IN THE SUPREME COURT OF NEW ZEALAND

SC 4/2011
[2011] NZSC 135

BETWEEN	LISA MARIE COLLEEN MANDIC AND STEPHEN NEIL DOHNT Appellants
AND	THE CORNWALL PARK TRUST BOARD (INC) Respondent

Hearing: 23 June 2011

Court: Elias CJ, Blanchard, Tipping, McGrath and William Young JJ

Counsel: E St John and K M Quinn for Appellants
M E Casey QC, J K MacRae and A F Buchanan for Respondent

Judgment: 11 November 2011

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellants are to pay the respondent costs of $15,000 and reasonable disbursements in connection with this appeal, as fixed by the Registrar if necessary.

REASONS

ELIAS CJ

[1] The appeal concerns the correct application of the rent-setting provision on renewal at 21-year intervals of a perpetual lease first granted by the Cornwall Park

Trust Board as lessor in 1910. The lease restricts use of the land contained in the lease to a single dwelling, unless the lessor waives the restriction at the request of the lessee.[1] Upon expiry of each 21-year term the lessee has the right to accept a renewed lease on the same covenants and provisions and on the basis of an annual rental of five per cent "on the gross value of the land after deducting therefrom the value of the substantial improvements of a permanent character".[2] The gross value of the land and the value of the permanent improvements are as established by separate valuers for the parties and an umpire, according to the method specified in cl 13(b) of the lease agreement:

> (b) ... two separate valuations shall be made namely a valuation of the then gross value of the fee simple of the land then included in the lease and also a valuation of all substantial improvements of a permanent character made or acquired by the Lessee and then in existence on the land.

[2] The lessees applied to the High Court for declarations that the effect of cl 13 of the lease is to arrive at a residual value for the land (to which the annual rental of five per cent applies) either as actually occupied by existing improvements on the land or on the basis of its use for a single dwelling. The lessor contended, rather, that the residual value specified by cl 13 is the unimproved value of the bare land according to its highest and best use, unconstrained by either existing development on the land or by the restriction on its use contained in the lease (although the restrictions in the lease had been taken into account by its valuers in previous rental reviews). Courtney J in the High Court found in favour of the lessor.[3] The Court of Appeal dismissed an appeal by the lessees.[4] On further appeal to this Court, the lessees argue that the residual value specified in cl 13 must take into account the existing development on the land and the restriction on its use contained in the lease. They also criticise the methodology adopted by the valuers for the lessor, which they say wrongly attempts a valuation of the land as if unimproved, rather than following the approach required by the lease of deducting the value of improvements from the gross value of the land to reach the residual value on which rent is set.

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1 See cl 4 of the lease. Other restrictions to residential use are contained in cl 9, but it is not necessary to refer specifically to them.

2 Clause 13(h).

3 *Mandic v Cornwall Park Trust Board* (2009) 10 NZCPR 790 (HC).

4 *Mandic v Cornwall Park Trust Board Inc* [2010] NZCA 576, (2010) 12 NZCPR 34.

[3] I have had the advantage of reading in draft the reasons of William Young J. I agree with his conclusions that the appeal does not turn on the approach taken to valuation, if the prescribed formula is fulfilled. I agree also with William Young J's conclusions that existing development of each site does not constrain the gross value of the fee simple or the residual value reached when the value of improvements is deducted from the gross value. I differ from the reasons given by the other members of the Court, however, in taking the view that the restriction on the use of the land contained in the lease is a relevant consideration in fixing the gross value of the fee simple of the land and the residual value reached after deduction of the value of improvements. The agreement between the parties to the lease that use of the land is restricted to a single dwelling is the context in which the rent-setting provisions are to be interpreted. I do not agree that the reasoning in *Cox v Public Trustee*[5] suggests that such restriction is properly to be treated as irrelevant to the valuation. I explain why I reach these conclusions in what follows.

[4] First, however, it is necessary to express disagreement with views expressed in the Court of Appeal about the jurisdiction under the Declaratory Judgments Act 1908.[6] Although its observations were not, in the end, material to the outcome there and do not affect the appeal to this Court, they may create difficulties in application of the Act in future cases if not corrected.

The jurisdiction under the Declaratory Judgments Act 1908

[5] The case came before the High Court on application by the lessees for declaratory judgment under s 3 of the Declaratory Judgments Act. The lessor, while opposing the interpretation contended for by the lessees, did not object to the form of the proceedings in the High Court or in the Court of Appeal. Despite that, and although it dealt with the substantive points of interpretation, the Court of Appeal prefaced its determination with observations about the scope of the jurisdiction under the Declaratory Judgements Act, suggesting that it was one of "limited availability".[7] The Court of Appeal considered that an applicant for declaratory judgment would

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5 *Cox v Public Trustee* [1918] NZLR 95 (SC).
6 At [12]–[19].
7 At [12].

normally have to "establish the existence of a genuine dispute or a lis" and overcome the "threshold" of being able to point to "an actual controversy between the parties which cannot be more appropriately determined in another forum, such as by arbitration".[8] Its subsequent separate discussion of discretion indicates that the Court was not simply emphasising the discretionary nature of the jurisdiction[9] or that application for declaratory order is inappropriate when there are questions of fact to be determined (as is implicit in the terms of s 3). Rather, it seems to have been suggesting a narrower jurisdiction than is suggested by the language of s 3 of the Declaratory Judgments Act.

[6] The only threshold prescribed by s 3 is that the person applying:

> ... has done or desires to do any act the validity, legality, or effect of which depends on the construction or validity of any statute, or any regulation made by the Governor-General in Council under statutory authority, or any bylaw made by a local authority, or any deed, will, or document of title, or any agreement made or evidenced by writing, or any memorandum or articles of association of any company or body corporate, or any instrument prescribing the powers of any company or body corporate; or
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> ... claims to have acquired any right under any such statute, regulation, bylaw, deed, will, document of title, agreement, memorandum, articles, or instrument, or to be in any other manner interested in the construction or validity thereof ...

[7] Where that threshold requirement is met (as it is in the present case of dispute about the meaning of a lease agreement):

> ... such person may apply to the High Court by originating summons ... for a declaratory order determining any question as to the construction or validity or such statute, regulation, bylaw, deed, will, document of title, agreement, memorandum, articles, or instrument, or of any part thereof.

[8] Declaratory judgments are available to make "binding declarations of right" whether or not "any consequential relief is or could be claimed".[10] The effect of a declaratory order is to the same effect "as the like declaration in a judgment in an action". It is binding "on the person making the application and on all persons on whom the summons has been served, and on all other persons who would have been bound by the said declaration if the proceedings wherein the declaration is made had

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8 At [13].
9 Stipulated in s 10 of the Act.
10 Section 2.

been an action".[11] A declaratory judgment may be given "by way of anticipation with respect to any act not yet done or any event which has not yet happened".[12] The High Court may direct service of the summons on such persons as it thinks fit, to ensure that any person affected has notice and may take part in the determination.[13]

[9] The jurisdiction under the Declaratory Judgments Act enables anyone whose conduct or rights depend on the effect or meaning of an instrument, including an agreement, to obtain an authoritative ruling. In New Zealand, questions concerning the interpretation of rental review provisions of leases have often been addressed under the provisions of the Declaratory Judgments Act, as is illustrated by *The Drapery and General Importing Co of New Zealand (Ltd) v The Mayor of Wellington*.[14] Access to the jurisdiction does not depend on there being an existing dispute. Nor is it necessary that there be a lis. It is desirable to express this disagreement with the reasons of the Court of Appeal although, in the event, the approach it adopted is not material to the determination of the appeal.

Approach to valuation

[10] The residual value of the land to which the rental formula applies is obtained by deducting from the then gross value of the fee simple the value of the "substantial improvements of a permanent character", as cl 13(h) of the lease provides. As the word "improvements" indicates, the calculation is of value *added* to the land, assessed at the date of valuation. It is only the improvements made by the lessee or to which he has succeeded (not value arising from other causes intrinsic or extrinsic to the land) that are to be deducted, and only to the extent that they continue to add to the gross value of the land at the date of valuation. The appellants criticise the methodology followed by the valuers for the lessor. They say that it does not follow the sequence provided for in cl 13(h) but, rather, proceeds on the erroneous

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11 Section 4.
12 Section 9.
13 Section 5.
14 *The Drapery and General Importing Co of New Zealand (Ltd) v The Mayor of Wellington* [1912] NZLR 598 (CA).

assumption "that the residual value is for all intents and purposes equivalent to the unimproved value of the land".

