have not been renegotiated under the new API and NZPI structures.

³ Reported by Lam (2002).

Undoubtedly, all members conscious of the need to strengthen their profession and have a more global focus will view the benefits of an international organisation, such as the RICS or WAVO, more favourably. However, some Australasian members remain parochial and resistant to change in the face of the challenges of internationalisation and doing business in the global economy. Sole practitioners are particularly at risk of not managing to keep pace with change and compete at an international level. Concern has been expressed that the larger firms will get larger and that the sole practitioners will not be able to compete and will be forced out of business. It is true that the pace of change threatens the livelihood of many valuers and only those that can meet the challenges will survive.

Legislative Challenges:

New Zealand –The Valuers Act 1948, Deregulation and Rating Legislation

The Valuers Act 1948 is the piece of legislation that gives formal statutory recognition to valuers. Further, it provided for the establishment of the Valuers Registration Board, the body responsible for registering valuers. However, many of the references made in the Act relate to the old New Zealand Institute of Valuers (NZIV) and now, with the merger of NZIV with PLEINZ and IPMV, the future of this Act is questioned. Much debate has ensued over the relevance of the Act in light of the new Institute and in particular, the question of deregulation of the profession. There are pros and cons for repealing the Act and for deregulation.

The arguments advocated **for** repealing the Act and deregulation include:

- It is costly and inefficient to continue two separate administrative bodies: NZPI and NZIV.
- It would allow for flexibility to change the rules and constitution without the constraint of the Act.
- It would allow for internal restructuring to be fully implemented.
- It would provide voluntary membership to NZPI.
- It would provide for a seamless new institute with a strong focus and undivided interests.

The arguments suggested **against** repealing the Act and deregulation include:

- It provides legislative (State) protection of valuers and the terms “Registered Valuer” and “Public Valuer” would go.
- Public protection through statutory registration, compulsory professional membership and discipline would be weakened.
- Problems may arise with obtaining Professional Indemnity Insurance if State Registration disappears and no substitute measure of “professionalism” is activated.

The major concern voiced by many members over these crucial issues was that Council did not canvas a representative selection of the membership for their opinions. This has now occurred in retrospect. The options currently suggested to deal with the issue include:

- Status quo: “If it ain’t broke why fix it?”
- Amended status quo: correcting defects and changing references to NZPI and NZIV.
- State Registration (New Minimalist Act): protects the public and professional recognition of valuers.
- Land Information NZ (LINZ) proposal: repeal the Act and replace it with mandatory disclosure and banning regime. This would require all valuers to provide potential clients certain information:
 - Qualifications obtained.
 - Level of experience.
 - Membership to a professional body.
 - Level of indemnity insurance held.

If no disclosure is provided, exposure to the implications of the Fair Trading Act would result.

- Self-governance (deregulation): total control of own future.

From a survey of membership opinions the status quo and amended status quo options seem to be those preferred. No final decision has yet been reached over the option to be adopted.

A major change to the tradition of rating valuations in New Zealand occurred in 1998. *The Rating Valuations Act 1998* repealed the *Valuation of Land Act 1951* and amended the *Rating Powers Act 1988*. Under the previous legislation all properties in New Zealand had to be valued for rating purposes by a quasi-government body: Valuation New Zealand (previously The Valuation Department). The new Acts formalised the corporatisation of VNZ and provided for the appointment of a Valuer-General within Land Information New Zealand (LINZ) and for the creation of a crown-owned company (Quotable Value NZ). The new Act also provided for contestability of valuations - by 2002 all territorial authorities are able to choose who provides their valuations that they use for rating purposes. Thus, Quotable Value NZ has had to compete with other valuation service providers. The only requirement is that the valuation services provided must be carried out under the authority of a registered valuer. Sending of notices of Valuation to ratepayers is the responsibility of Territorial authorities. The Valuer-General regulates provision of valuation services to local authorities to ensure national consistency (rather than provide these as previously).

This change has not only made the market for territorial valuations more competitive but also more contentious in terms of uniformity despite regulation by the Valuer-General. Standardisation of valuation methods and access to a central database are no longer possible when the rating valuation work and associated databases are spread between various organisations. The quality and maintenance of those databases is left to the discretion of each independent valuation provider. This brings into question the quality and fairness of the valuations for rating purposes where a level "playing field" is paramount.

