

NEW ZEALAND

SUMMER 2023

PROPERTY PROFESSIONAL MAGAZINE



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REGULATION IN THE PROPERTY MARKET

Passive houses
– the way of
the future

SEISMIC ISSUES IN COMMERCIAL LEASES

Branch chair
profiles

2023 PINZ CONFERENCE PREVIEW

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VIV GURREY

Unprecedented events

Just when we all thought things couldn't get any crazier, its looking like 2023 may deliver a cruel blow to our business confidence and economy. We're all familiar with extreme weather in New Zealand, but things have changed across the nation in a very short time, and I want to acknowledge the significant and devastating events we have seen unfold. These events are unprecedented, with a national state of emergency declared only occurring three times in our history.

The impact of this is already being felt with a 'long tail' across the country bringing extra stress and pressure which many will never have experienced before. The huge area affected, the massive disruption to daily lives, supply chain issues and the enormous price tag for rebuilding will leave an historic legacy.

There are no quick fixes and we hope the advice being compiled from officials and our own experts is proving helpful to our property professional members. This resource will continue to be developed, and there's a full programme of CPD under development as we navigate the challenges ahead.

Many may need extra support to get through this period and one of the membership benefits I am most proud of is the new counselling and assistance programme for our members.

Many may need extra support to get through this period and one of the membership benefits I am most proud of is the new counselling and assistance programme for our members. It's confidential and free, and its introduction to our suite of benefits could not have been better timed.

If you need some help, I'd encourage you to consider if this programme is something you could benefit from. Please feel free to contact me personally for further information. Members are at the centre of all we do and your welfare is incredibly important to us.

Branch AGMs

Despite some weather-related disruption, the Branch AGM season is almost complete. The feedback from our grassroots has been encouraging and supportive, with good numbers attending.

Our branches are critical leaders in our organisation's future. These volunteers are committed to the property professions, and we thank them all for their dedication, contribution of time and insights into the regional pulse of our industries.

PINZ Constitution

There will be a 'PINZ members only' electronic vote held between 11 April and 17 April on the adoption of the new Constitution. We thank those who took the time to thoughtfully review the document and offer their feedback.

Some very minor technical changes to the Constitution have resulted and these have been reviewed by our legal advisors for compliance with the Incorporated Societies Act.

For those of you outside the organisation, a new Constitution has been recommended by experts as the best answer to law changes introduced in 2022. Members have consistently reported that our old rules and bylaws are no longer fit for purpose. That member input has helped guide the principles outlined in the new Constitution.

Driven by the Incorporated Societies Act changes that were signed into law in April last year, the Constitution will lay the bedrock for the Property Institute's future, offering more flexibility to meet changing member needs and ensure that members continue to be at the centre of everything we do. Our desire to maintain and improve the day-to-day services of the Institute is at the forefront of modernising the organisation through this move.

This huge piece of work has been peer-reviewed and has undergone a comprehensive legal and governance review by Simpson

I'd strongly urge members to consider entry into the 2023 Awards. It's a real opportunity to be recognised for your contribution to our professions in front of an audience of industry heavyweights.

Grierson. And it's important to repeat that we have little choice but to make a change given the 2022 law changes. We do hope members will support this initiative as a critical future-proofing exercise that will allow us to deliver on our mission to become the home of property professionals.

To be clear – this does not affect NZIV at all and is a PINZ-only document. It is an important step in our modernisation and compliance journey.

Conference & Awards

The [2023 National Property Conference](#) is shaping up to be something very special.

This year, we're also privileged to be hosting the WAVO/IVSC Global Valuation Conference in Christchurch between 7 and 9 June. I'd encourage all property professionals to review the website [HERE](#) for the latest updates on the programme.

We have already signed some first-class speakers and our programme of education will be second-to-none. Expect more strong

speakers to be added to the schedule over the coming weeks.

We are also calling for nominations to our new and improved [National Property Awards](#). We've added new categories and streamlined the process to offer a more 'user-friendly' experience.

Given the unique and prestigious nature of this year's conference, I'd strongly urge members to consider entry into the [2023 Awards](#). It's a real opportunity to be recognised for your contribution to our professions, or to recognise the contributions of your peers in front of an audience of industry heavyweights.

Final word

It's been an unbelievable start to 2023. It's clear the challenges ahead are daunting. But, with the strong team behind the Property Institute, once again we can say that the 'comeback will be stronger than the setback'. Your team is working hard to ensure you get the support you need to adapt, deliver and thrive.

