IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

AP.35/96 (Rotorua)

UNDER	the Valuation of Land Act 1951
BETWEEN	FLETCHER CHALLENGE FORESTS LIMITED
	Appellant
AND	THE VALUER-GENERAL
	Respondent

Hearing: 2 July 1998

Counsel: M. E. Casey for Appellant
M. T. Parker for Respondent

Judgment: 25 AUG 1998

JUDGMENT (No.2) OF SALMON, J.
AND J. P. LARMER

Solicitors: Kensington Swan, DX CP 22001, Auckland, for Appellant
Crown Law Office, Wellington for Respondent

Background

By a judgment dated 17 December 1996 we upheld in part an appeal by Fletcher Challenge Forests Ltd against a decision of the Waikato No.2 Land Valuation Tribunal. The appellant appealed that decision and the appeal was the subject of a judgment of the Court of Appeal dated 29 September 1997. The appeal was allowed and certain matters were referred back to us for reconsideration. Our earlier judgment which had assessed the value of the Tahorakuri Forest at $15,200,000 was set aside. In this judgment we will reassess the value of the forest in the light of the findings we make on the matters referred back to us by the Court of Appeal. We have heard argument from counsel in relation to those matters.

There were four issues referred back. They are:

1. The appropriate adjustment to be made for pre-plant costs.
2. The appropriate adjustment, if any, to be made in respect of lot size.
3. The appropriate adjustment, if any, to be made in relation to market conditions.
4. The appropriate adjustment to be made in respect of land contour classification.

A further issue which was the subject of submission before us was the order in which the adjustments should be made. We intend to consider

that issue first and then to deal with the other matters in the appropriate order.

The order in which the various adjustments (if allowed) should be made

The parties accept that the starting figure for the valuation of the Tahorakuri Forest is $1,750 per hectare. The parties are agreed that the appropriate method of valuing the forest is to value equivalent pastoral land and to make the necessary adjustments needed to allow for the fact that the land is used for forest. The figure of $1,750 per hectare is one which the parties agree is an appropriate per hectare value for a block of pastoral land of less than 500 hectares. The adjustments proposed by the appellant are for fertility, lot size, market considerations and pre-plant difference. The first adjustment to be made should be that for lot size (if indeed it is appropriate to make an adjustment under that head). The lot size adjustment is a two-step process. The first step is to determine whether or not the market pays a premium for smaller blocks of pastoral land as compared with larger blocks and to assess the relevance of that to the value of this large block. The second step involves an inquiry into what adjustments in either direction should take place because the subject land is in reality forestry land.

In our view the next adjustment that should be made is one for market conditions. The appellant's argument is that there should be an adjustment to reflect the fact that in 1992 there was a firm market for

pastoral land, whereas the market for forestry land was slack. Such an adjustment, if it is to be made, would recognise that the value of pastoral land for forestry purposes at that time was less than it was for pastoral purposes.

Once the above two adjustments have been made the resulting per hectare value will be one that reflects the size of the block and the market conditions prevailing in 1992. It is then necessary to make the agreed adjustment for fertility value. The Land Valuation Tribunal reduced the per hectare value that it considered otherwise appropriate by 20 per cent in order to reflect the fact that in general the fertility of pastoral land as a result of the farming practices applied to it is higher than that of forestry land. Consequently, pastoral land converted to forestry may grow trees more rapidly than land like the subject land which has never been farmed. There was no appeal against the Tribunal's finding in relation to fertility value.

The final adjustment to be made is the pre-plant difference. This is an adjustment to recognise the difference in the costs involved in planting land already used for forestry as compared with the costs of planting pastoral land. The purpose of these adjustments is to arrive at a figure which will represent the per hectare value, which would be paid by a willing purchaser for forestry land but, excluding the value of any trees on that land.

Lot Size

In our original judgment we noted that there was agreement that in the case of pastoral land the value per hectare could be expected to decline as the size of the property increased. The appellant's valuer considered that there should be a 20 per cent reduction on account of the impact of size. The valuers called by the respondent noted that factors which reduced the per hectare value in the case of large blocks included location, topography and stock carrying capacity. Those valuers also concluded that the decline in per hectare value that applied for pastoral land did not apply to forestry land. In our earlier judgment we noted that the Land Valuation Tribunal had concluded that the weight of the evidence was against the contention that there should be a discount for size and we agreed with that conclusion.