[11] I do not consider that the appeal turns on the approach taken. I agree with the views expressed by William Young J at [60] to [69] that it does not much matter how the valuation is approached, as long as it results in a residual value that is the gross value of the fee simple (land plus improvements) less the value of the improvements. In cases where the existing development on the land fulfils its potential and is "highest and best" use, improvements may properly be valued on current depreciated cost and then deducted from a capital value reached perhaps after comparing sales of comparable properties. But in many cases, especially when it is necessary to consider potential value in the land not achieved by its existing development, valuers may find it necessary or helpful to attempt assessment of the value of the land as if unimproved in order to determine or to provide a cross-check for both the gross value of the fee simple and the value added by the improvements (as may be arrived at through deducting the unimproved value from the gross value). Such an approach is not impermissible simply because it may entail starting with an assessment of unimproved value (the residual value which is also the end of the exercise) if in the end it also yields appropriate valuations of the gross value of the land (land plus improvements) and the improvements, as the lease envisages. As Hosking J said of a similar rent review provision in *Thomas v Valuer-General*, "[i]f the result is right, does it matter whether [the valuer] adds from the top or the bottom?"[15]

Treatment of existing development on the land

[12] It is possible in the case of valuable land that a building on the land may add no value. More commonly, escalating land values may reduce the proportion of the gross value of the fee simple attributable to the improvements. To the extent that the lessees seek to avoid this "squeeze" of their interests, and the associated increase in rent resulting from the higher value attributable to the land, I agree with the conclusion of William Young J that the effect is inherent in the rental provided for in

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15 *Thomas v Valuer-General* [1918] NZLR 164 at 175–176.

the lease. The gross value of the fee simple includes any development potential in the land and is not constrained by the existing development in existence. If the existing development on the land is not "highest and best use" of the land, the value of the potential is captured in the residual value of the land once the value added by improvements is deducted. The scheme of the rental review provisions is that the lessor obtains the benefit of increase in value of the land.

[13] I therefore do not accept the arguments advanced by the appellants that the valuation of the fee simple under the rent-setting formula in the lease is "burdened" by the existing development. The High Court and Court of Appeal were right in my view to reject the contention that the gross value of the land is limited by the existing development on it, denying any development potential where the existing development is not "highest and best use".[16] As I explain in what follows, however, the highest and best use of the land is constrained not only by external restrictions (such as zoning restrictions imposed by territorial authorities) but by the restriction as to use imposed by the terms of the lease.

The restriction in use under the lease is relevant to the valuation of the land

[14] I am of the view that the lease restriction of use to a single dwelling is relevant to the valuation of the land. In this I differ from other members of the Court.

[15] The meaning of contractual provisions depends on the context within which they are used and the object the parties had in mind.[17] The approach properly taken by a court was described by Lord Bingham in *Bank of Credit and Commerce International v Ali*:[18]

> To ascertain the intention of the parties the court reads the terms of the contract as a whole, giving the words used their natural and ordinary meaning in the context of the agreement, the parties' relationship and all the relevant facts surrounding the transaction so far as known to the parties. To

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16 See the High Court judgment at [22] and [26], and the Court of Appeal judgment at [48]–[50].

17 *The River Wear Commissioners v Adamson* (1877) 2 AC 743 (HL) at 763 per Lord Blackburn; *Prenn v Simmonds* [1971] 1 WLR 1381 (HL) at 1383–1384 per Lord Wilberforce. See also *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50 at [14]–[30].

18 *Bank of Credit and Commerce International v Ali* [2001] UKHL 8, [2002] 1 AC 251 at [8].

> ascertain the parties' intentions the court does not of course inquire into the parties' subjective states of mind but makes an objective judgment based on the materials already identified.

The inquiry is objective: "what a reasonable person, circumstanced as the actual parties were, would have understood the parties to have meant by the use of specific language".[19] In the present case, the rent review clause must be interpreted in the context of the lease and the intentions of the parties expressed in it.

[16] Under the terms of the lease, revaluation occurs on its renewal at 21-year intervals. The renewed lease is subject to the same covenants and provisions. If the lessee does not renew, the lease is offered by public auction at the upset rental established by application of the five per cent formula to the revaluation.[20] The disposition by auction is an indication that the lease at the upset rental is marketable. Restriction as to use must be material in any market for the lease. Although the lessor may waive the restriction as to use, the waiver depends on the lessee's request and is therefore a change that cannot be imposed on the lessee.[21] If the rental must be set on the gross value of the land as if unrestricted as to use, such result seems to me to be contrary to the objective intention of the parties in the lease. I do not think it is sufficient response to say that the lessor will not then reasonably be able to withhold consent to more intensive development.[22] That could well produce a further result which is contrary to the intention of the parties to the lease if, as is likely over time, it makes more intensive development inevitable. Indeed, the evidence from the Cornwall Park Trust Board valuers was that the land has been valued as if residential land because in practice the gross fee simple was valued on an as-occupied basis (that is, as occupied by a single dwelling). Taking into account the use restriction, as I think is required by the terms of the lease, does not therefore overthrow settled expectations in result.

[17] It is said that *Cox* v *Public Trustee* compels the result that restrictions in the lease must be ignored. I do not think on proper reading the reference in *Cox* to the

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19 *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd* [2004] UKHL 54, [2004] 1 WLR 3251 at 3257 per Lord Steyn.

20 Clause 13(k).

21 See cll 4 and 9.

22 Per ss 225 and 226 of the Property Law Act 2007.

fact that "the existence" of the lease is to be ignored[23] supports it. The Full Court was there drawing on the Valuation of Land Act 1908 provisions then in force to illustrate that "in the case of the fee simple", marketable value was to be assessed on the basis of what the land could expect to realise at the time of valuation "if unincumbered by mortgage or other charge thereon".[24] It was in connection with the "unincumbered" fee simple that the Court added:[25]

> In the case in hand the proviso must, of course, be made that, in addition to excluding mortgages and charges from consideration, the existence of the lease must also be put out of account. *The very object of the provisions for valuation requires this qualification.*

[18] As the italicised sentence makes clear, the "existence" of the lease is "put out of account" for the reason that the valuation on a fee simple basis provided for requires that the fee simple be viewed as if unencumbered by the leasehold estate. It would defeat the basis of valuation if the fact that the land was leased out (and on a perpetually renewable basis) had to be taken into account in assessing the value of the fee simple. Thus in *Re an Arbitration between Napier Harbour Board and Faulknor* the umpire was held to be wrong to value land not as if "straightout freeholds", but rather as "freehold hampered by the restrictions of continuous lease".[26] That approach (by which the freehold was reduced by one-third from the value it had as if unencumbered by a lease) defeated the object of the rent review provision by valuing not the freehold land, as was required, but the lessor's interest under the lease.[27] Similarly, in *Hawke's Bay Regional Council v Plested*,[28] Cooke P, for the Court of Appeal, considered that it was "axiomatic" that the existence of the head lease there in issue was to be "put out of account" because "[w]hat has to be ascertained is the fair annual value of a lease of the fee simple; it is not a valuation of the lessor's interest or the lessee's interest under the head lease".[29]

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23 *Cox* at 101.
24 At 100–101.
25 At 101 (emphasis added).
26 *Re an Arbitration between Napier Harbour Board and Faulknor* [1930] NZLR 184 (SC) at 186.
27 At 189.
28 *Hawke's Bay Regional Council v Plested* [1994] 2 NZLR 1 (CA).
29 At 4. Although *Plested* was concerned with the setting of a fair rental, rather than the application of the identified percentage in issue here, as Cooke P pointed out in that case at 4, the necessary ascertainment of the value of the "land hereby demised" does not differ according to whether rent is as a percentage of the value found (such as the five per cent he described as "common") or is used to arrive at "fair annual ground rent".

[19] As these cases make clear, the existence of the lease is ignored in valuing the "land alone" (as it was described in the lease in issue in *Cox*) or the "fee simple" (as the "land demised" was treated in *Plested*,[30] and as it is described in the lease which is the subject of the present appeal) *because* taking it into account would be to value only the lessor's interest under the lease and defeat the formula adopted which values the unencumbered land. None of the authorities deal with the different question in issue here or suggest that a restriction on use intended by the parties should be irrelevant to the valuation of the land. Taking such a restriction into account is not inconsistent with valuation of the fee simple interest, as a valuation of the land as subject to a lease is. The latter values the lessor's interest in the land, not the fee simple. It is the necessary contradiction between the fee simple valuation required and a valuation of the lessor's interest alone that requires the *existence* of the lease to be ignored.