Australian taxation valuations are still undertaken by the equivalent of the NZ Valuation Department, The Valuer General's Office (VGO). It will be interesting to see if similar privatisation and free-market moves that have occurred in NZ are replicated in Australia.

Australia – Goods and Services Tax (GST)

A New Tax System (Goods & Services Tax) Act 1999 became effective in Australia on 1 July 2000. The introduction of GST follows similar moves in New Zealand (1987) and Canada (1991). The Howard Government, re-elected in 1998, made a major reform of the taxation system by reducing personal income taxation and introducing the Goods and Services Tax (GST). This has given rise to a number of questions from valuers over the application of GST to property transactions and also from a business-owners perspective.

An example of the uncertainty that exists over GST liability relates to commercial property and whether it is a going concern or not. A commercial property sold as a "Going Concern" is GST-free. For a commercial property to be sold as a "Going Concern" the following must apply:

- the purchaser must be registered or required to be registered,
- the sale of the property is for consideration, and
- the vendor and the purchaser must agree in writing that the supply is of a going concern.

In addition:

- the vendor must supply to the purchaser all of the things necessary for the continued operation of the enterprise, and
- the vendor must carry on, or will carry on, the enterprise until the day of transfer of the property.

However, there is, at present, no defined level of occupancy of leased commercial premises included in the definition of "Going Concern". At present the sale of a commercial property with an income stream may be viewed as a going concern. The vendor is responsible for remitting GST to the Australian Tax Office (ATO). For the vendor to recoup the GST from the purchaser the sale contract must state the method of disposal utilised and include a clause requiring the purchaser to pay the GST to the vendor. Purchasers of commercial property do not have to be registered to acquire property or be able to claim input tax credits. They may, however, be required to be registered in order to claim an input tax credit.

Also relating to commercial properties another issue arises over whether or not landlords will be able to recoup GST payable on building expenses regardless of whether or not a lease is explicit on the payment of GST. As can be seen from the above examples the treatment of GST is not straightforward. Clarification from the ATO will be required where interpretation of the Act is unclear.

To help address these issues the Australian Property Institute established a national GST Committee head by KPMG Tax Partner Peter Poulos and other leading practitioners from the property profession to review the GST legislation and provide advice to members. A number of Continuing Professional Development (CPD) events have been held throughout the country to clarify some of the issues relating to the impact of GST on property. The API has since released a series of advice notes for its members on GST and Real Property.⁴ The package provides practical guidance to the property profession in applying GST to construction contracts, leases and a number of other relevant topics and clarifies what should be considered when applying the GST.⁵

Professional Indemnity Insurance Challenges:

Associated with these challenges (concerns over national consistency of valuation standards and deregulation in NZ and taxation liability of property transactions in Australia) is the growing concern over the availability and cost of professional indemnity insurance to cover the greater risks involved in providing valuation services. External factors such as the collapse of insurance company HIH Australia in March 2001 and the insurance events of September 11th, 2001 in New York have had damaging effects on insurance markets globally.

There are currently **no** Australian insurance companies prepared to underwrite professional indemnity (PI) for valuers and only one international insurer (Lloyds, London)⁶ that is willing to do so. Further, the premiums have escalated sharply. Apparently, Australian valuers have claimed 350% of the premium-pool for the last several years with huge court settlements making a hefty contribution. Australian courts have set precedents that allow for higher awards to litigants than is common in some other jurisdictions. The highest settlement awarded to date has been for \$3.5AU million in 1999 (Kooymans, 2001). Premiums for certified practicing valuers (CPVs) are between \$4,000AU and \$12,000AU per annum for an average of \$1 million in cover having increased by around 100% p.a. in the last three years.⁷ Excesses have increased 10 fold in the last 12 months. This is an enormous expense when CPVs fees average only a few hundred dollars and their incomes are often quite modest by professional standards, (API, 2002).