The Court of Appeal after noting the appellant's complaint that no adjustment for size had been made when the value of the land as pastoral land was assessed went on to say:

> "We consider that Fletcher Forests' complaint has validity. The Valuer-General has not followed his adopted methodology consistently in this respect. The block being valued is at step one deemed to be pastoral land. It must be deemed to be a single block of pastoral land comprising 11,874 hectares in its actual location. The value of adjacent pastoral land can properly be used in order to fix the value of the subject block as pastoral land, but as the adjacent land contains the premium (for its smaller size) which does not apply to the subject land (because of its larger size) the premium must be excluded when valuing the subject land as pastoral land. Step two involves an enquiry into what adjustments (in either direction) should take place because the subject land is in reality forestry land. At step two, questions of economies of scale in relation to forestry operations and whether the earlier writing out of the premium should be adjusted, because of conditions in the forestry market, will require consideration. It is possible that the same overall result as that reached in the High Court might be reached by the proper application of steps one and two, but we cannot be confident that this will necessarily be so. The matter should be examined on the correct basis."

It will be noted that what is required is a two step approach. The first step is to determine the pastoral land value of a block the size of the Tahorakuri Forest excluding any premium for smaller size included in the agreed pre hectare pastoral land value of $1,750. As we recorded in our earlier judgment all valuer witnesses agreed that in the case of pastoral land there was a reduction in per hectare value for large blocks as compared with smaller blocks. It was acknowledged that the $1,750 per hectare figure represented a per hectare value appropriate for a smaller block, that is to say, one of under 500 hectares.

There was a considerable amount of evidence before the Committee and on appeal before this Court. Unfortunately, most of that evidence related to sales in the South Island and on the East Coast of the North Island, rather than in the vicinity of the subject land.

The principal valuation evidence for the appellant was given by Mr H. H. Reynolds, who has experience in the valuing of forest lands. He reached the conclusion that there was no authoritative data enabling a valuer to say with confidence how much the unit rate per hectare should decline for parcels of land the size of Tahorakuri. He noted that in the 1970s a study concluded that large scale forestry should have lower direct costs but did not consider those conclusions to be applicable in 1992. He concluded that in the absence of authoritative writings relating to size and economies of scale it was necessary to rely upon market evidence in order

to quantify the impact of size. The only market evidence available was that in relation to sales of pastoral land. He acknowledged that the 16 pastoral sales he analysed in Taupo County indicated a limited sensitivity to size but found much greater evidence of such an impact in the larger data bases available relating to sales of pastoral blocks in the East Coast of the North Island and in the South Island. He placed greater emphasis on the trend lines evidenced by the East Coast sales because those properties did not exhibit the extremes of physical characteristics found in the South Island and were within closer proximity to the Bay of Plenty. He also considered an analysis of the Wenita Crown Forest Licence negotiations and a hypothetical subdivisional approach. He concluded that the East Coast sales showed a 36 per cent difference between areas of 500 hectares and those in excess of 1,000 hectares, that the Wenita negotiations indicated a 22 to 24 per cent reduction in relation to larger blocks and that the hypothetical subdivision approach indicated a 32 per cent discount between the value of the large block and the values of the subdivided blocks. He adopted a 20 per cent reduction which he said acknowledged the benefits that might arise from a large contiguous area.

He acknowledged that there were a variety of factors other than size which could account for the difference in value between large and small blocks. These included locality, topography, soil type, altitude and climatic factors. An illustration of the wide variations in per hectare value resulting from these factors was noted by Mr Parker in his submission where he

compared three sales in Gisborne, each of around 600 hectares with values ranging from $477 per hectare to $1,338 per hectare.

In cross-examination Mr Reynolds was asked whether he would accept that as a general proposition larger farming properties tended to be in more marginal or less favourable country and have a lesser stock carrying capacity than smaller properties. He acknowledged that in general that was fair comment and that for that reason he had disregarded the South Island sales. He also acknowledged that a decline in value was not always apparent and gave the Emerald Hills Pakata Forest Enterprises Ltd sale near Gisborne as an example, but concluded that one should look at the trend lines in the big picture and not at the small picture.

It is our view that little weight can be placed upon Wenita because it was a negotiated settlement in relation to Crown forest licence fees. We also note that Mr Reynolds had no personal involvement in that matter.

As to the hypothetical subdivisional budget, such budgets are very sensitive to the assumptions made. Particular assumptions in that budget which have an important impact on the result are that a subdivider would require a 15 per cent allowance for profit and risk and interest on his outlay.