Viv Gurrey

REGULATION IS STILL A KEY PROPERTY MARKET THEME

KELVIN DAVIDSON

Given the regulatory pressures that have come to bear on the property market lately, it's timely to refresh ourselves about what's changed, look at their significance, and assess what might be in store for the next 12 months or so – as we head to and past the election.



A steady flow of regulatory changes...

Just as property values were primarily driven up in the first few post-COVID years by low mortgage rates, now the downturn is being caused in large part by the increase in interest rates. But it's not just the credit environment that has impacted the property market – there's also been a broad regulatory reassessment going on too. And that doesn't seem likely to change this year either.

A rule-change refresher

Let's start, however, by running through what's already happened on the regulatory front in recent years – primarily impacting property investors:

- Ring-fencing of tax losses on rental property – meaning that landlords can't use a property loss to reduce their taxable non-property income.
- The Foreign Buyer Ban, which means that only Singaporeans and Australians can continue to freely buy New Zealand residential property (without applying to the Overseas Investment Office). Other nationalities can, however, do so if they're investing in large off-the-plans developments (with the idea being that their capital will help to get these projects completed).
- Healthy homes standards, which aim to lift the minimum quality of a rental property, but this has probably had some kind of upwards impact on rents too (as landlords have looked to pass on some of these costs to tenants).
- Extension of the Brightline Test for existing properties (new-builds still at five years), aimed at quelling short-term speculative behaviour in the property market. A couple of extra points on this one:
 - this is a capital gains tax,
 - but it may not actually be collecting much revenue, as people can just avert it by holding their property until the deadline passes, and
 - it's questionable how much speculative behaviour was really going on anyway.
- Removal of mortgage interest deductibility for existing properties (phased over five years for existing investors), but kept in place for a new-build for the first 20 years of its life.
- Reform of the land and housing supply system, with the Resource Management Act going through a major structural change (over a long time horizon), and now more dwellings of more floors allowed on the same plots of land.
- Ongoing use of loan-to-value ratio (LVR) rules to curb low equity lending in the property market and insulate the banking system from falling house prices – these are popularly seen as hampering first-home buyers more than investors. And it's certainly true that raising a 20% deposit is still tricky for many first-home buyers. But it's also fair to say that investors are pretty hard hit by having to raise a 40% deposit, and their decline in market share certainly took a leg down when the 40% requirement kicked in from May 2021.



The most impactful of these rule changes so far has probably been the removal of interest deductibility.

- The looming imposition of caps on debt-to-income (DTI) ratios from early 2024, potentially at a level of seven, with exemptions for new-builds and some kind of allowance for high DTI loans outside the cap – these are seen as hampering investors the most.
- And now, just in the past few weeks, we've got a large group of organisations (both private and public sectors) banding together to push the Government to encourage a significant improvement in the quality of our housing stock, especially in making them 'greener' and lower in risks for health conditions such as asthma. As yet, neither of the main political parties has really responded publicly to this (albeit Jacinda Ardern's resignation probably overshadowed most things at the time).

Some changes more significant than others

In my view, the most impactful of these rule changes so far has probably been the removal of interest deductibility, and then from a financial stability/Reserve Bank perspective the LVR restrictions.

Certainly, the percentage market share of all property purchases going to mortgaged multiple property owners (including investors) has been weak lately, at around 20-21%, which is a record low – and that's a low share in a market where the *number* of deals is very subdued too. Now to be fair, there are many things weighing on investors at present, including those listed above, as well as the simple fact that gross rental yields are low and now rents themselves have gone flat too.

Banks still have a cautious attitude and are keeping a strong buffer between what they could do and what they're actually doing.

But interest deductibility still looms large. After all, although the sums will differ across each individual investor, some simple calculations suggest that the loss of interest deductibility could mean an increased tax bill to the tune of 'many thousands' each year (e.g. \$5,000 or more) for many investors. This potentially turns a number of cashflow positive properties into loss-makers.

Meanwhile, the LVR rules are still playing a key role too, and the latest figures show that it's very difficult to get a mortgage without the required deposit. For example, less than 1% of investors were approved with a small deposit (<40%) in November and only about 4% of owner-occupiers had less than a 20% deposit. Keep in mind that the allowable caps for that lending are 5% and 10%, respectively, showing that banks still have a cautious attitude and are keeping a strong buffer between what they could do and what they're actually doing.