[20] There is no such logical inconsistency in taking into account a use restriction agreed to by the parties. Fee simple land is often affected by restrictions as to use which inevitably affect its value. Such restrictions may be the result of covenant, especially where the land is part of a developed estate, as the Cornwall Park Trust estate is. If the covenant runs with the land, it is a restriction relevant to the value of the fee simple. The position is not different because the restriction is contained in a lease rather than being a covenant registered against the fee simple. The restriction is the context in which the rental review provision must be read. It would be inconsistent with that context and with the objective intention of the parties for the restriction as to use to be ignored in the valuation of the land for rental purposes.

[21] Nor is it inconsistent with other New Zealand authority. In *Re Brechin and Drapery Importing Co Ltd* the Court of Appeal held that it was necessary to take into account the terms and conditions contained in a lease in setting the rental for the land.[31] Although this case was one where a fair rent was to be set, the same approach should in my view be taken to valuing the land on which rent is set through application of a set percentage of value, as was accepted in *Plested*.[32] There is a

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30 At 4.
31 See *Re Brechin and Drapery Importing Co Ltd* [1928] NZLR 241 (CA) at 248.
32 At 4.

statement in *S & M Property Holdings Ltd v Waterloo Investments Ltd* that, taken out of context, might suggest more broadly that the lessor's interest as owner is "not affected by the use of the land".[33] The issue in the case was the very different one whether a heritage order on a building affected the value of the land. It was common ground between the parties in that case that the valuation of ground rent was to be arrived at taking into account the terms of the lease.[34] The judgment of Thomas and Blanchard JJ cited with approval a Canadian decision in which it was said that, while in general landlords are not burdened by development decisions made by tenants (as is the case under the Cornwall Park leases where existing residential development is not of a value commensurate with the value of the land), the position is different if the lease itself imposes a use requirement.[35] The position is also consistent with that taken in *Plaza Hotels Associates v Wellington Associates Inc*.[36]

[22] The valuation of the gross fee simple as if unencumbered by the lease (the point being made by the Court in *Cox* and which is necessary to achieve the fee simple valuation) should reflect the intention of the parties in the lease. On that basis, the gross fee simple is properly to be valued taking into account the restriction in use to a single dwelling. Ignoring the restriction is contrary to the expectations of the parties and is potentially unfair in result.[37]

[23] The terms of the lease are the context in which the rental provision falls to be interpreted. Many of its terms have no impact upon the valuations required in the rent-setting provisions. Restriction as to use, however, is clearly material to the valuation of the land. I do not consider there is any sound basis for excluding it from consideration. I would allow the appeal and make a declaration that cl 13 requires the rental to be set on the basis of the restriction of the land to use for a single dwelling.

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33 *S & M Property Holdings Ltd v Waterloo Investments Ltd* [1999] 3 NZLR 189 (CA) at [89].

34 See Gault J at [3], Thomas and Blanchard JJ at [71]. (As already indicated in reliance on *Plested*, I do not consider it is a point of distinction that the current lease, unlike that in issue in *S &M Property Holdings*, applied a fixed percentage to the land value.)

35 At [86]–[89]. See *Revenue Properties Co Ltd v Victoria University* (1993) 101 DLR (4th) 172 (Ont Ct (Gen Div), Div Ct) at 187–188 per Adams J.

36 *Plaza Hotels Associates v Wellington Associates Inc* 285 NYS 2d 941 (SC 1967) at [2].

37 The respondent's written submissions accept that it is "reasonable to assume that the drafters of the lease sought to achieve fairness as between the lessor and lessee".

BLANCHARD, TIPPING, McGRATH AND WILLIAM YOUNG JJ

(Given by William Young J)

The appeal

[24] In 1901, Cornwall Park in Auckland was gifted by Sir John Logan Campbell to the Cornwall Park Trust Board. With a view to providing endowment income for the Trust Board, Sir John later transferred an additional 58 hectares of adjoining land to the Board. This land was subdivided and, between 1910 and 1923, the Board leased (for perpetually renewable terms of 21 years) 115 residential sections to individual lessees at agreed ground rentals. In due course the lessees constructed homes on, and made associated improvements to, the sections. The leases provide a formula for calculating the rent on renewal. The appellants are lessees and, representing themselves and a significant number of other lessees, challenge the way in which the Trust Board seeks to assess the rent for renewed terms which have recently commenced or are about to commence. They have been unsuccessful (at least in substance) in both the High Court (before Courtney J)[38] and the Court of Appeal.[39] They now appeal to this Court.

Background

Glasgow leases

[25] Long-term ground leases (usually of 14 or 21 years) renewable in perpetuity with rent calculated either by an assessment of fair or market rent (or some similar concept) or, as in this case, as a percentage of a sum established pursuant to stipulated valuation exercises, are referred to as Glasgow leases. They were mainly put in place in the 19th and early 20th centuries. A Glasgow lease is, in economic substance, a bond which is revalorised every 14 or 21 years and secured against the demised land. The income generated, while usually a modest return on the value of

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38 *Mandic v Cornwall Park Trust Board* (2009) 10 NZCPR 790 (HC).
39 *Mandic v Cornwall Park Trust Board Inc* [2010] NZCA 576, (2011) 12 NZCPR 34.

the land, is very secure and can be expected to increase over time, at each renewal date, as land increases in value. For these reasons, Glasgow leases were seen as providing secure endowment income for charities (such as schools) and public bodies (such as harbour boards). They also facilitated development, enabling those who wished to develop land (and were willing to take the associated risks) to do so without incurring the capital costs of land acquisition.

[26] Glasgow leases proceed on the basis that:[40]

(a) increases in the value of the land due to extrinsic factors are for the lessor's benefit; but

(b) the rent should not be fixed in relation to value due to improvements made by the lessee.

[27] The administration of Glasgow leases, particularly at times when leases fall for renewal, has generated much litigation and has also been the subject of a number of official reports. As will become apparent, we consider that the leading case is *Cox v Public Trustee*.[41] That case was decided in relation to leases issued under the West Coast Settlement Reserves Act 1892. The history and operation of the leases under that legislation were reviewed by a Royal Commission of Inquiry chaired by Sir Michael Myers which reported on 8 March 1948[42] and by the Waitangi Tribunal,[43] which also addressed separately a similar leasing scheme operating on the West Coast of the South Island.[44] As well, there is the report of Mr Anthony Lusk QC who was appointed in 1992 by the Government to inquire into Glasgow leases of residential land granted in the eastern suburbs of Auckland.[45]

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40 See generally *Cox v Public Trustee* [1918] NZLR 95 (SC) at 99 and *S & M Property Holdings Ltd v Waterloo Investments Ltd* [1999] 3 NZLR 189 (CA) at [72]–[73].

41 *Cox v Public Trustee* [1918] NZLR 95 (SC).

42 Michael Myers, Hanara Reedy and Albert Samuel *Report of Royal Commission Appointed To Inquire Into And Report Upon The Operation Of The Law Relating To The Assessment Of Rentals Under Leases Of The West Coast Settlement Reserves* [1948] III AJHR G1.

43 Waitangi Tribunal *The Taranaki Report*: *Kaupapa Tuatahi* (WAI 143, 1996) at [9.3]–[9.3.8].

44 Waitangi Tribunal *Ngai Tahu Report 1991* (WAI 27, 1991) at [2.10] (vol 1) and Chap 14 (vol 3).

45 Anthony Lusk QC *Ministerial Inquiry into Certain Perpetually Renewable Leases in Auckland* (1993).

The Cornwall Park leases

[28] Clause 13 of the Cornwall Park Memorandum of Lease provides for rental assessment as follows:

> (a) On the expiration by effluxion of time of the term hereby granted and thereafter at the expiration of each succeeding term to be granted to the Lessee ... the outgoing Lessee shall have the right to obtain in accordance with the provisions hereinafter contained *a new lease of the land* hereby leased at a rent to be determined upon the basis of the valuation to be made in accordance with the said provisions for the term of twenty-one years computed from the expiration of the expiring term and subject to the same covenants and provisions as this lease as may be applicable to such new lease.
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> (b) Within twelve calendar months previous to the expiration by effluxion of time of the term hereby granted or such succeeding term as aforesaid *two separate valuations shall be made namely a valuation of the then gross value of the fee simple of the land then included in the lease and also a valuation of all substantial improvements of a permanent character made or acquired by the Lessee and then in existence on the land.*
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> (c) The said valuation shall be made by two indifferent persons as arbitrators one of them shall be appointed by the Lessors and the other by the Lessee and such arbitrators shall before commencing to make the valuations together appoint a third person who shall be an umpire as between them.
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> (d) The decision of the two arbitrators if they agree or of the umpire if the arbitrators do not agree or in such respects as they do not agree shall be binding on all parties.
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> ...
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> (h) Before the expiration by effluxion of time of such term as aforesaid or if the valuation be not completed at an earlier period than two months before such expiration of the said term then within two calendar months of the decision of the arbitrators or umpire as the case may be and the giving of notice thereof to the Lessee the Lessee shall give notice in writing signed by [ ] or [ ] agent duly authorised in that behalf and delivered to the Lessors stating whether [ ] desires to have *a renewed lease of the said land at an annual rental equal to five pounds per centum on the gross value of the land after deducting therefrom the value of the substantial improvements of a permanent character as fixed by the respective valuations as aforesaid.*
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> (emphasis added)

[29] The leases provide for what is to happen should a lessee not renew[46] and also for the possibility of forfeiture.[47] These contingencies have not occurred in the history of the Cornwell Park leases and it was not suggested in argument that the relevant provisions of the lease are of practical moment to the valuation issues we must address. Save for a brief comment later in these reasons,[48] we do not propose to discuss them.

[30] The leases impose certain obligations and restrictions on the lessees: most relevantly, unless the consent of the lessor is obtained lessees cannot erect more than one dwelling on the demised land or use the demised land otherwise than for residential purposes.

The Carter arbitration

[31] The leases do not all fall for renewal at the same time but it would appear that a significant cluster of the leases fell due for renewal in or around 2005. In relation to this particular cluster there has been one completed arbitration ("the Carter arbitration").

[32] The renewal date for the lease in issue in the Carter arbitration was 10 December 2004. The lessor appointed Mr AR Gardner as its arbitrator and the lessee appointed Mr CN Seagar. They are both valuers. The rent proposed by Mr Gardner was $45,000 per annum and that proposed by Mr Seagar was $28,350 per annum. The primary difference between them was as to the value of the improvements. These were valued at $950,000 by Mr Gardner and at $1,203,000 by Mr Seagar. The umpire held that the gross value of the land was $1,850,000 and the

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46 In which case the lessor is required to offer at auction a new lease, containing the same key terms, at the upset rental as calculated according to cl 13, with the costs of the auction borne by the lessee. Any new purchaser must pay the value of the buildings and improvements as calculated to the lessor, who holds that sum in trust for the lessee, payable on demand, less outstanding rent and other payments.

47 Should no purchaser take the lease at auction for a rent greater than or equal to the upset rent, the land leased, with all buildings and improvements, absolutely reverts to the lessor. If this happens, the lessor is free from any payment or compensation at all, and with no obligation to grant a new lease.

48 See [79](a).

value of the improvements was $1,050,000, leaving a residual value of $800,000 and an annual rent of $40,000 (as compared to the previous rent, set in 1983, of $2,350).

[33] In assessing the value of the improvements, the umpire discussed the differing approaches of Messrs Gardner and Seagar. He described Mr Gardner's approach in this way:

> 10.2 Mr Gardner for the Trust Board calculated the valuation of the improvements on the basis of an analysis of sales, deducting his opinion of the market value of the land (as vacant), deducting for site improvements, with the residual divided by the dwelling floor area to arrive at a net rate for the dwelling, to then compare with the subject, after making adjustments for size, quality, etc.

Mr Seagar, on the other hand, valued the improvements on the basis of their current depreciated replacement cost.

[34] The umpire seems to have broadly adopted the approach contended for by Mr Gardner:

> 10.23 The improvements value, when assessed, should be derived from an analysis of sales (residual) and checked by a depreciated replacement cost approach, but with the depreciation being market tested rather than just allowing for physical depreciation.[49]

Continuing disputes

[35] The award of the umpire in the Carter arbitration did not resolve the broader methodological disputes between the lessor and the lessees represented by the appellants. And by the time the present litigation began (in September 2008), the arbitration process was underway in relation to 32 of the leases, in that the parties had appointed arbitrators but those arbitrators had not appointed umpires.

[36] In the course of the litigation, the lessees have advanced three primary overlapping and intertwined arguments:

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[49] There is an apparent conflict between these remarks and those at [10.20] in which the umpire said that he "gave more weighting to the Lessee's approach to value". This conflict is most easily explained on the basis of a typographical error, as presumably the umpire meant to say that he gave more weighting to the Lessor's approach.

(a) improvements cannot be valued by deducting the value the land would have had if unimproved from the gross value of the land;

(b) the gross value of the land must be valued on a basis which allows for restrictions imposed on the lessee by the lease; and

(c) the land must be valued in its "as-occupied" state.

The last two arguments are subsets of a broader argument, namely that "highest and best use" valuations are not appropriate, but it is convenient to address them separately as this is the way they were advanced by Mr St John for the lessees.

[37] In advancing these arguments the lessees had to confront the decision in *Cox*. The rental formula in issue in that case was materially identical to cl 13 and the Court concluded that in valuing the improvements for the purposes of the leases, a valuer would have to consider the value, if any, they added to the land from its value in an unimproved state.[50] We will refer to this as an added-value approach. The Court indicated that, depending on the circumstances, the value of improvements might be able to be derived by subtracting the value of the land as if unimproved from its gross value. We will refer to this as subtraction. A feature of subtraction is that if it alone is employed to derive the value of improvements, the residual figure against which rent is fixed will necessarily be the same as the value of the land as if unimproved, thus apparently rendering redundant the valuation and arithmetical steps postulated by the formula. The Court also concluded that the valuation assessments required ought not to take into account the terms of (and thus the restrictions in) the lease.[51] We will discuss *Cox* in more detail later in this judgment.[52]

[38] The lessor has adopted and supports an added-value approach. Its valuer, Mr Gardner, analysed sales of developed properties and derived per square metre figures for improvements based on his assessment of what the land in those instances would have sold for if not improved. This methodology does not involve

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50 At 100.
51 At 100–101.
52 See below from [45].

subtraction, at least directly, and throughout the litigation the Trust Board has accepted that it is not entitled to adopt subtraction methodology. It accepts, however, and rightly, that the effect of Mr Gardner's exercises is to produce residual values which are likely to be the same as the value of the land if vacant and unimproved, a concession which indicates that Mr Gardner's approach is very much a roundabout equivalent of subtraction.

[39] Relying on *Cox*, the lessor has never accepted that the terms of the leases are material to the assessments which are required. However, Mr Gardner has adopted a practice which allows for the existence of structures which have been erected on the land pursuant to the leases. We say this because in his affidavit to the High Court, Mr Gardner said that he valued the land "on an occupied site basis". He said that this recognised "that the purpose of this part of my analysis is to assess the market value of the actual improvements on the land". He then went on to say:

> In this exercise, the actual or in situ improvements on land developed as a single residential dwelling may limit the value of the land compared, say, with an identical vacant site suitable for development as a two unit site.

The arguments to us advanced by Mr Casey QC (for the lessor) proceed on the basis that Mr Gardner was, in this respect, wrong in law.

The litigation

The relief sought by the lessees

[40] The lessees sought a number of declarations, some of which are non-contentious or no longer of moment. Rather than address them in those terms we think it simpler to deal with the case by reference to the following questions:

(a) Are improvements to be valued on an added-value basis, and if so, can subtraction methodology be employed?

(b) Is the assessment of gross value constrained by use restrictions under the lease?

(c) Are the required valuations constrained by the state of the land as occupied by improvements?

We will revert to these questions once we have reviewed briefly the judgments of the High Court and Court of Appeal and discussed *Cox*.

The High Court

[41] Courtney J's judgment was broadly against the lessees.[53]

[42] Having referred particularly to *Cox* but also to *Valuer-General v Lalich*[54] and *S & M Property Holdings Ltd v Waterloo Investments Ltd*,[55] she concluded that:

> [22] … the residual value on which ground rent is paid is the equivalent of the unimproved value of the land, subject to any factors that affect that value ... .

Later in her judgment, however, when reviewing the evidence of Mr Gardner, she concluded that he had not valued improvements by subtraction.[56] As we have already explained, Mr Gardner's methodology involved an added-value approach to improvements, albeit arrived at indirectly. More generally, there is an apparent disconnect between this aspect of her judgment and her view, expressed at [22], that the effect of the lease is that the residual value of the demised land is its unimproved value.

