Valuer M (hearing) [2010] NZVRB 2

VALUERS REGISTRATION BOARD

IN THE MATTER OF an Inquiry under Section 32(2) of the Valuers Act 1948

AND

IN THE MATTER OF charges under Section 3l(l)(c) of the Valuers Act 1948 against VALUER M, Registered Valuer

BOARD OF INQUIRY: M E L Gamby (Inquiry Chairperson)

HJ Puketapu

PA Curnow

KR Taylor

COUNSEL: J A L Oliver for the Valuer General

D E Smyth for Valuer M

DATE OF HEARING: 11 & 12 May 2009

DATE OF DECISION: 20 March 2010

Background

The Valuers Registration Board received a letter of complaint dated 26 February 2008 from the complainants. In their letter, they state that they invested in a property with a company, Company 1, who have since gone into liquidation.

The development was completed either in late 2005 or early 2006. Valuer M undertook a valuation of the property they purchased, the subject property. Their report is dated 20 March 2006. Apparently, the complainants entered into an agreement to purchase the property with settlement due August 2006.

The valuation was prepared following an inspection of the property. Reference is also made in the report to "plans and specifications supplied".

The valuation totals $405,000 (inclusive of $10,000 chattels) and was said to comply with Practice Standards Nos. 1 and 2 of the New Zealand Property Institute. The value is described as a "current market value for mortgage security purposes".

An investigation was undertaken by the Valuer General who submitted his report to the Board on 21 October 2008. Accompanying his report were valuations undertaken on a retrospective basis by two registered valuers, Valuer 1 and Valuer 2.

In the bundle before the Board, the range of valuations, including the most recent rating valuation, was summarised. Full reports were included in the bundle.

Valuer	**Effective Date**	**Current Market Value**	**Remarks**	**Mortgage Recommendation**
Valuer M (20.3.06)	20 March 2006	$405,000	GST inclusive, if any Incl chattels: $10,000	$263,000
Valuer 1 (30.04.08 retrospective)	March 2006	$285,000	GST inclusive, if any, Incl chattels: $2000	$....................
Valuer 2 (30.06.08 retrospective)	20 March 2006	$300,000	GST inclusive, if any Incl chattels: $5000	$147,500

Rating Valuation (as freehold)	July 2005	$300,000	Land Value: $105,000	

A letter comprising a one-page summary was tabled at the hearing. This referred to a full valuation report dated 17 November 2005 prepared by Valuer 3 and signed by Valuer 4 with an indicated value of $365,000 and a mortgage recommendation of $240,000. The full report was not provided to the Board. Neither Valuer 3 nor Valuer 4 were called to give evidence.

The Valuers Registration Board considered the valuations before it and noted that the valuation by Valuer M was 39.58% higher than that of Valuer 1 and 33.9% higher than that of Valuer 2's. In the alternative, the valuation by Valuer 1 was 28.35% lower than that of Valuer M and Valuer 2'a valuation was 25.32% lower than Valuer M. At the time it considered the Valuer-General's report, the Board had no knowledge of the Valuer 3 valuation. An inquiry was ordered.

The Charges

The charges against Valuer M are set out below.

(1) Section 31(1) of the Valuers' Act 1948.

That you have been guilty of such incompetent conduct in the performance of your duties as a valuer as renders you liable to a penalty provided by the Valuers Act 1948 in that in compiling a valuation report dated 20 March 2006 with respect to a property, you grossly over-valued that property.

(2) Section 31(1) (c) of the Valuers' Act 1948.

That you have been found guilty of such incompetent conduct in the performance of your duties as a valuer as renders you liable to a penalty provided for by the Valuers Act 1948 in that in the above-mentioned valuation report dated 20 June 2005 in respect of the above-described property, you made a mortgage recommendation that was excessive.

On the application of Counsel for Valuer M, the excessive mortgage recommendation charge was dismissed. Accordingly, the hearing proceeded on the one charge of a gross over-valuation.

Background

Valuer M

Valuer M signed the subject valuation report as the registered valuer responsible for its preparation. The report was also signed by Valuer 5, an unregistered valuer. There is no indication in the body of the report as to the respective responsibilities of the valuers or the work undertaken by each but in any event as the registered valuer, Valuer M takes full responsibility. The terms and conditions attached to the report indicate that Valuer M supervised the valuation but again, there is no indication either that they inspected the property or that they personally carried out the valuation.