What lies ahead?

The regulatory environment has been a key feature of the property market in recent years and this will remain the case in 2023. For a start, we've recently had a change of PM and so we'll wait and see what that might mean for property market policy. Of course, nothing

has been announced yet, but surely there's some kind of chance we'll see some movements from Chris Hipkins.

What could that be? There haven't been any whispers we've heard, so this is merely speculation – but potentially a broad-based capital gains tax could come back onto the table and/or land tax. Clearly, both would be unpopular with the property-owning 'middle classes'. So it's up for grabs whether Labour would campaign on those issues – with Jacinda Ardern having previously ruled out a broad CGT under her leadership (and Chris Hipkins also noting a reluctance to look at this again).

In fact, there are two further issues around regulation that are worth watching more closely. First, it's simply whether or not National might win the next election (14 October) and then whether they'll follow through with the promise to reassess the Brightline Test and the removal of interest deductibility. That's certainly what they've been constantly repeating in the media, so there has to be fair chance this will play out, and savvy investors may start to look more seriously at existing properties in advance of that (potential) outcome. But nothing is guaranteed in politics either.

But, in our view, an even larger change than that looms in early 2024 – that being the introduction of caps on DTI ratios for new mortgage lending (covering new loans, bank switches and top-ups). Now, it's worth noting that as mortgage rates have risen, the amount of debt going out at a high DTI ratio has already naturally come down – as people simply can't service as big a loan as before (given the same income). So the imposition of a DTI cap is probably more about restricting the next upturn in property values rather than having any meaningful effect in this cycle.

And we think this restriction could be something of a game-changer. After all, with LVRs, people can keep buying so long as their equity is rising, which has tended to be the case in the recent past. These rules are more about protecting the banking system rather than the borrower as such. But DTIs are a much tougher beast – given that you can't instantly raise your income significantly in the short run, they basically limit how much debt you can have at any point in time, and hence how much can be paid for houses, and/or how many houses can be owned by an individual.

As noted earlier, these could have the biggest impact on those people wanting to expand a property investment portfolio, but who can only get their income up over a long period of time as wages generally rise. Relatively fewer investors in the market, as well as the natural restraint on house prices that will result from borrowing caps, will tend to play into the hands of other buyer groups, such as first-home buyers (and cash buyers who don't rely on the bank).



Wrapping up

The regulatory environment has no doubt been a factor in driving this property downturn, and it will obviously also play a key role in where the market goes over the next 3-5 years too. However, right now, it's all about mortgage rates (and serviceability tests), with loans expensive to service for new borrowers and tricky to keep servicing for existing borrowers as they roll off old/lower mortgage rates (arranged in the immediate post-COVID period) and onto a much higher repayment schedule.

In our view, sales activity will start to improve and property values trough only once most people are convinced that mortgage rates have truly peaked and they can then quantify the worst case for their finances.

But other factors will amplify that effect. For a start, net migration has turned around very sharply in the past 3-6 months, and will provide a reasonable boost to New Zealand's population and aggregate property demand this year. Many new arrivals will go into the rental sector for a start, but that will still have some kind of upwards influence on price (as rents go up, for a given yield, prices rise too).

Ultimately, house prices will change based on the net effect of all of these influences, and others too (e.g. any tax regime changes, new housing supply). With the regulatory environment less favourable in a long-run sense, we wouldn't be surprised if property prices grow more slowly over the next 5-10 years than they have done over the past decade or so 🙄

Right now, it's all about mortgage rates (and serviceability tests), with loans expensive to service for new borrowers and tricky to keep servicing for existing borrowers.



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PASSIVE HOUSES

VAUGHAN
WILSON

the way of the future

Passive housing is in its infancy in New Zealand and we as a country are lagging behind the developed world in the adoption of passive house design and principles. With a sea change of rules and legislation on reducing carbon in construction, and heightened requirements around insulation, it could mean passive housing is the answer to future residential development.

State of the New Zealand housing stock

A typical New Zealand family produces around 37-48 metric tonnes of CO₂ per annum. The largest contributors are food, consumption, transportation and household energy. The numbers vary from household income, with poorer families tending to consume food requiring more CO₂ in its production. Wealthier families often live closer to destinations (such as places of work) and can afford to purchase electric vehicles.

Household production also varies with certain factors (such as age of housing), with older houses requiring more energy, and location of housing (such as colder climates needing households to spend more on heating).