[43] Courtney J found that the assessment of the gross value was not constrained by the land's current use (including improvements as constructed). She accepted that the valuation exercise was constrained by planning restrictions but not any heritage listings.[57] As well, and in this respect following *Cox*, she rejected the argument that use restrictions (most significantly confining lessees to one-unit residential development and use) constrained the valuation assessments.[58] Finally

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53 *Mandic v Cornwall Park Trust Board* (2009) 10 NZCPR 790 (HC).
54 *Valuer-General v Lalich* (1981) LVC 903 (HC).
55 *S & M Property Holdings Ltd v Waterloo Investments Ltd* [1999] 3 NZLR 189 (CA).
56 See [64] and [59].
57 At [27]–[31], applying *S & M Property Holdings.*
58 At [36].

she accepted broadly that improvements are to be valued by reference to the enhancement (if any) in the value of the land as improved compared to its unimproved value, although she noted the approach actually taken by Mr Gardner and concluded that he had not, in fact, sought to value the land on the basis of its highest and best use.[59]

The Court of Appeal

[44] The Court of Appeal dismissed the appeal of the lessees from the judgment of Courtney J.[60] That Court also applied *Cox*. It concluded that a correct application of the formula might produce a residual value which would not correspond to the unimproved value of the land (and to this extent disagreed with Courtney J's opinion recorded above at [42]).[61] As well, and going further than Courtney J, it expressed the view that a highest and best use approach to valuation was appropriate at all stages of the valuation process.[62] To this extent the Court of Appeal's judgment was more adverse to the lessees than that of Courtney J. In other respects the Court of Appeal agreed with Courtney J.

Cox v Public Trustee

[45] Between 1896 and 1970, New Zealand valuation legislation provided for the assessment of the "unimproved value" of land.[63] The legislation in force when *Cox* was decided was the Valuation of Land Act 1908 which, as amended in 1912, defined "capital value", "improvements", "unimproved value" and "value of improvements" as follows:[64]

> "Capital value" of land means the sum which the owner's estate or interest therein, if unencumbered by any mortgage or other charge thereon, might be

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59 See [63]–[64].

60 *Mandic v Cornwall Trust Board Inc* [2010] NZCA 576, (2011) 12 NZCPR 34.

61 At [43].

62 At [49].

63 This was initially provided for in the Government Valuation of Land Act 1896 which was elaborately amended in 1900 and then, as amended (including subsequent amendments), re-enacted in the 1908 consolidation. The same concept was provided for in the Valuation of Land Acts of 1925 and 1951. It was finally replaced by the related but different concept of "land value" which was introduced in the Valuation of Land Amendment (No 2) Act 1970.

64 Valuation of Land Act 1908, s 2.

> expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a *bona fide* seller might be expected to require:
>
> …
>
> "Improvements" on land means all work done or material used at any time on or for the benefit of the land by the expenditure of capital or labour by any owner or occupier thereof in so far as the effect of the work done or material used is to increase the value of the land, and the benefit thereof is unexhausted at the time of valuation; but does not include work done or material used on or for the benefit of the land by the Crown or by any statutory public body, except so far as the same has been paid for by the owner or occupier either by way of direct contribution or by way of special rates on loans raised for the purpose of constructing within a county any road, bridge, irrigation-works, water-races, drainage-works, or river-protection works:
>
> Provided that the value of improvements made out of loan-moneys raised for the purpose of constructing within a county any road, bridge, irrigation-works, water-races, drainage-works, or river-protection works as aforesaid shall not exceed the amount of principal estimated by the Valuer-General to have been repaid by the owner in respect of any such loan by way of special rates.
>
> …
>
> "Unimproved value" of any land means the sum which the owner's estate or interest therein, if unincumbered by any mortgage or other charge thereon, might be expected to realize at the time of valuation if offered for sale on such reasonable terms and conditions as a *bona fide* seller might be expected to impose, and if no improvements (as hereinbefore defined) had been made on the said land:
>
> "Value of improvements" means the added value which at the date of valuation the improvements give to the land.

It is clear that these definitions, and particularly the definition of "value of improvements" were of some materiality in the reasoning of the Court.

[46] As already explained, *Cox* concerned leases of rural land under the West Coast Settlement Reserves Act 1892 and the rent-fixing provisions were materially the same as those in the Cornwall Park leases. The lessees issued proceedings seeking the opinion of the Court on a number of questions involving the interpretation of the leases. The first, and most important, of the questions put to the Court was in these terms:[65]

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[65] At 96.

> I. Whether for the purposes of clauses 56 and 57 of the Schedule to the West Coast Settlement Reserves Act, 1892, the value of substantial improvements of a permanent character is to be determined—
>
> (a) By ascertaining the value of the land with such improvements, and subtracting therefrom the value which such land would have had if such improvements had not been effected, which last-mentioned value is hereinafter termed "the unimproved value";
>
> (b) By reference to the actual cost incurred by the lessee in effecting the improvements;
>
> (c) By reference to the estimated cost of effecting similar improvements at the date of valuation; or
>
> (d) By any other method.

[47] The primary issue was whether improvements should be valued by reference to their current replacement cost (as contended for by the lessees)[66] or by subtraction.[67] The case was heard by Stout CJ and Chapman and Hosking JJ, sitting as a Full Court of the then Supreme Court. The judgment of the Court was delivered by Hosking J.

[48] The Court set the scene for what was to follow with some general observations:[68]

> Land in a natural state may receive an increase in value from two factors—one intrinsic, consisting of what has been done on or to the land itself and may be comprised under the term "improvements"; the other consisting of extrinsic circumstances, such as public roads or railways, public systems of drainage, increased settlement in the neighbourhood, public services brought within reach, or other causes to which the tenant does not contribute. The object to be served by the valuations required by the leases under consideration is to give to the tenant the benefit of so much only of the increased value as is due to substantial improvements of a permanent kind, and to leave to the landlord the value attributable to all other intrinsic improvements and the whole value due to extrinsic circumstances. The landlord gets the benefit of the value added by extrinsic circumstances and by such intrinsic improvements as are not substantial and of a permanent kind in existence at the time of valuation.

[49] The Court equated the gross value of the land with its capital value:[69]

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66 The contention of Sir John Findlay KC for the lessees is set out at 97.
67 Which was the contention of Mr Charles Skerrett KC for the lessor: see 98.
68 At 99.
69 At 100.

> Having regard to the subsequent provision that for the purpose of ascertaining the new rent the value of the improvements is to be deducted from the "gross value of the lands," we think it is manifest that the value of the fee simple which is to be ascertained is the total or capital value of the lands inclusive of substantial improvements. ... We therefore consider that in valuing the fee simple the land with the improvements must be dealt with as a whole. That value is the capital value into which the value of the improvements enters as an undiscriminated part.

[50] The Court was of the view that improvements were to be valued by reference to the value they added to, or "the melioration they effect upon", the land:[70]

> A still further observation is that the provisions for valuation do not correspond with those found in many leases of town land granted by public bodies where two valuations are provided for, one of the value of the land without any buildings or improvements thereon, and the other of the buildings or improvements. There is nothing in those provisions to indicate that the two values are together to be equivalent to the capital value of the land, buildings, and improvements as a whole. That is not the character of the provisions now submitted for our consideration. Here the direction is to ascertain the value of the fee simple of the lands then included in the lease as one item, and the value of all improvements of the kind mentioned then in existence on the land then comprised in the lease as the other item. ...[71] We deduce from this that in valuing the improvements for the purposes of these leases the point of view of the melioration they effect upon the land as land in an absolutely unimproved state must be considered ... .

[51] Returning then to the assessment of gross value of the land, the Court made it clear that in assessing gross value the lease was to be ignored:[72]

> We may, however, say that in the case of the fee simple we have no doubt it is the exchangeable value in money or the marketable value which is meant, and that there can be no legal objection to the adoption in that respect of the test laid down in the Valuation of Land Act, 1908, s 2—namely, what the land, "if unencumbered by mortgage or other charge thereon, might be expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a *bona fide* seller might be expected to require." In the case in hand the proviso must, of course, be made that, in addition to excluding mortgages and charges from consideration, the existence of the lease must also be put out of account. The very object of the provisions for valuation requires this qualification.

[52] Also material are the following passages:[73]

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70 At 99–100.

71 The omitted passage is the Court's discussion of the establishing of the gross value of the land quoted above, in part, at [49].