The report addressed to 18 Potential Lenders records that Valuer M's firm had received instructions, but who instructed and the date the instructions were given was not noted in the report. That matter was partly addressed in the evidence of Valuer M when they confirmed that they received their instructions from Company 1. The valuation is recorded as being a" ... current market value for mortgage security purposes".

The subject development, built on leasehold land, was completed in 2005/2006. It comprises 132 apartments located in five separate apartment wings.

The subject unit is on the sixth floor and provides one-bedroom accommodation and is said in Valuer M's report to have an overall estimated gross floor area based on architect's measurements of 50 m2 There is no indication in the report that Valuer M or Valuer 5 measured the premises.

The valuation is recorded as being calculated as follows:

Living: 50 m2 @ $6,800/m2	$340,000
Carpark: 1@ $55,000	$ 55,000
	$395,000
MORTGAGE SECURITY VALUE- adopt	$395,000
Chattels - estimated added value	$ 10,000
MARKET VALUE (as of 20 March 2006)	$405,000"

The valuation is inclusive of GST (if any).

The mortgage recommendation of $263,000 represents approximately two-thirds of the value of the property exclusive of chattels. There are no special conditions noted in the report.

There is much to criticize in the valuation report. This is a leasehold valuation. That is to say that the purchaser was buying a Lessee's interest and was obliged to pay a proportion of the ground lease as part of the outgoings on the property. There is reference under the heading "Legal Description" to there being a head lease over the property to the lessor and that the ground rent is to be reviewed to market value every seven years. However, there is no mention of the current ground rental payable, what a market ground rent might be or what impact the leasehold tenure of the land would have on an assessment of the leasehold (lessee's interest) market value.

The general market comments in the report refer to a buoyant residential property market in March 2006 tempered by the possibility of some slowing in the market and business confidence with a decline in the volume of residential sales. This property is recorded as being in a sound location.

There are lists or recorded sales in the report, that do not distinguish between leasehold and freehold transactions. It is not clear from the report which sales are for off-the-plan new apartments and which are re-sales. There is no summary to assist the reader that describes how the individual sales have been compared to the subject, although it is said the sales have been analysed and compared. The sales section of the report appears to be a standard section possibly designed to be included in a number of reports.

Freehold property sales are scarcely comparable to leasehold property transactions. A consideration of actual lease terms is very important. It is extremely difficult without knowledge of the lease terms to tell how one leasehold property transaction compares to another. As Valuer M nowhere records the leasehold rental for the subject and how that is taken into account in their assessment of value, it is difficult to judge from the report how they utilised the sales evidence to arrive at their assessment of value. Put in the alternative, a mere recording of volumes of sales provides little guidance as to the strength of their sales comparison or its relevance.

The Evidence

Valuer 1

Valuer 1 was instructed by the complainants, to carry out a retrospective valuation as at March 2006. He reported to them on 30 April 2008. The Board notes that he prepared his assessment in accordance with the Property Institute New Zealand Practice Standard Guidance Notes of Professional Practice 2006 which were not operative at the time.

Under the lease summary, Valuer 1 records that the ground lease payable for the total developments from 20 June 2005 was $315,643 per annum which required this unit to be responsible for a ground lease payment of $1742 per annum. He goes on to say that the ground rental for the subject property was well below a market rental, that would increase to around $4,000 per annum - $5,000 per annum when reviewed in 2011. Market reviews are to be undertaken at 7-yearly intervals. There is a ratchet clause preventing the ground lease rental falling below the initial figure.

Valuer 1 measured the unit as having an area of 47 m^2, which is not materially different to the area adopted by Valuer M of 50 m^2

Under his heading "Market Considerations", Valuer 1 records that a "2-tier" market had been operating in respect of apartments within the Central Business District over the previous two or three years. The off-the-plans market had been dominated by developers selling primarily through direct marketing agencies at a pronounced premium over and above the secondary market which is the re-sale market. He states in his report:

> *"We do not believe that the direct marketing method of sales satisfies the definition of market value, as many of the purchasers are ill-informed, do not take independent advice, and are often sold units by way of a 'high pressure' sales method"*

In the Board's opinion that statement, if correct and supported by sales evidence is significant as market value is defined as:

> *"Market value is the estimated amount for which a property 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. "*

The only variation between that definition recorded by Valuer 1 from the International Valuation Standards (adopted by the Property Institute New Zealand in 2006) and that of Valuer M is the word "property". The word "asset" is recorded by Valuer M in their report. Nothing turns on that difference in the definition for the purpose of a valuation of the subject property.