Around 40% of all CO₂ produced in the world is related to real estate of all types, including the construction and operation of property, but is around 20% in New Zealand due to the relatively high levels of agricultural CO₂ emissions affecting the average. Residential property accounts for between 17-21% of energy-related CO₂ released

in the world per annum. So, housing (where we live, work and play) accounts for a significant percentage of the CO₂ production on a per person and per family basis.

New Zealand's climate is not particularly hot, or incredibly cold, and does vary along the length of the country. In general, the housing stock is of very poor quality over the generations of houses and does not cope well with our seasonal climatic changes. There are around 1.95 million houses shared across 1.865 million households, with the remainder being holiday homes. More than 75% of the houses as of 2019 were built before 1978, the same year the NZ Building Code changed to require a minimum level of insulation.

The poor quality of housing has resulted in some of the highest rates of asthma in the world, affecting one in four Kiwis. One in six people are sick with respiratory illnesses on a regular basis, including asthma, pneumonia and bronchiectasis, costing (2019) over \$6.1 billion in public health and private costs. Most homes built to the NZ

More than 75% of the houses as of 2019 were built before 1978, the same year the NZ Building Code changed to require a minimum level of insulation.



Building Code pre-2004 are only 1° warmer than the average outside temperature and well below the 18° minimum set by the World Health Organization. The average New Zealand home is 16° inside during winter – the same temperature at which respiratory illnesses increase.

Mould is another issue with the New Zealand housing stock, with over one-third having some form of it. Once indoor relative humidity reaches 70%, it is virtually impossible to keep mould at bay, and over 20% of homes measured in a recent study had over 70% relative humidity for at least 90% of the time.

New Zealanders have historically sought bespoke housing solutions that provide a point of difference from their neighbours, friends and family. A place of comfort, but also pride, like their contemporaries overseas they see housing as a personal castle they can stamp their own mark on. This has meant that the ubiquitous housing developments overseas have not been as popular here until recently.

The standard of New Zealand homes is being continuously upgraded through government legislation and rulings, advised by central bodies (such as BRANZ) and administered by local councils. Governance aside, the system works well in determining nationwide standards that are consistent over the length of the country.

Recently, the industry has seen significant cost increases for materials, labour and compliance. Over the medium term this will greatly affect the number of residences constructed, as the cost of construction (along with increases from the very low interest rates of only a few years ago) see a reduction in the number of new houses being built and house renovations carried out.

History of passive houses

Overseas experience from Europe and North America has provided a new and useful way of looking at house construction, to take advantage of new technology and improved construction techniques and design. This is called passive housing.

The history of passive housing is a mix of varying outputs in history, but which stem from the 1970s and 1980s. During the oil shocks of the 1970s, Americans sought improved housing construction to minimise heat loss, and reduce the requirement for heating, as well as reduce the costs of operating a household. Canada embraced this trend and independently developed many of the attributes we now find in passive houses.

William Shurcliff, who worked on the Manhattan Project in World War 2, has largely been credited with coining the phrase 'passive' for housing stemming from the 1970s and was well known for his interest in reducing energy consumption in housing.

In the late 1980s, Bo Adamson from the Lund University in Sweden and Wolfgang Feist of the Housing and Environment Institute in Darmstadt, Germany worked together on a set of principles for a completely passive house. The first passive house was constructed in Darmstadt in 1991. Since then, Germany has embraced the passive house principles, with tens of thousands of houses constructed both there and abroad.

Five passive house principles

While some techniques and technologies were developed especially for passive houses, other aspects already existed but were brought

A 'passive house' is a standard of design and construction whose primary focus is energy efficiency and to lower the ecological footprint of a building.

into the passive house format as part of the overall method. By definition, a 'passive house' is a standard of design and construction whose primary focus is energy efficiency and to lower the ecological footprint of a building. Similar in many ways to green commercial buildings, passive houses are deemed to be healthier and cheaper to operate and therefore better for the environment.

However, a passive house is not prescriptive. It may be of any size or style and a vast array of materials and building techniques can be enlisted in its construction. Flexibility is the key, and designs can be created to increase elements in one area to compensate for a reduction in others.