72 At 100–101.

73 At 102–103.

> To the question whether the value of any particular matter of the specified kind is to be affected by reference to the cost of labour and material at the time of valuation, we consider that the answer is that the current cost of labour and material is a factor which must be taken into account. It is said that present prices due to war conditions are not to be considered because they are temporary. Whether they are so or not is a question of fact for the arbitrator or valuer.
>
> …
>
> Now, if Question I (a) implies that some result would or might be arrived at different from what must be the result if the value of the substantial improvements is taken as one item and deducted from the capital value as the other item, then it must be answered in the negative. If, however, the method suggested by the question will give a true result with respect to the value of the improvements, then it is open to the arbitrators or valuers to adopt it. If the capital value has been truly ascertained, then the value of the substantial improvements, *plus* the unimproved value as previously explained, *plus* whatever value is added by intrinsic improvements not of a substantial and permanent character, ought to be equivalent to the capital value.
>
> (emphasis in original)

[53] For the sake of completeness, we should record that the way in which these leases were administered in the 1930s and the associated disputes, litigation and legislation are reviewed at length in the report of the 1948 Royal Commission Report to which we have already referred.[74] That report shows that when leases came to be renewed in the 1930s, the rent-fixing process was heavily influenced by the arguments advanced by lessees to the effect that improvements should be valued independently of the gross and unimproved value of the land. This had the effect of reducing the residual figure against which the rent was calculated with the result that rents for renewed terms were sometimes lower than they had been previously.[75] The recommendation of the Royal Commission was that the rent-fixing process should be tied directly to the unimproved value of the land.[76] The report did not engage directly with whether the lessees' argument to which we have referred was consistent with *Cox*. In our view it was not. *Cox* interpreted the rent-fixing provisions in the leases in a way which was consistent with the land valuation legislation and in particular established that improvements were to be assessed on an added-value basis. This seems to have been lost sight of in the 1930s.

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74 See [27] above.

75 See [20]–[24] and [78]–[80].

76 As defined in the Valuation of Land Act 1925 (which is materially the same as the approach taken in *Cox*): see [102].

Are improvements to be valued on an added-value basis, and if so, can subtraction methodology be employed?

The lessees' concerns

[54] Because improvements cannot (at least usually[77]) be sold separately from the land they are attached to, there can be no direct market evidence as to their value. Transactions affecting the interests of lessees and lessors in leasehold properties are of limited relevance because they involve the sale and purchase of interests under the leases concerned (of either lessor or lessee) and thus reflect the terms of the lease.

[55] Mr St John for the lessees contended that no particular valuation methodology was required to be employed in assessing the value of improvements but the thrust of his submissions and of the evidence adduced by the lessees was that the current depreciated replacement cost of the improvements would be likely to provide the best measure of their value.

[56] The primary concern of the lessees is in relation to situations where the land has not been developed in accordance with its highest and best use. In these circumstances, adopting the added-value approach and subtraction methodology will produce a proportionately lower value for improvements than current depreciated replacement cost. For instance, a valuer may assess the unimproved value on the basis of a highest and best use involving a multi-unit development but there may be only a single unit dwelling on the site. From the point of the view of the lessees, such an approach would tend to "squeeze" the value of improvements. They maintain that in a leasing context in which the improvements currently on the properties were approved by the Board (which must approve the plans of any buildings), the valuation exercises should be based on the existing uses to which the land is being put. Variants of this argument are relied on by the lessees in relation to the other questions which we have identified.

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[77] Houses are sometimes removed and re-assembled elsewhere, but no-one suggested that an analysis of transactions of that sort would be of any assistance in the present context.

[57] We accept that current depreciated replacement cost is likely to be material to a valuation of improvements. It is, for instance, difficult to see how improvements could be valued at more than their current depreciated replacement cost. As well, assuming that the improvements are congruent with the highest and best use of the land, their current depreciated replacement cost is likely to be a fair measure of their value. This is illustrated by the result of the Carter arbitration. In that situation there was no substantial suggestion that the property's development was not in accordance with its highest and best use.[78] Nor does it seem to have been suggested that the properties which had been the subject of the comparator sales had not been developed in accordance with their highest and best use. Unsurprisingly, therefore, the umpire's ultimate assessment was within the range contended for by the parties on the basis of current depreciated replacement cost.

[58] Very much at the heart of the lessees' legal argument is the contention that the added-value approach and subtraction methodology are inconsistent with the structure of the formula in the lease. That formula starts with gross value and requires a separate valuation of improvements with the resulting figure deducted from the gross value to produce a residual against which rent is calculated. An added-value approach applied using subtraction methodology would appear to replace those calculations with an unimproved valuation, and such a valuation is not explicitly mentioned in the lease.

[59] It was the apparent logic of this argument which led Mr Gardner to adopt his roundabout mechanism for valuing improvements. He considered that he could not, consistently with the structure of the rent formula, deduce the value of improvements by subtraction. Likewise, Mr Casey for the Trust Board was adamant that the Trust Board had not adopted – and could not adopt – the subtraction methodology for valuing improvements. The reality, however, is that the methodology adopted by Mr Gardner is very much a proxy, albeit a roundabout one, for subtraction, as indicated by Mr Casey's acceptance that the resulting residual value figure could be expected usually to correspond with the value of the land as if unimproved.

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[78] As explained, Mr Gardner was valuing on an "as-occupied" basis.

Some general comments

[60] We consider that what should be a reasonably simple process has become unnecessarily encrusted with complexity and subtlety. Under the rent formula the sum of the value of improvements and the residual value of the land for rent-fixing purposes equates to the gross value. There may be market evidence which provides direct evidence of the residual value (for instance sales evidence of similar but vacant land in the vicinity). This evidence necessarily will also inform the assessment of the value of the improvements. As well, for reasons already explained, the valuer can also be expected to assess the current depreciated replacement cost of the improvements. So where there is limited or no direct market evidence in relation to unimproved land and the land has been developed in accordance with its highest and best use, the valuer might rely primarily on that current depreciated replacement cost. This is not because the leases require a cost-equates-value approach but rather because, in those circumstances, current depreciated replacement cost may provide an accurate measure of the value of the improvements (reflecting the difference a purchaser could be expected to pay for the land as developed as against what a purchaser would pay for the land without improvements).

[61] What is required is an integrated consideration. This is likely to involve both a current depreciated replacement cost analysis and an assessment of the value of the land as if unimproved. So we can see no reason why a valuer, when engaged in such an assessment, should not envisage the land as if unimproved and attribute a value to the land in that state. The fact that residual value will at least usually – and perhaps always[79] – be the value the land would have if unimproved is simply a logical corollary of the application of the formula and the added-value approach. Either way the valuer is arriving, as required, at a "separate" value of the improvements.

[62] We reject any suggestion that what we contemplate is inconsistent with the rent formula. A valuer will, of course, not proceed directly to assess the value of the

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[79] We have struggled to come up with a plausible scenario when this would not be the result. Mr Casey made some suggestions, but all involved work which had been carried out which either had not added value (and thus would not be an improvement) or otherwise would not be in the category of improvements required to be deducted under cl 13.

land as if unimproved and in this way render the formula redundant. Mr Casey for the Trust Board accepted this. There will be a practical, as well as contractual, necessity for an assessment of the gross value. There will have to be an assessment of the value of the improvements which is likely to encompass consideration of their current depreciated replacement cost. But if there is relevant market evidence available as to vacant land, that too should be factored into the assessment.[80] Depending entirely on the circumstances, the simplest and most accurate measure of the value of improvements may be a subtraction exercise. If so, we do not see that it matters that, as part of the improvements valuation, the valuer has assessed a value for the land as if unimproved which corresponds, by reason of arithmetical necessity, to the residual value against which rent is calculated.

The added-value approach

[63] On the fundamental question whether the added-value approach is correct, we can see no legitimate basis on which *Cox* can be distinguished. The rent-fixing provisions of the leases in issue in *Cox* were materially identical to the Cornwall Park leases. The lessees under the West Coast leases were subject to obligations and restrictions which broadly correspond to those relied on by the lessees in the present case. So although the *Cox* leases were of rural land, there is no logical reason why that should make a difference to the application of the rental formula.