Spencer (2001), a sole practitioner in Perth, Western Australia, points out that many major clients require a continuing professional indemnity cover before they will enter a valuation contract. Valuers are understandably concerned about what will happen with those clients in the event that PI cover is unavailable.

“Senior members of the API appear to be speculating that many valuation practices, if not all, may not be able to afford to arrange PI cover next year....if this worst prognosis is correct, many practices will have to consider whether to continue without cover or do something else” (Spencer, 2001).

The Australian Property Institute is currently examining the problems of PI insurance within the property profession and believes the crisis in PI insurance is now an issue that state governments should urgently examine if they want to ensure that Australian consumers can afford the services of their professionals. The API National Council Sub-Committee on PI Insurance (formed in early 2001) surveyed members to ascertain members' experience with PI and have developed a Compulsory CPD Risk Management course

⁴ See <http://www.propertyinstitute.com.au/resources/tax/apialerts.htm>.

⁵ Of note is the effect GST has had on the property market. For example, in 2000/1 there was a severe post-GST slump in the residential market. Total dwelling commencements reduced by 33%, (Goodman, 2002).

⁶ Brian King, Managing Director of Crown Insurance Group (the API's broker), managed to reach an agreement with Lloyds in London to underwrite valuers PI but at a high premium price.

⁷ Spencer (2001) reports that a small operator, such as himself, has to pay around \$5,000 per annum for a \$1m cover and \$15,000 excess and that this premium has almost doubled in just two years!

for practising valuers (piloted April 2002). The aim of these initiatives is to deliver sustainable and affordable PI insurance cover to members (API, 2002).

The concept of the Compulsory CPD Risk Management course is that on completion of the course separate CPD risk management certificates are to be issued. The intention is that PI insurers will require individual valuers certificates to be appended to a firms PI policy renewals each year. The course will be administered by the API national office and is to meet the following criteria: 1) be available to members throughout Australia; 2) be available to members at any time of the year; 3) be available in both face-to-face format; and 4) be available on the internet so that it meets the first two points above.

Topics to be covered in the Module include: best practice; better communication; better client selection; rules of conduct/code of ethics/disciplinary procedures; principles of law; professional office practice procedures; and adherence to basic valuation principles. It is envisaged that the course will be completed in the first quarter of the 2002-2003 financial year ready for presenting. The API is to market the course to insurance brokers, insurers and underwriters, and users of valuation services.

New Zealand valuers are facing similar problems to their Australian colleagues. There are only two PI insurance companies and costs to obtain cover are rising. However, initiatives to deal with PI cover availability and the rising costs of obtaining it have only recently been addressed by the NZPI. The NZPI has sent out a survey to members (October 2002) to determine members' experience of the problem and they propose to introduce a Risk Management CPD module in late 2002.

Another PI issue valuers face is the need to obtain "running cover". This need arises due to the definition of the "loss date" of a PI claim. When a claim is made against a valuer the loss date is not usually taken to be the date of valuation, as may be expected, but is most commonly the date the claim was made. Yet, valuers are not always aware of this clause in their PI policy. Thus, in the situation where a valuer has ceased practising and later a claim is made against him/her if they have not obtained "running cover" under a PI policy then they will not be covered. In NZ, the Statue of Limitations applies (liability is limited to six years) and a valuer can be sued up to six years after a valuation has been completed. As such, it is recommended that running cover be obtained for this period. While various options exist for obtaining running cover the most popular option is to apply for this annually with premiums amounting to around 85% of the premium for full PI cover, (Thomson, 2002).

Meanwhile, uncertainty remains about the future of the profession in the event that no affordable PI insurance cover be made available.

The Level of Fees

While the costs of doing business are rising, as evidenced from the previous section, the charges for professional valuation services are falling. The level of fees for valuation services has been dropping over recent years, partly due to the competition for valuation work from non-traditional suppliers of valuation services: banks, accountants, lawyers etc. These related disciplines are seen by many valuers to be encroaching and poaching on their area of specialisation. It is not uncommon for valuers in NZ to be charging a mere \$225NZ for a residential valuation (and in some instances, even less). These fee levels compromise a reasonable duty of care.