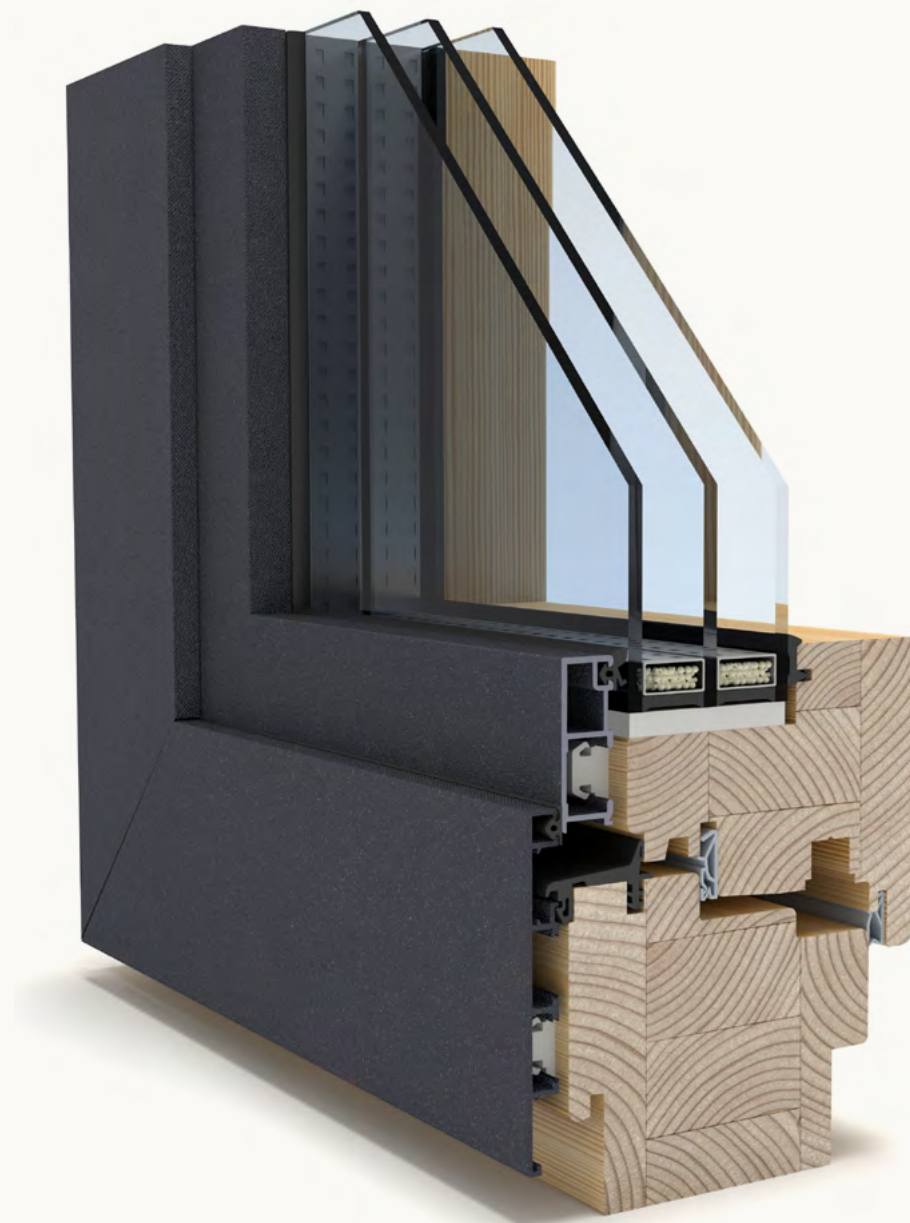
A passive house is designed to optimise the health and wellbeing of the occupants while consuming very little electricity. Typical reductions range from 81% less energy consumption in Auckland to 92% less in Christchurch. The methods, principles and technology can be utilised for non-residential buildings and in some countries this has been in schools, hospitals and other buildings.

Passive house designers use modelling programmes incorporating seasonal sunlight, orientation to the sun and planned shading (such as from verandas and trees) to calculate expected performance and likely energy consumption. The programmes are also used to ensure the house design meets the specifications of a passive house.

The five main principles of passive house design are:

1. **High-quality insulation** – often referred to as ‘superinsulation’, this is the process of using high R-value insulation on all external surfaces (roof, floor and walls – see principles below on windows and thermal bridges). Thicker insulation results in a reduced internal footprint (usable area) unless the overall house area is increased to compensate. Very cold climates can require up to 335 mm in the walls and 500 mm in the ceiling (Sweden). In New Zealand, it typically varies from 235 mm in Dunedin to 90 mm in Northland.
2. **High performance glazing** – double and triple glazing are standard with high-performance frames in passive houses. Window framing can be made from aluminium, PVC or timber, but the design is far more complicated than typical framing. It also has better thermal properties, including three or more levels of seals to prevent heat loss via air leakage.