What Valuer 1 was saying in his report is that when assessing the market value of this property, sales of new off-the-plans, units sold directly to purchasers by a developer or its agent do not comply with the Institute's market value definition. He justified his statement by referring to recorded re-sales on the secondary (re-sale) market at a lower price level than the off-the-plans prices.

Valuer 1 does not refer to New Zealand Institute of Valuers Guidance Note 7 (NZVGN 7) that required a valuer to state clearly in his report where there is a difference in value level between new properties whether occupied or not and re-sales, but this appears to be the line of his reasoning as evident from his report. The NZVGN 7 Guidance Note was carried forward with little amendment, as NZVGN 4 in the PINZ 2006 Standards.

Valuer 1 considered that the property had a value of $285,000 inclusive of GST in March 2006 which he assessed by comparison with properties that had sold on re- sale, excluding those sold under forced sale conditions.

Valuer 2

The Valuer General instructed Valuer 2 to undertake a retrospective valuation as at 20 March 2006 having regard to market conditions prevailing at the time, and taking into account only those matters that would have been known to a valuer preparing a valuation as at that date. Valuer 2 completed his valuation report on 11 August 2008 following an inspection on 5 August 2008.

He recorded the same definition of market value as that adopted by Valuer M. That was the definition in force at the time.

Valuer 2 recorded the ground rental payment of $315,643 per annum, representing
$1,742 per annum for the subject unit, and stated his opinion that in 2011, he would expect, under prevailing current market land value conditions, that the current market ground rental if reviewed in 2006 would be $4,000 per annum - $5,000 per annum plus GST.

Accordingly, both Valuer 1 and Valuer 2 were of the same opinion that the current ground rental was understated. This factor was either totally ignored by Valuer M or, if they were aware of it they made no mention in their report and how that would affect an assessed market value.

Valuer 2 measured the premises as having a floor area of 47.25 m^2, again, an area slightly less than that adopted by Valuer M and similar to that of Valuer 1.

Valuer 1 confirmed Valuer M's statement that the general residential market continued buoyant in early 2006 but was more critical of the apartment market which they stated was receiving significant negative press coverage and this was being reflected in negative buyer perception. Valuer 2 distinguished the general market from the direct market by property investment companies to individual investors. Like

Valuer 1 he considered direct market selling may not have met the willing buyer/willing seller (i.e., full knowledge) test.

Valuer 2 recorded sales both within the subject development at the time and sales in the secondary market. His conclusions on the market evidence are worth recording here as they confirm the difference in sale price (value) that can arise between the direct selling approach and the re-sale market:

> *"If a value was simply to be based upon the "new" sales within the subject development, then we consider a value for the subject apartment at or around $330,000 - $350,000 would be arrived at. Nevertheless, and having regard to valuation standards requiring, when valuing new property that consideration is given to secondary market sales, we would then consider that a value based upon "new" sales that had occurred within the subject development would result in an inflated value.*
>
> *The secondary market sales on the basis of each apartment having one carpark indicates a range between $170,000 - $340,000, and with the majority ranging between $270,000 - $320,000."*

In making that comment, Valuer 2 has been relying on NZVGN 7 of the 1995 New Zealand Institute of Valuers Valuation Standards, which required a valuer to consider both secondary market sales and new apartment sales stating clearly in his valuation report that where there is a difference both values should be stated.

Valuer M

Valuer M gave evidence before the Board. They confirmed their qualifications and that they have been registered as a valuer since 1998. Valuer M stated that they were instructed by Company 1 to undertake a valuation of the subject property in March 2006 and that an internal inspection of the property was undertaken by their firm, although they did not confirm that they inspected the property themselves. They confirmed that they were assisted in their valuation by Valuer 5, an unregistered valuer.