[64] *Cox* has been referred to and relied on in many subsequent cases and, as far as we are aware, has always been accepted as correct. There is a very significant number of perpetual leases with similarly expressed rent-fixing provisions. There must have been a large number of transactions (many thousands over the last 93 years) in respect of such leases which would have been premised on the understanding that the application of the rent-fixing procedure had been settled by

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[80] In the course of argument, Mr St John suggested that one of the problems faced by the lessees is that vacant land comparable to that of the lessees is extremely scarce, meaning that such sales as may be identified are likely to reflect a scarcity value which ought not logically be able to inform the valuation exercises for all 115 leases. We consider that this concern is answered by the judgment of the High Court of Australia in *Maurici v Chief Commissioner of State Revenue* [2003] HCA 8, (2003) 212 CLR 111.

Cox. It would be unacceptably destabilising if this Court were now to adopt a different approach.

[65] We would not in any event favour a different approach. Improvements cannot (at least usually) be sold otherwise than as an integral but undiscriminated part of the land to which they are attached. Logically they have no value beyond the extent to which they enhance what would have been the value of the land if they were not there. An added-value approach is intrinsic to the concept of improvement. If work done does not add value it is not an improvement. And attributing to improvements a value which exceeds that enhancement would result in the lessor not receiving a rent based on the value of the land. The approach taken in *Cox* was consistent with the structure of contemporary valuation legislation.[81] The added-value approach is consistent with the economic substance of the leases which, as explained in *Cox*, are intended to give the lessor a return based on the appreciating value of the demised land. As Mr St John accepted in his written submissions, the corollary of the lessees' approach is that the residual value arrived at is likely to be less than the value of the land as if unimproved. This would be inconsistent with the scheme and purpose of the lease because it would leave the lessor with the burden of development decisions which were made primarily by the lessees.[82] The purpose of subtracting the value of the improvements is to prevent lessees paying rent on value they have created. The added-value approach is consistent with that purpose.

The subtraction methodology

[66] It seems to us that a necessary corollary of accepting the added-value approach is that there must be an assumed state of the property to which the improvements can be said to have added value. That state can logically only be the state of the land as if unimproved. So to arrive at an added-value figure, the valuer must envisage the land as unimproved and, at some stage in the process, attribute a value to the land in that condition. The value of improvements is necessarily the

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81 See [45] above.

82 We accept that building plans must be approved by the Trust Board. But such approval cannot be treated as a Trust Board endorsement of the economics of the proposed buildings. As to this see the comments in *S & M Property Holdings Ltd v Waterloo Investments Ltd* [1999] 3 NZLR 189 (CA) at [75] and preceding paragraphs.

difference between the gross value of the land and its value as if unimproved. Given this, it is difficult to see why improvements should not, where appropriate, be valued by subtraction.

[67] In this regard, *Thomas v Valuer-General*[83] is of some significance. This case was argued before the same judges who heard *Cox* (that is Stout CJ and Chapman and Hosking JJ) and in the same month (October 1917). The judgment in *Thomas* was released in December 1917 while the judgment in *Cox* came out the following month. In the valuations in issue in *Thomas*, the valuer had started with an assessment of unimproved value before assessing capital value and the value of improvements for the purposes of the Valuation of Land Act 1908.

[68] The criticism that this was back to front was dealt with by Stout CJ in this way:[84]

> It was further submitted that the way to obtain the unimproved value of the land was to ascertain the capital value first, then to ascertain the value of the improvements, and the balance would be the unimproved value. That is not the way in which the amending Act of 1912 assumes that the valuation is to be ascertained. It states that the unimproved value is to be ascertained as if no improvements had been made on the land, and the value of the improvements means the added value which at the date of the valuation the improvements give to the land. Even if the capital value was ascertained first, still the unimproved value must be ascertained without a method of mere subtraction.

We note in passing that the reference to "mere subtraction" was to a postulated process in which unimproved value was arrived at by deducting from the capital value the assessed value of improvements. This is not the subtraction methodology now under discussion.

[69] In the same case, Hosking J, in large measure anticipating what he was shortly to say in *Cox*, commented:[85]

> The other point involved in the appeal is that in ascertaining the value the valuer proceeded on a wrong basis in that he had first fixed and determined the unimproved value and thereafter had fixed the value of the improvements, and by the addition of the two values had ascertained the

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83 *Thomas v Valuer-General* [1918] NZLR 164 (SC).
84 At 171.
85 At 175–176.

> capital value. It is said this process is wrong, and that he should first ascertain the capital value and then deduct the value which the improvements add to the land. I do not quite see how the method adopted by the valuer is a matter of law unless it must end in a wrong conclusion. If the result is right, does it matter whether he adds from the top or the bottom? If his result is wrong, then upon an appeal it is open to be attacked on evidence whichever method he has adopted. What he has to find, however, is not the value of the improvements but the added value which at the date of valuation the improvements give to the land—that is to say, to the unimproved value of the land. I cannot see how the valuer went wrong in principle because he first found the unimproved value and then added the value given by the improvements.

That *Thomas* is consistent with assessing the value of improvements by subtraction is made perfectly clear by *Cox*, in particular in its answer to question 1(a) which specifically upheld subtraction as a possible way of arriving at the residual value. As well, there are a number of instances where the courts have experienced no difficulty with valuations of improvements or unimproved land being arrived at by simple subtraction.[86] While this has been in statutory contexts which define the value of improvements by reference to the added value they give the land, we do not see that as material for present purposes given that the same approach was taken in *Cox* in relation to rent-fixing provisions which were indistinguishable from those in the Cornwall Park leases.

Is the assessment of gross value constrained by use restrictions under the lease?

[70] We recognise that the interpretation of the rent-fixing provisions is necessarily affected by the contractual context and thus the scheme and purpose of the leases. As Mr Casey therefore accepted, it is appropriate to address the rental formula having regard to both the lease itself, construed as a whole, and the circumstances which obtained when the lease was entered into. The courts would

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[86] See, for instance: (a) under the Valuation of Land Act 1951 in *Re 110 Martin Street, Upper Hutt* [1973] 2 NZLR 15 (CA); (b) under the Maori Vested Lands Administration Act 1954 in *Re Wright's Objection* [1959] NZLR 920 (LVC) at 922; *Proprietors of Atihau-Wanganui v Malpas* [1979] 2 NZLR 545 (CA) at 548 and 550–553 per Cooke J and at 553–555 per Richardson J; and *Proprietors of Atihau-Wanganui v Malpas* [1985] 2 NZLR 468 (CA); (c) under the Maori Reserved Land Act 1955 in *West Coast Settlement Reserve Lessees Association Inc v Valuation Appeal Committee for the West Coast Settlement Reserves* [1997] 1 NZLR 413 (CA); and (d) under the the Land Act 1948 in *Assistant Commissioner of Crown Lands v Associated Taverns Ltd* (1983) LVC 25 (HC).

struggle to avoid an interpretation which was subversive of the underlying scheme and purpose.[87]

[71] The lessees contended that the assessment of gross value should reflect the particular restrictions in the lease, most relevantly the requirement for lessees to obtain the consent of the lessor for anything other than residential use of the land and the construction of a single-unit dwelling house. The argument is that because the lease restricts the lessee to a single-unit dwelling and residential uses, it would be wrong to value the land on the basis of, say, multi-unit development and home office (or other commercial) use which might reflect the land's highest and best use.

[72] We have some reservations about the practical significance of the argument. We have seen nothing in the material before us to suggest that the Board has attempted to rely on highest and best use assessments which differ from the current uses to which the land is put or that such arguments would, in the future, be actually as well as theoretically available. As well, it is important to recognise that the restrictions in the lease are now subject to ss 225 and 226 of the Property Law Act 2007, meaning that the lessor's consent to uses other than those specifically contemplated cannot be unreasonably withheld. Further, the restrictions in question are akin to the covenants often imposed when land is subdivided and developed – covenants which are intended to enhance ultimate values. While the relevant restrictions might conceivably be to the detriment of a particular lessee, they are generally for the collective benefit of all lessees as they provide a mechanism by which the Trust Board can maintain the general amenities of the area.

[73] We accept that where a rent-fixing provision in a lease is in general terms (for instance providing for a "fair rent"), the valuer must assess a rent which reflects the terms of the lease.[88] In England and Wales, the same approach has been adopted in such cases (that is where what is in issue is a fair or reasonable rent)[89] by

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87 This is illustrated by *West Coast Settlement Reserves Lessees Association Inc v Valuation Appeal Committee for the West Coast Settlement Reserves* [1997] 1 NZLR 413 (CA).