Regular window frames that have opening windows can work well under external increases in pressure (such as wind gusts), but act poorly by increasing air pressure inside a residence. Modern windows designed to passive house standards will ensure little to no heat loss from the increased air pressure internally, or decreased external air pressure effectively sucking the opening window frame



Triple glazed windows

outward. The designs can extend to a window latch activating up to eight internal latches, securely fixing an opening frame around its perimeter.

The passive house glazing standard incorporates sealed argon or krypton gas for improved thermal performance. Glazing can also incorporate low e-coating, which is a coating on the glass that helps to reflect UV and heat. Placement of the coating on a single side of the glass is variable, depending on what the architect is attempting to do with the glazing in question.

External doors have a lot more science about them too. Lift-slide doors are very heavy doors made for the passive house environment, where the user turns a lever to lift the door up off the seals before sliding it. When the desired opening/closing is determined, the user then lowers the lever, dropping the door downwards ensuring an airtight seal (see www.youtube.com/shorts/CdVn8MmgXcM).

Triple glazing also has better acoustic properties and can provide a quieter internal environment coupled with high R-levels of insulation in walls and ceilings.

3. **Thermal bridge free design** – one of the main roles of the passive house designer is to design a house that is free of thermal bridges. In other words, to design one that minimises the amount of heat that can escape to the outside, particularly where walls and floors meet and where walls and ceilings/roofs meet.

Steel is an excellent conductor of heat. Portal frames can therefore either be elevated outside of the cladding or, in reverse,