At the time Valuer M completed their report, they said there was no assessment of actual outgoings or ground rental although the developer provided estimates. That cannot be correct with respect to the total property ground rental as it was fixed some 12 months earlier. However, the ground rental may not have been allocated or apportioned on a individual unit basis requiring them to make an estimate to complete their valuation. There is no evidence that they undertook an assessment of the market rental. It would not have been difficult and was required as part of the valuation to determine a leasehold interest in the apartment.

As part of their evidence before the Board, Valuer M provided an analysis of sales. Their evidence does not confirm that this analysis was undertaken at the time of their valuation. The analysis includes a development which was under construction at the time and comprises only new sales. Valuer M gave evidence that had both the sales from Company 1, and sales recorded on RPNZ including their understanding of a bulk deal whereby some 30 units were purchased by Company 1 at prices ranging from $350,000 to $370,000. They analysed their sales on an overall per square metre basis.

Valuer M included in their evidence the letter earlier referred to as signed by Valuer 4, dated 8 March 2006. The letter is addressed to potential lenders and is for the same unit valued by Valuer M. Valuer 4, is a registered valuer but did not give evidence. The letter refers to a full report which is not in evidence. Valuer 3 may have been the valuer who undertook the work as he is given as the contact person.

The value recorded in the letter signed by Valuer 4 is $365,000 including carparks and chattels, and inclusive of GST. There is a mortgage recommendation of $240,000, referred to as a two-thirds recommendation, indicating that the realty component of the valuation was $360,000. The Board notes that Valuer M’s valuation of $405,000 is approximately 11% above that figure.

The Board is entitled to take into account any evidence put before it, but the weight given to the evidence will depend on individual circumstances. The extent to which the Board can examine both the written evidence and any witness produced at a hearing are particularly relevant. Also relevant is that the one-page letter states that it: "... should be read in conjunction with the full valuation report ... " and is expressed as "Subject to the conditions noted in the report, ... " and later that "This letter serves to confirm that the addressees named above may rely <u>upon the full valuation report</u>
... ". (underlining by Board)

In the Board's opinion little weight can be placed on that one-page letter when the valuer is not available to be cross-examined and the full valuation report referred to in the letter is not in evidence.

From the opening paragraph of Valuer 4’s letter, it would appear that the full valuation report refers to all of the individual apartment values as separate unit entitlements within the subject development. Very little more can be said other than the Board accepts Counsel's submission that it is entitled to consider Valuer 4’s value within the range of possible values.

Counsel Submissions

At the conclusion of the prosecution's evidence and following cross-examination of Valuer 1 and Valuer 2, the Board received an application for dismissal of charges. The Board here must note that the complaint on the subject property, was heard in conjunction with a separate complaint against Valuer M in relation to a similar property in the surrounding area of the subject property. The Board has prepared a separate decision on that complaint (see Valuer M (hearing) [2010] NZVRB 2).

The Board agreed with Counsel and dismissed charges relating to mortgage recommendations. This matter then proceeded only on the charge relating to a gross over-valuation.

The Board noted that in the application to have charges dismissed the wrong test was applied by Counsel for Valuer M. The law had moved on quite considerably since the tests applied in the matter of *Findlay v. Valuers Board* [unreported Ml71/87 High Court, Auckland] Doogue J. There have been a number of reversals of fortune with respect to the correct test to be applied in professional disciplinary matters. The test is now settled being on the balance of probabilities applied flexibly in accordance with the Supreme Court decision on appeal in the matter of *Z v. Dental Complaints Assessment Committee* SC 22/2007 [2008] NZSC 55.

The Board does not accept Counsel's submissions with respect to Valuer 1’s evidence. Whether or not Valuer 1’s valuation was obtained to support the claim of the complainants in a civil matter is, considered by the Board, irrelevant. Valuer 1 was obliged to prepare a market valuation in accordance with his professional and ethical obligations. Under cross-examination Valuer 1 stated that he was not aware of Valuer M’s assessment and had not seen Valuer M’s valuation or comparative values. Whether or not a valuer had seen the report of another valuer is not solely determinative but may go to weighting depending on such factors as cross-examination and the comparability of market evidence.