Witnesses for the respondent whilst generally acknowledging that the evidence suggested that some adjustments should be made, did not

agree that it should be as large as that proposed by Mr Reynolds. Indeed, one of the respondent's witnesses, Mr Armstrong, referred to an analysis that had been undertaken, which indicated that there was no significant discount for size and that differences in the per hectare value of small as compared with large lots related to factors of productivity, location and contour. That study related to the purchase of both forest land and pastoral land purchased for forestry use.

As we have said, so far as pastoral land is concerned there was substantial agreement that in 1992 the market did recognise the existence of a discount in relation to large blocks (or as the Court of Appeal put it, a premium for smaller size). The only witness who attempted to quantify that difference was Mr Reynolds. In making his assessment he acknowledged the difficulties that arose because of the impossibility of identifying and appropriately measuring all the variables referred to above. In the end it is a matter of judgment.

For the respondent, Mr Parker argued that the reduction in price per hectare shown in respect of the East Coast and South Island properties was meaningless without any further knowledge of the properties and the reason for the difference in sale prices. He submitted that a close analysis of the schedules of sales shows that there is no clear pattern.

As to the evidence relating to the Wenita negotiation, Mr Parker referred to evidence called on behalf of the respondent which challenged that given by Mr Reynolds. Witnesses for the respondent, who were actually involved in the negotiations, gave evidence that a discount for size was never a consideration.

Mr Parker's criticisms are valid, but we are left with the fact that there was general acknowledgement of a reduction in value due to size alone. We accept, however, that the difficulties in assessing the extent of that reduction, given the number of variables, are considerable.

Our judgment is that Mr Reynolds did not make a sufficient allowance for the difficulties associated with comparing the value of large and small blocks. For present purposes those difficulties include not only the matters referred to above, but the further difficulty of applying East Coast values to central North Island land.

The uncertainties inherent in making an assessment as to the extent of the discount to be applied to large areas of pastoral land require that a conservative approach be taken so that there is an adequate margin for error. We acknowledge that Mr Reynolds approached the matter on this basis. However, it is our judgment that a figure of 15 per cent would make a more appropriate allowance for the uncertainties we have identified rather than the figure of 20 per cent adopted by Mr Reynolds. If, therefore, we

were valuing the land just as pastoral land we would apply a 15 per cent reduction to the figure of $1,750 in order to reflect the large size of the subject land.

Step two involves an assessment of what adjustments (in either direction) should take place because the subject land is in reality forestry land. At this stage we exclude any consideration of market conditions which will be dealt with separately. As the Court of Appeal has noted, in this step questions of economy of scale in relation to forestry operations will be relevant.

It is obvious that if a forester is purchasing pastoral land he will expect to pay the market price. If because of the size of the block that price reflected a per hectare discount in relation to smaller areas of land, the purchaser would expect to obtain the benefit of that discount. However, it is not pastoral land which is being considered here but land already planted in forest. The potential purchasers of this land are large investment companies and large forestry companies. The market is an international one and is very different to that which would exist in the case of the sale of pastoral land.

The principal witness for the appellant on this topic was Mr B. C. Johnson, who is employed by the appellant as investment manager of the manufacturing division. In his evidence he addresses the economies of scale

arguments presented by Mr Buckleigh, for the respondent, and concludes that any economies of scale relate not to forest size, but to the size of the operation of the forest owner. He did, however, produce an exhibit which showed that in the years 1991 and 1992 there was a reduction in business overheads associated with larger forest holdings, although that reduction disappeared in the subsequent two years.

The appellant maintained that the reduction in per hectare value apparent in the case of the sales of large pastoral blocks should also apply to the sale of blocks of forestry land.

The unanimous and unequivocal evidence of several witnesses called for the Valuer-General is that there would be no discount for size in relation to a large block of forest land. The witnesses who expressed this view included Mr D. J. Armstrong and Mr P. Tierney, both of whom were subpoenaed by the Valuer-General. Both of these witnesses are valuers with considerable experience in forestry valuation. Mr Armstrong whilst acknowledging that traditionally in the case of pastoral land the larger the property the lesser the per hectare rate, said that he had investigated forest land sales and had concluded that the same discount factor did not apply.

On the same topic Mr Tierney said:

> "If you undertook a valuation for a forestry company of a range of properties from 1,000 up to 49,000 hectares the rationalisation for a reduction for size is completely erroneous. The foresters would tell you that their most valuable properties are those that are not small and scattered but are those that are large,

> compact and easily administered. So in all these areas I developed a valuation style that made no allowance for size either up or down."