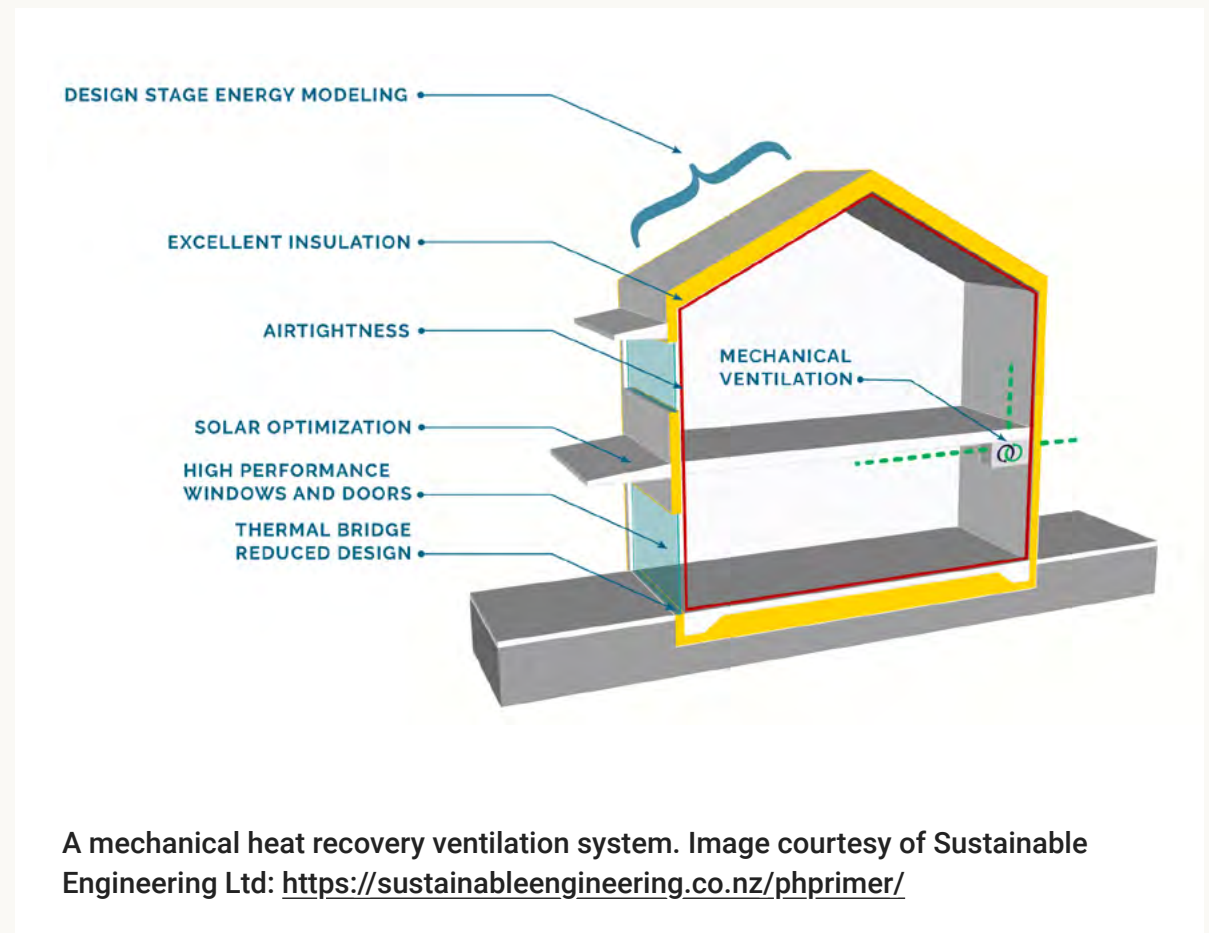
Airtightness sealing

internalised with appropriate material shielding the connection points from bridging heat outwards. This can be a real challenge for the architect to prevent thermal bridging.

4. **Airtight construction** – passive houses are tested and certified by a suitably qualified expert. They test the house's airtightness during construction by using a pressurisation machine that increases the pressure in the new residence to 50 pascals. Certifiers then decrease the internal air pressure to ensure the windows and airtight construction will work on high external air pressure. Any gaps are located and remedied (such as from hotpoints on walls, gaps around external doors etc). Once construction is completed, a second blower test is carried out to confirm the air changes per hour (ACH) standard.

5. Heat recovery ventilation – a mechanical heat recovery ventilation system allows fresh air into the house by way of ducting, transferring latent heat in the existing air as it exists the house. That way the heat built up in a house is not lost to the outside through ventilation. The fresh air and exiting air do not mix, but the mechanical system simply removes heat from one and gives it to another. This heat exchange prevents any sensation of draughts too. The system also filters incoming air removing contaminants (such as pollen), making the interior environment much better for asthma and hayfever sufferers.

These systems do not normally have active dehumidification included, but reduce moisture through reducing the relative humidity in the incoming air once it has passed the heat exchanger. If required, heating and cooling equipment can be added to the mechanical ventilation system, but often a simple heat pump is used as a separate device for additional heating and cooling when required.



One of the main roles of the passive house designer is to design a house that is free of thermal bridges.

Older houses (such as old villas), which are common in New Zealand, would likely have around 40 complete ACHs. A passive house has a maximum allowable air leakage of 0.6 ACH (66 times less than an old house).

For a passive house to work and operate properly, and to meet the exacting standards, all five principles must be included in the design and construction and work in concert. For instance, without the mechanical heat recovery system, all you would have is a well-insulated and airtight home, but it would to a degree still require more heating than a passive house.

Older houses (such as old villas), which are common in New Zealand, would likely have around 40 complete ACHs. That is why it is so difficult to heat an old house, as the air is constantly escaping and you are continually heating fresh air as it enters the inside. A passive house has a maximum allowable air leakage of 0.6

ACH (66 times less than an old house). This startling statistic is a good example of why passive house design is so effective.

Passive houses work just as well in hot climates as in cold. They can also be designed to create the same healthy, environmentally-friendly building in warmer climates (such as in Australia).



Four levels of passive house design

The four levels are:

1. **Low energy building standard** – not technically a passive house, but it follows many of the principles with a 30 kW per square metre per annum consumption of energy to heat.
2. **Passive house classic** – most passive houses are classic and are certified to 15 kWh per square metre per annum or energy to heat or less.
3. **Passive house plus** – same as for a classic, but with a renewable energy element included (e.g. solar panels generating the same amount of renewable energy each year as the dwelling uses – total energy used, not just heating and cooling).
4. **Passive house premium** – same as for passive house plus, but it generates renewable energy equal to what the occupants use in their daily lives (at the dwelling and away from it), making a renewable energy grid work for everyone.

It is difficult to retrofit an existing building to be a passive house. Therefore, a separate certification scheme was developed called EnerPHit (passive house certificate for retrofits).