The Board does accept, however, that the prosecution should not be referring to valuers' evidence as "check valuations". That term is misleading. They are "retrospective valuations". The Board is mindful of the care with which such valuations should be prepared and the weight to be ascribed to a retrospective assessment of value. In all cases where significant weight is given to retrospective valuations, the valuers are required to give evidence before the Board, are subject to cross-examination by Counsel and often extensive questioning by the Inquiry Board to ensure that the valuations prepared properly reflect, as far as possible, a market value that a valuer should have arrived at had he been undertaking a valuation of the property as at the retrospective date. Frequently, valuers who provide evidence before the Board are selected for their knowledge of a particular market. They research their records to determine how they were judging the market at the time of valuation. The Board is satisfied that both Valuer 2 and Valuer 1 applied themselves correctly to the task.

The Board does not accept that the substantial variation in value between Valuer 2 and Valuer M can be resolved by a consideration of Valuer 4's assessment. The Board notes that on the very limited evidence before it, Valuer M's value was still greater than Valuer 4's by more than 10% and was therefore an outlier.

Counsel sought to rely on the decision in *Gosper and Olsson v. Relicensing (NZ) Limited CP225/96* [98] Mr McGeechan J. That decision (the Fletcher decision) is well known to the Board and does refer to the possibility that values can be as much as 30% apart without one valuation necessarily being wrong.

There are two issues with the Fletcher decision that need to be addressed:

The Board has never accepted a percentage variation as a cut-off point. While noting that in this matter (Valuer 4's assessment excluded) the percentages are greater than 30% apart, each case must be treated on its merits having regard to the state of the market, the complexity of the valuation assignment, the available market evidence and the correct approach to be taken when valuing a property.

The Fletcher decision should also be put into context. Following that decision, the New Zealand Institute of Valuers issued guidance note NZVGN 7. That Guidance Note makes it quite clear that where a new, previously unoccupied property is to be valued and the price may differ from that on a secondary market re-sale, there is an obligation on the valuer to present evidence relating to both assessments if a property is to be used for mortgage finance security purposes. The variation that may occur as a result of considering different market evidence would assist the mortgagee in determining a safe lending margin.

Decision

On the evidence before the Board, referring firstly to "off-the-plans" sales, Valuer M over-valued the subject property. In the Board's opinion, that over-valuation was not less than 15%. The Board has reached that conclusion by comparing Valuer M's valuation in March 2006 with those of the two valuers who gave evidence and were cross-examined.

Valuer 2 in his report stated that based on new sales the value would be between $330,000 and $350,000. At the upper end of the range, Valuer M’s assessment is 15.7% higher than the best figure that Valuer 2 would place on the property.

Valuer 1 did not express an opinion by relationship only to new sales. By comparison with the sales evidence, he concluded a range between $270,000 (after a typo in the report was corrected) and $347,500, but that of course was after a fall in the market in April 2008. Paradoxically, although his valuation in March 2006 was higher than his April 2008 value, Valuer 1 referred to a range of sales from $237,000 to $335,000 for comparable properties as of March 2006. Using the upper limit of that range as a comparison, there is a variation between Valuer 1 and Valuer M of 20.9%.

Valuer 1 relied principally on re-sales in fixing his value level at $285,000 in March 2006 and on the same basis Valuer 2 concluded a value of $300,000. That is what each believed a "willing buyer and willing seller" transaction would give rise to and their figures are close to one another.

The range in valuations between their figures and those of Valuer M is significant with the retrospective valuations showing variations from Valuer M of 39.58% and 33.9%.

Valuer M gave evidence that they did take into account re-sales, and their report states that they prepared their valuation conforming to Practice Standards. Nowhere in the report is it evident that Valuer M took into account NZVGN 7 or its successor NZVGN 4, although the report does refer to Practice Standards Nos. 1 & 2 of the New Zealand Property Institute (presumably they meant New Zealand Institute of Valuers). The report and valuation were deficient for the purpose of a mortgage security valuation over an apartment subject to leasehold tenure.

NZVGN 7 was prepared by the New Zealand Institute of Values (NZIV) to address the disparity in figures that can occur in a market when properties are packaged and sold as new houses and then, when they appear on the open market having been lived in or not as the case may be, will only sell at a significantly lower value on re-sale.