Mr Buckleigh, who gave evidence on behalf of the respondent, is with the forest industry advisory firm of D. A. Neilson and Associates. He emphasised the key locational factors enjoyed by the appellant and other major forest owners in the central North Island, including the heavy transport industry, the co-operation between owners in the protection of forests from fire and disease, lower costs because of economies of scale, flat terrain, pumice soil, the extensive road and rail infra-structure, and the firstclass regional infra-structure and concludes that the attributes and location of the plantation forests in the central North Island make the region relatively unique in the world for fast growing soft-woods.

A comparison which he made of regional potential for plantation forestry showed low land availability in the Bay of Plenty, high competition for that land and very high land price compared with other areas of New Zealand. He noted that the Tahorakuri Forest provides the benefits of predominantly flat to undulating contour, which minimises logging costs, close proximity to numerous wood processing plants and a major export port, a very good growing site by international standards, and a remarkably high percentage of productive land. All these factors, he said, maximise the value of the trees and land for an 11,874 hectare forest in an area of relatively small holdings.

It seems to us that these locational factors are of considerable significance and support the evidence of Mr Armstrong and Mr Tierney. Mr Buckleigh's evidence then dealt with what he considered were economies of scale arising from large blocks of forestry land. In respect of that part of his evidence we think that there is validity in Mr Casey's criticism that the matters identified as conferring economies of scale relate not to the area of land, but to the size of the operation of the forest owner. We do, however, conclude that there are some benefits derived from the ownership of a large contiguous area of forestry land compared with a number of smaller non-contiguous blocks.

Mr Buckleigh also referred to the market for forestry land. He identified as potential purchasers not only large forestry companies but also institutional investors from North America and Europe.

He concluded that:

> "The relative scarcity of larger forest estates on the market in New Zealand and the propensity of international investors to seek larger opportunities it would be difficult to conclude that a discount for forest land value based on scale should apply.[sic] There may be evidence that in fact premiums might apply for medium/large scale existing plantation forest estates generated by an increasingly active international investor base."

He produced a table which shows that the land component of a forest represents 7.8 per cent of the total land and forest package and said:

> "We believe that in a competitive bidding situation major international companies and/or pension fund insurance groups would be less likely to discount the relatively minor land value component and risk losing a bid."

His conclusion was that:

> "Against this background and the increasing interest being shown in plantation forests in New Zealand it is most unlikely that there would be a discount for scale in the sale of forests or forest land in the central North Island.
>
> In my opinion if an 11,000 hectare forest such as Tahorakura was put up for sale a premium for the size of the property would apply rather than a discount."

We have concluded that the evidence overwhelmingly supports the proposition that in respect of forest land, it is not appropriate to provide a discounted per hectare rate for an area of land the size of the Tahorakuri Forest.

This too was the conclusion of the Land Valuation Tribunal who had the advantage of seeing and hearing the witnesses as they gave their evidence. With that advantage the Tribunal concluded:

> "After considering all of the evidence we find the weight of the evidence opposing the objector's contention draws us to the conclusion that the case for a reduction on account of size is not established."

We conclude, therefore, that the discount that would apply in the pastoral market would not apply in the forestry market. Indeed, some of the evidence called for the respondent would suggest that in the forestry market a premium would be paid for size but considering the totality of the evidence it is our judgment that the appropriate conclusion is that in the forestry market the 15 per cent discount appropriate in the pastoral market would be

off-set by factors relevant to the forestry market and that it is appropriate that no discount for size be made.

Market Conditions

In our earlier judgment we concluded that the evidence was that while in the pastoral sector land prices had risen significantly in the period leading up to October 1992, the factors driving those prices were not evident in the forestry sector. We expressed the view that the evidence did not enable us to assess an allowance for this factor.

The Court of Appeal has pointed out that:

> "Simply because a factor relevant to a valuation cannot be quantified by evidence does not mean that it should not be taken into account. The weakness or otherwise of the market must be a factor bearing on the price likely to be asked and paid for the subjectmatter. Assessing the impact of such a factor is a matter of judgment rather than calculation. It is a judgment which a valuer must bring to bear. The fact that any allowance to be made for the state of the market cannot be defined or justified by formula, calculation or other convenient touchstone does not make the factor any less real. An informed judgment is what is required."

We have reconsidered this issue. The Valuer-General has asked that we take the following matters into account.

1. That a purchaser of Tahorakuri would be buying a complete forest with an immediate cashflow. We accept that this is so but, of course, the purchaser would pay for the trees which would result in that cashflow.