According to a survey of 16 valuation firms in NZ conducted by Waikato University in 2001 (as reported by Lawrence, 2002) the average annual turnover for a firm is \$434,709NZ (\$140,000NZ per valuer) with net profit to the working owner of \$72,241NZ p.a. (compared to \$120,000NZ p.a. in the accountancy profession) and is lower than the previous year and reducing. Lawrence points out that to earn a salary of \$100,000NZ p.a. valuers would have to be charging \$100-\$140/hour or \$390-\$400NZ per valuation, nearly double that currently charged.

The message is clear that valuers are under-charging for their services especially considering their exposure to risk, costs of operation and time taken to prepare valuation reports. Some valuers are

suggesting that the NZPI return to a recommended scale of fees for valuers yet set scales of fees are not permitted under the Fair Trading Act 1997 and a recommendation for such would unlikely be tolerated.

While under fee pressure valuers, in an attempt to increase turnover volume, are pushed at an increasing pace resulting in greater risks of making mistakes and lower grade work. In Australia, according to the API (API, 2002),

“Market practices have also seen some lenders instructing and/or encouraging valuers to deviate from robustly developed API standards...and of addressing reports to multiple instructing parties (for example up to 30 parties for some lenders) so that lenders may hawk valuations between lenders... However, the “catch 22” nature of these issues is that, in the scramble to achieve panel appointments and compete for work, members will accept unreasonable terms of appointment,” p.3.

In connection with the above, enormous pressure is being placed on valuers by banks to provide a greater level of detail in valuations particularly for commercial lending on proposed developments. Pressure to produce work involving greater detail and exactness is also coming from landlords and tenants in rent-review valuations. In practice, an increase in valuation detail and accuracy is to be encouraged but it is posing a major challenge for valuers as clients resist paying extra for the time necessary to achieve this.

A related issue is the use, or abuse, of the computer. While technological advancements have made valuers' tasks more efficient they also pose huge challenges to valuers to maintain high standards, especially when clients expect portfolios to be valued in ridiculously short time frames. The potential for error is enormous. Valuers are cutting and pasting documents incorrectly, printing out documents and sending them to clients without proof-reading them, or mistakenly sending out old drafts. All of these errors are a result of valuers trying to do too much in too little time, an indirect consequence of the low fees being charged.

The design and implementation of robust and mandatory self-audit functions would help overcome many of the potential pitfalls outlined here, according to Daly (2001). The enforcement of the introduction and mandating of such functions would ideally be by the professional body from within each country.

Valuing Public Sector Infrastructural Assets

Together with increased pressure on valuers to do more for less they are now being required to value non-traditional asset classes such as infrastructure. As a result of legislative changes⁸ and the movement towards public accountability and more efficient resource management⁹ local authority assets and resources are now required to be defined, valued and recorded, and to do so using specific financial reporting guidelines. The main purpose of this process is to enable authorities to make the most cost-effective use of their capital and to ensure that no asset is overlooked or under-utilized. This exercise is not unique to Australasia, other countries are in the process of, or have completed, the collation of such data.

According to Kellett (2001), in 1996 most local authorities in NZ did not have detailed information on the historic cost of their infrastructural assets. The Local Govt Amendment Act 1996 classifies infrastructural assets as depreciable assets and so a valuation basis had to be established for charging depreciation on them. Independent valuers using accounting and valuation standards available at the time carried out most of the infrastructure valuations.

National professional bodies have worked at an international level to ensure a similarity of approach in response to the increased awareness of the need to adopt common standards globally, as discussed below. However, these developments are not without their problems. For example, it is questioned if the methods of valuation are sophisticated enough to cope with the task, especially when dealing with assets that are held primarily to provide services to the community rather than to generate revenue, such as infrastructural assets. Most valuation methods are based on the assumption that property is purchased and held

⁸ Introduction of the Financial Reporting Act 1993 and The Local Government Act (No. 3) 1996.

⁹ Including the inclusion of infrastructure and utilities in the Rating Valuation Roll.

for financial gain and that it will be utilized to meet that purpose. Hence, the values being assessed do not fit in with the philosophy of the undertaking concerned. Herein lies the problem.