NZVGN 7 refers to houses. 'House' is defined in the Concise Oxford Dictionary as: "Building for human habitation or occupation" a definition that includes the concept of an apartment. The term apartment is not as consistently or well defined but includes a room or suite of rooms either as part of a residence or in a building occupied by more than one household. In the Board's opinion NZVGN 7 applies to apartments in the same manner as it applies to single household units.

The sale of new off-the-plans apartments by direct selling with the equivalent of pre- arranged finance is no different in concept to the sales of new houses as a pre- arranged finance package deal. The deals contain the same or similar components that, in the Board's opinion, are unlikely to comply with a market value definition and need to be tested against re-sales. Therefore, valuations that do not make clear a distinction (where it occurs) between the value of new, previously unoccupied apartments and re-sales on the open market of apartments whether lived in or not, could expose an owner and/or a lender to a loss. Apartments fall within the ambit of NZVGN 7 and its successor NZVGN 4.

The Board has concluded based on the evidence before it that Valuer M did prepare a valuation of the subject property that was grossly excessive.

Sanctions

The Board is required to adopt a two-step process in accordance with the decision in "*Z*" referred to in the *King* Decision, which is a December 2009 decision on appeal by the Valuers Board of Appeal in the matter of Jeremy David Allen King and the Valuer General.

The process that the Board is required to adopt is:

1. Whether the matters alleged in the disciplinary charges had been established to the point that there was a departure from acceptable standards; and then quite separately –
2. Whether that departure was significant enough to warrant a disciplinary sanction.

The judgement in "*Z*" requires a balance of probabilities "flexible" approach. The appeal decision in *King* required the Board to consider the consequences of the departure from standards. The consequences the Board must consider are not necessarily those of potential loss suffered, which may or may not be relevant even if they do occur but, and more importantly, the consequences of a valuer applying an incorrect methodology and ignoring standards. In this case Valuer M ignored NZVGN 7 and either ignored or minimised the impact of the leasehold tenure of land on the value of the interest to be valued.

Following the collapse of Company 1 and other financial organisations, many investors in apartments who had borrowed against their personal property and the apartment they were buying, lost heavily. In some cases, they lost their life savings.

It is well known that during the period 2005 - 2006, investors were attracted to buy Company 1 investments using high pressure marketing strategies that often involved mortgaging their own home to buy a unit based on a guaranteed rental that applied for a limited period of time. There were potential tax savings that could be obtained, and investors were hoping for a capital gain. The Company 1 schemes in general were risky, but were particularly so for leasehold apartment properties where the purchaser never owns the land and would always be obliged to pay a ground rental, a cost that would be deducted from any rental income derived by letting the apartment and would likely increase on review, further reducing the apartment owners ability to achieve a net income and retain equity in the property.

On the evidence the Board heard, many market investors at the time were naive. Valuer M, however, should have appreciated the implication of their method of valuing, which was principally by comparison with a large body of new apartment off-the- plans sales. A consideration of the re-sale market was particularly relevant and any variation between the two markets required Valuer M to report the difference to inform a recipient of the report. Valuer M did not undertake that task if they even considered the sales disparity. Valuer M’s report therefore left any purchaser and/or lender uninformed and exposed to a loss on resale.

Valuer M considered themselves an expert in the apartment market. They stressed in their evidence that they had taken a particular interest in valuing and advising on inner and fringe city apartments and had a significant role in advising and valuing apartments both in the CBD and the fringe over a 12-year time span. Of concern is their statement that they have valued the majority of the subject area’s inner city apartment buildings for a variety of reasons including finance. To ignore in their valuation the implication of a lease at a below market rental could only compound the reliance their report places on new off-the-plans sales.

In the Board's opinion Valuer M should have realised the dangers of placing a grossly excessive valuation on a leasehold apartment in a heated investment market and at the very least warned the reader accordingly.

In the Board's opinion, Valuer M’s actions did carry with them the potential for serious consequences and a sanction is appropriate.

The Board finds the charge proven against Valuer M of preparing a grossly excessive valuation of the subject property and invites submissions as to penalty.

The Board notes in the submissions of Counsel for Valuer M that Valuer M be entitled to present evidence before the Board in mitigation, in person, and therefore directs that Counsel discuss with the

Board whether submissions will be on the papers, or before the Board. The timeframe for consideration is one month from the date of this decision.

Evan Gamby

Inquiry Chairperson
20 March 2010