88 See for instance *S & M Property Holdings Ltd v Waterloo Investments Ltd* [1999] 3 NZLR 189 (CA) at [71] and *Granadilla Ltd v Berben* (1999) 4 NZ ConvC 192,963 (CA) at [6].

89 As in *Basingstoke and Deane Borough Council v Host Group Ltd* [1988] 1 WLR 348 (CA) (a case which did involve a ground lease).

reference to what is sometimes called the "presumption in favour of reality".[90] But the rent-fixing formula in this case is not of that character. It is intended to provide the lessor with an annual return based on the value of the land. The fairness of this return (five per cent of the residual) in the context of the lease as a whole, including all restrictions imposed on the lessees, must be taken to have been settled when the leases were first taken up.

[74] Significantly, the valuation formula is addressed to the value of the land and not the lessor's interest, and the lessees did not strenuously dispute this.[91] Mr St John's primary argument was not that all leasehold terms be taken into account (as would be required on the valuation of a leasehold interest) but only those which imposed restrictions on the practical ability of the lessees to use the land to its best advantage. The spectre which he raised was of lessees being required to pay rent assessed against a hypothetical highest and best use which was not in fact permitted under the lease. Mr St John was able to take us to cases from other jurisdictions in which rental assessment provisions in long-term ground leases based around land valuations have been applied in a way which factors in such lease restrictions.[92]

[75] We see no need to review the cases referred to by Mr St John. This is because we think that the issue is controlled by (a) the limited relevance of the restrictions, (b) the terms of the particular leases in issue and (c) *Cox*.

[76] The restrictions relied on by Mr St John are, as we have endeavoured to explain, very much what might be expected in planned residential development. We do not see them as detrimental to the interests of the lessees, at least when viewed collectively. The lessees' arguments as to possible highest and best uses which are restricted by the leases were confined to multi-unit developments and home office occupations. We see no likelihood of the Trust Board advancing valuation

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90 The phrase seems to have been coined in *Lynnthorpe Enterprises Ltd v Sidney Smith (Chelsea) Ltd* [1990] 1 EGLR 148 (Ch), see 151.

91 In his written submissions, Mr St John noted that an actual purchaser of the land as at a renewal date would take the land subject to the lease, which might be thought to be an argument in favour of a leasehold interest valuation, but this point was not further developed.

92 For instance *Plaza Hotel Associates v Wellington Associates Inc* 285 NYS 2d 941 (SC 1967) and *936 Second Avenue LP v Second Corporate Development Co Inc* 861 NYS 2d 256 (2008).

assessments based on such highest and best uses and then being able successfully to prevent lessees using the demised land for such purposes. We are accordingly not persuaded that the lease restrictions are practically material in the way in which the lessees contend.

[77] In any event, as Mr Casey argued, the language and structure of cl 13 are against the argument advanced by the lessees. As a matter of simple English, it is extremely difficult to construe the phrase "gross value of the fee simple of the land" as incorporating restrictions on use provided for in a lease. The structure of the clause (with its provision for the deduction of the value of improvements from that gross value) does not expressly contemplate any further step at which lease restrictions might become relevant. As the Supreme Court of Canada observed in *Musqueam Indian Band v Glass*,[93] in the context of a rent-fixing formula broadly similar to that provided by cl 13, what is required is a valuation of the land in terms of its exchange value, rather than a valuation of its use to the lessee. Of importance in all of this is that the rent-fixing process is envisaged as taking place at the expiry of the lease and at the commencement of the renewed lease ,and not in the context of a continuing lease.

[78] Finally, and most importantly, as the passage cited at [51] above shows, the Court in *Cox* was clear that the existence of the lease was to be ignored. This approach has subsequently been consistently taken in New Zealand in relation to clauses similar to cl 13.[94] Given that *Cox* can fairly be taken to have settled the law in New Zealand on this point, it would be wrong for us to take a different approach.

[79] We think it appropriate at this point to provide a brief response to the conclusion of the Chief Justice that the valuation should take into account the restriction in use to a single dwelling:

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93 *Musqueam Indian Band v Glass* 2000 SCC 52, [2000] 2 SCR 633.

94 See *Valuer-General v Lalich* (1981) LVC 903 (HC); *Re An Arbitration Between Napier Harbour Board and Faulknor* [1930] NZLR 184 (SC); *Hawke's Bay Regional Council v Plested* [1994] 2 NZLR 1 (CA) and *Juken Nissho Ltd v Attorney-General* CA93/99, 22 March 2000. In his 1993 report *Ministerial Inquiry into Certain Perpetually Renewable Leases in Auckland* at [12.29], Mr Lusk QC referred to what he described as "unanimous agreement amongst valuers that a highest and best use approach is precluded" by lease-imposed restrictions corresponding to those relied on by the lessees in this case. No attempt was made in the report to correlate that proposition, which seems to be based on valuers' opinions as to the effect of one particular lease's restriction provision, to the authorities to which we have referred.

(a) At [16], the Chief Justice suggests that the lease provisions which cover the contingency that the lease is not renewed are "an indication that the lease at the upset rental is marketable". The lease, however, also contemplates the possibility that there may be no purchaser at the upset rental – a recognition that the upset rental may not meet the market. More importantly, it is clear – indeed acknowledged on all sides – that the rent-fixing process was not intended to provide a fair rental formula allowing for the existence and terms of the lease.

(b) The Chief Justice does not explain where the proposed restriction fits into the prescribed elements of the rent-fixing formula. Such a restriction has no obvious place in assessing "the then gross value of the fee simple of the land". It is obviously irrelevant to the valuation of improvements. And since the residual is the difference between the gross value and the improvements, there is no scope for such a restriction there either.

(c) We consider that the approach favoured by the Chief Justice is not consistent with *Cox*. If the lease is to be ignored, how can restrictions provided for by the lease be taken into account?

(d) If applied in the way proposed by the Chief Justice, the formula would allow, albeit awkwardly (via the residual value assessment), for some of the lease terms. This would produce a hybrid – a cross between a fair rental assessment and a rental assessment based on the value of the land without improvements. The result will not necessarily be either a fair rent (because there is no guarantee that the formula will work out that way) or a return based broadly on the intrinsic value of the land, as envisaged by the lease.

Are the required valuations constrained by the state of the land as occupied by improvements?

[80] It is common ground (and sense) that in assessing the gross value of the land, the valuer must take into account the land as it then is including any improvements currently on the land. But the lessees claim that if it is appropriate to value improvements by reference to, inter alia, the value of the land as if unimproved, that should be assessed on "an occupied site basis". Their concern is if this latter valuation proceeds on a highest and best use basis this will have the tendency to "squeeze" the value of improvements, at least where the property's development has not been in accordance with its highest and best use, a point which we have already touched on.

[81] As is apparent from our discussion of the Carter arbitration, the position then adopted by Mr Gardner for the Trust Board, was that the land should be valued on "an occupied site basis" when assessing the value of improvements. This approach, however, has now been disavowed by the Trust Board as Mr Casey made clear. Although there is no authority directly on point in the context of rent-fixing clauses corresponding exactly to cl 13 of the Cornwall Park leases, authority in relation to other forms of ground lease supports the view that the existence of buildings on the site is to be disregarded when assessing land value.[95] And in any event, we see this approach as correct given the terms and the overall scheme and purpose of the leases. This is for reasons which are largely, but not entirely, the same as those already discussed in relation to the other questions raised by the case. The whole point of the exercise is to provide the lessor with a return calculated on a valuation of the land which excludes that portion of the value which has been contributed by the lessee in the form of substantial improvements of a permanent character. In applying an added-value approach, it is clearly the net value enhancement of the improvements which provides the measure of their value. On

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[95] See *Drapery and General Importing Co of New Zealand (Ltd) v Mayor of Wellington* [1912] NZLR 598 (CA) and *S & M Property Holdings*. The cases are reviewed in *Hinde McMorland & Sim Land Law in New Zealand* (looseleaf ed, LexisNexis) at [11.109]. In his report, Mr Lusk, in the context of Auckland Area Health Board leases similar to those in issue here, suggested at [10.30.3] that the wording of the leases "would certainly seem to exclude any room for the valuations to take account of development potential, ie a highest and best use valuation." Understandably Mr St John relied on this statement. Mr Lusk's comment, however, was not related to the decisions to which we have referred.

this approach there is simply no room for constraints of the kind postulated by the appellants.

The appropriateness of resort to the Declaratory Judgments Act 1908

[82] We agree with the views expressed by the Chief Justice at [5]–[9].

Disposition

[83] For these reasons the appeal should be dismissed.

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