Results from research conducted in 1995 both within the United Kingdom and New Zealand to determine the current practice of how local authorities record and value the assets they own showed that the procedures and methods adopted by local authorities, and the valuers they employ, varies widely (see Bond & Dent 1996, 1998 and Dent & Bond 1994).

Interestingly, the UK authorities are not required to value many of the more difficult to value asset classes, such as infrastructure and yet, the New Zealand authorities are. Given that the current legislation requires these assets to be valued in NZ (whether it makes sense to, or not), clear and specific guidelines are required by valuers on the methodology to use when valuing infra-structural assets. Thomson (1993) outlines the three traditional approaches to valuation and how applicable they are to valuing crown assets. He mentions that adopting the sales comparison approach for valuing city utilities is inappropriate as these are rarely traded so little market evidence exists upon which this approach relies. Even where sales do exist he feels these could not be sensibly compared due to New Zealand's small size. He considers the net income approach to be invalid for valuing (often) monopolistic businesses as price of services are not set by market forces and thus will not reflect Net Current Worth, as defined.

The literature indicates that the replacement cost, or variation of this (for example, the Optimised Replacement Cost Approach¹⁰) has been relied on where no active market exists for an asset and/or the assets are non-income generating. This is the method that is generally accepted within the NZ profession for valuing infrastructural assets. Perhaps the most difficult aspect of the replacement cost approach is in the assessment of depreciation and the economic lives of assets. Yet as the depreciation of New Zealand's local authority assets in 2000 amounted to \$771.4 million¹¹ it is critical that valuers get this estimate right. However, depreciation is difficult to identify accurately, much less quantify.

The most common and simplest method of assessing depreciation is by estimating the economic life of the asset and calculating the annual rate of depreciation that will reduce the value of the asset to nil by the end of its economic life, yet Kellett (2001) questions the reasonableness of this approach. For assets that are to be maintained in perpetuity, such as roading, an estimate of economic life is non-sensible as the asset will be maintained in perpetuity. The asset will, of course, suffer physical depreciation but to deduct this from an estimate of cost will derive a value figure unlikely to be related to its true worth. For example, to ensure the asset's continued existence the physical depreciation will, in most cases, be rectified on a continuing basis. However, if this cost were to be deducted from the cost of the asset, it would, over time, provide a negative value figure.

The approach to assessing depreciation, as outlined, assumes that depreciation accrues in equal annual amounts over the estimated life of a property but this may not be the case and is difficult to prove. Further, obsolescence is particularly difficult to measure due to its largely intangible nature and uncertainties over causes. Thus, any allowance for depreciation contains an element of judgement not capable of proof.

As depreciation charges are commonly determined by application of a depreciation rate to a valuation estimate, Kellett (2001) points out the dangers in wrongly assessing those values and the importance of getting it right: "If values are too low, depreciation charges will not be adequate to sustain the infrastructure. If values are too high we, as ratepayers, will be paying too much for the infrastructure services", p. 36.

A problem with using an Optimised Replacement Cost Approach is that assessments of the most appropriate asset configuration and of the existing asset structure against this requires engineering

¹⁰ Horsley (1991) lists factors that the approach accounts for that the traditional replacement cost approach ignores such as: exposure to private sector competition; obsolescence due to changes in public policy, or other confounding factors, such as industry regulation.

¹¹ As reported in Kellett (2001).

expertise. Thus, the valuation will involve the estimates from not only valuers, but engineers as well, adding to the total cost of the exercise that may well be beyond the budget of many local authorities.

For those assets with earning potential, such as water supplies, which operated as a monopoly where prices were set outside of a contestable market Thomson (1993) recommends an Optimised Deprival Value methodology. The reason given for advocacy of this approach is that it takes into account the monopoly nature of the assets by setting values at:

- No greater than Depreciated Replacement Cost (DRC), if Discounted Cash Flow (DCF) is greater than DRC,
- No less than Net Realisable Value (disposal value of the asset net of disposal costs), if DCF is less than NRV,
- Discounted Cash Flow value, if NRV is less than DCF, and this is less than DRC.

However, such an approach still requires the assessment of DRC, or variation of this and, as such, is open to the same criticisms outlined above. Further, as this approach requires the assessment of various value figures the time and cost of the valuation exercise will be greatly increased and, as mentioned, this may be beyond the budget of many local authorities.