2. The Valuer-General asks us to accept that because foresters were not buying pastoral land for conversion to forestry did not necessarily mean

that the forestry sector was not able to compete with the pastoral sector. Mr Parker pointed to evidence that showed that plantings increased substantially in 1992.

We acknowledge that at the relevant time there were special factors affecting the forest industry, including the rationalisation arising from large scale purchases of Crown forest licences one or two years earlier. However, as we found in our earlier judgment, we accept that there was in 1992 a buoyancy in pastoral land sales not evident in forestry land sales. We have concluded that the allowance of five per cent proposed by the appellant is a reasonable allowance to make to recognise this factor.

Adjustment for Pre-Plant Costs

In our previous decision we made an adjustment of $50. This has been criticised by the Court of Appeal on two grounds. First, that we made that adjustment on the assumption that the pre plant costs in relation to an established forest were tax deductible, whereas, those for a forest being created on pastoral land had to be capitalised. The Court of Appeal has held that that is wrong, that in both cases the costs have to be capitalised. The second criticism was that there was no discussion as to how the figure of $50 was arrived at.

Mr Casey in his argument has pointed out that there has been no challenge from the Valuer-General to the figure of $156 per hectare,

adopted as the difference in pre plant costs between forest land and pastoral land. This appears to be so.

In his submissions Mr Parker did not attempt to challenge the calculations used by the appellant to arrive at the $156 figure. Mr Parker's argument was that the evidence does not necessarily justify an assumption that a forestry purchaser would take these costs into account in arriving at a land price. He referred to a letter written on behalf of the appellant (Exhibit E) in response to a request on behalf of Valuation New Zealand for average or estimates costs including costs relating to replanting. In its response Tasman Forestry said:

> "... the relevance of our costs to fixing regional land values or in fact establishing the economic earnings rate of a forest would not be critical."

The company declined to provide the information requested. Nevertheless, the evidence produced for the hearing before the Land Valuation Tribunal, to which Valuation New Zealand had the opportunity to respond, very clearly relied upon pre plant costs as an important factor in the conclusions reached as to the appropriate valuation of the land.

Mr Parker pointed to other evidence which suggested that the value of the land was not an important factor in forestry economics. Whether or not this is so, our task is to fix the value of the land and to do so in the manner which both parties to these proceedings acknowledges was appropriate, that is to say, by starting with the value of pastoral land and

making necessary adjustments to arrive at a value for forestry land. This approach is necessary because there are no sales of established forestry land which would enable an assessment to be made of land value.

We have revisited the evidence and the assumptions and calculations undertaken on behalf of the appellant. The basis of calculation is open to the criticism that it relies on actual costs and tree age information which it is unlikely that a prospective purchaser would have. Nevertheless, in the absence of any challenge from the Valuer-General we see no reason to adopt a figure other than that proposed by the appellant, that is to say, $156 per hectare as the difference in pre plant costs between an area of pastoral land and an area of existing forest land.

Although appropriate for Tahorakuri on the evidence adduced by Mr Reynolds, we would point out that the allowance for this adjustment will necessarily vary from forest block to forest block. That is, the contribution to land value made by the pastoral condition, as well as being affected by fertility and cover (including weed and reversion status) will vary relative to perceived pre-plant cost advantages. Where there are clear cost savings the adjustment from actual pastoral land state to assumed land forest state may be significant; where the distinction between the two states does not result in demonstrable pre-plant or weed control costs savings, then the adjustment may be minimal or even non existent. In our view the evidence accepted in this case should not lead to the conclusion that all pastoral land

sales used for forest land comparisons should be adjusted in the same manner and case by case consideration of each of the factors affecting land value is required.

Land Contour Classification

The final issue for determination is the appropriate percentage reduction to apply to the skidder base in relation to land of tractor contour and hauler contour respectively.

The parties agreed that the appropriate percentage reductions were 17 per cent in respect of tractor contour and 40 per cent in hauler contour and those are the percentages that we adopt.

The effect of this judgment is that the resulting value per hectare for skidder contour is as follows.

Base value for pastoral land	$1,750.00
Deduction for market considerations 5%	$1,662.50
Less Fertility adjustment 20%	$1,330.00
Less pre plant difference - $156.00	$1,174.00

The land value is therefore -

Skidder 9,334 hectares @ $1,174	$10,958,116.00
Tractor 1,926 hectares @ $974	$1,875,924.00
Hauler 269 hectares @ $704	$189,376.00
Reserves 346 hectares @ $100	$34,600.00

Total	**$13,058,016.00**
Say	$13,058,000.00

As previously, costs are reserved. Submissions may be made in writing should costs be sought.