Fortunately, some of the issues surrounding the valuation of infrastructural assets will be resolved with the introduction of new valuation standards. A New Zealand local government initiative formed a national asset management steering (NAMS) group that has, among other things, published guidelines for the valuation of infrastructure assets. The guidelines were included in the NZ infrastructure asset management manual that was developed by the NAMS group in 1996. The guidelines have been superseded by the NAMS asset valuation and depreciation guidelines version 1.0 published in April 2001 (Kellett, 2001). However, until these standards, together with The Institute of Chartered Accountants of NZ (ICANZ) Financial Reporting Standard Number 3 (FRS-3) Accounting for Property Plant and Equipment (outlined below), become widely known and effective in 2002 inconsistencies in valuation approaches are likely to continue.

Valuation Standards

There is a huge range in both the quality of reports produced and the advice provided by valuers in Australasia. To address this, after the Memorandum of Understanding (MOU) was signed in 2001, the NZPI and API Standards Boards were established to set standards to the valuation profession and contribute to international standards. The NZPI standards board currently focuses on three key areas:

1. Provide input into the development of international valuation standards through membership to The International Valuation Standards (IVS) Committee.

The IVS Committee released IVS 2001, a substantial document that has received international recognition by valuers, standards setters and institutional users of valuation standards. This document provided the substance for the re-write of the New Zealand Valuation Standard 3. In areas other than financial reporting, globalisation is also impacting with demand for standardization in banking, securitisation and insurance reporting. Expert groups have been established for public sector property, securitisation, bank lending, and emerging markets. Reports will be received from these groups over the next year. The next edition of IVS is due out in early 2003.

2. To introduce a new financial reporting standard.

“Valuation Standard 3 – Valuations for Financial Statements” was introduced in 2002 and became effective from 15 February. Introduction of the Standard was undertaken to incorporate changes introduced by Financial Reporting Standard 3 (Accounting for Property, Plant and Equipment) to the basis upon which valuations for financial statements are prepared. Financial Reporting Standard 3 (FRS-3) results from the revision of, and replaces, Statements of Standard Accounting Practice 28 (SSAP28) Accounting for Fixed Assets and SSAP3 Accounting for Depreciation. The key changes

for valuers are that “market value existing use” has gone as the standard has shifted to a “fair value” basis and secondly, that depreciated replacement cost has been strengthened as an application where there is no direct market evidence. The Standards Board worked closely with the Institute of Chartered Accountants of New Zealand through the review process.

3. The integration of the NZ and Australian Standards by the year 2003 so there is only one set of standards across the two economies.

This project will be an important step in the globalisation process for New Zealand. The IVS 2001 is to be adopted as the foundation of the API-NZPI Professional Practice Standards and Guidance Notes 2003. The number of Standards is to be reduced from 5 to 3 and will include:

- PS01 – Valuation Procedures
- PS02 – Valuations for Mortgage & Loan Security Purposes
- PS03 – Valuations for Financial Reporting.

The Standards recommended are to become mandatory in NZ as they currently are in Australia. The Professional Practice 2003 manual is to be a combined API/NZPI publication and is likely to be presented as a CD-ROM.

Summary and Conclusions

The above discussion indicates that many of the challenges confronting the valuation profession in Australasia are interconnected. There are enormous pressures for valuers to compete for work, to produce more of it but in less time, and to meet increasingly complex and stringent standards of professional practice. The inability of some valuers to keep abreast of the dynamic and changing environment through failure to attend Continuing Professional Development (CPD) courses has led to falling standards of valuation practice and greater exposure to risk. It is perhaps not surprising then, that insurance companies are no longer prepared to underwrite valuers' PI cover.

The way forward for the profession in Australasia is open to speculation but appears to be pivotal on the following moves:

- Establishment of risk reduction and risk management processes including, mandatory self-audit functions,
- Introduction and enforcement of valuation standards relating to methodology and reporting,
- Internationalisation of services,
- Raising the profile of the profession both nationally and globally,
- Raising fees.

Until such moves are instigated the future of the valuation profession remains in doubt.

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