The first passive house in New Zealand (and Australasia) was constructed in 2012 in Glendowie in Auckland. There are now around 80 passive houses, with a further 70 planned for 2023. An unknown number have also been designed, and in some

cases consented, but have been put on hold due to the costs of construction and interest rates.

Form factor

Passive houses love simple house designs that minimise surface areas. Two-storey houses are preferred over a single-storey due to the surface area ratio. This is a term used to compare the design for efficiencies in the form factor, where the total external surface area of the thermal envelope is divided by the treated floor area. The lower the form factor, the better the result.

Low carbon emission building materials

Passive houses do not prescribe particular building materials due to the low carbon emissions in their manufacture. New Zealand specialises in sustainably managed planted forest producing timber for the housing industry. This timber is often the main building product used in the construction of passive homes here. Other products created from recycled items can be used in flooring, insulation and internal wall surfaces.

The challenge here is to retain the principles of the passive house and at the same time use recycled and low carbon emission products. There is an additional software package available – the Passive House Planning Package (PHPP) – the main design software used for passive home design, to calculate the carbon emission of building products in the design. This aspect of passive house design will become more common and important to homeowners as the market for passive houses develops.

Certification

Passive houses are designed to meet the performance targets outlined in the standard. A house that has been certified has been independently assessed. Passive houses typically contain a greater resale price over regular houses of the same proportions, around 10-12% or more. To certify a passive house, a licensed certifier reviews the PHPP thermal model and calculations.

Photographs are submitted by the owner/builder to the certifier showing various aspects of the construction, window installation, insulation etc. They will also confirm the test results from the final blower door test. The cost of the certification process is around \$6,000 per dwelling.

Costs of passive house construction

One of arguments against a passive house is the increased costs associated with design and construction. The truth is the costs for most passive houses are in line with regular housing, albeit with a few differences and increases as follows:

1.	Construction costs (including mechanical ventilation and heat exchange system)	circa additional 10% – \$20,000
2.	Certification	\$6,000
3.	Additional costs of architect (over and above normal architectural fees)	circa \$8,000–\$12,000



Blower door

Total additional costs for a passive house for a typical 200 m² house (calculating \$5,000 per m² in construction) is around \$118,000, or about 15% more overall.

Total additional costs for a passive house for a typical 200 m² house (calculating \$5,000 per m² in construction) is around \$118,000, or about 15% more overall. Many new houses do not use an architect at all and instead use a draughtsperson. Passive houses typically require a certified passive house designer as part of the certification and hence the cost of the base architect fees is not incorporated in this 15%.

As the passive house trend becomes more mainstream in New Zealand costs should come down. Builders will become more experienced with the construction methods, and passive house related building products more commonplace, reducing costs (such as the mechanical ventilation and window joinery). Energy prices are expected to rise over the coming decades, making the decision to construct more expensive passive houses a more financially prudent decision.

Trends overseas and in New Zealand

Vancouver has the greenest building code in North America. Since May 2017, all re-zoning applications need to meet low emissions building standards, which has greatly increased the number of passive houses being constructed.

Sweden has embraced the climate change challenge, committing the country to eliminating CO₂ emissions by 2050. The EU has directed that all new buildings from 2020 onward must have close to nil energy consumption.

Scotland has recently passed legislation requiring all new housing to be of a Scottish passive level of design by 2024. Similar to the passive house requirements in this article, Scotland is leading the way for the rest of the UK and aiming to minimise energy requirements for domestic heating, particularly in their harsh winters.

The certified passive house designer qualification is an international certification, and those architects can work anywhere in the world with this. New Zealand has its own Passive House Institute (PHINZ) advocating for the growth of passive houses in this country.

BRANZ and MBIE are continuing to make changes to design standards, materials and the energy performance of new structures. Proposed changes to the Building Act will cover energy performance and waste during demolition and construction as part of the Government's aim to be net carbon zero by 2050. Consultation is expected later this year, with the new Act to be active by 2025. Many of these changes include aspects from passive house design, but building a passive house itself is not expected to be made mandatory.

New Zealand has its own Passive House Institute (PHINZ) advocating for the growth of passive houses in this country.

Much of the change is around utilising more low carbon emission building products in the design. PHINZ is working with the NZ Green Building Council to develop a crosswalk document, to provide guidance on how a passive house could achieve dual certification with the Homestar standard.

Summary

Passive house encapsulates a building standard that is energy efficient, comfortable, ecological and at a cost-effective price. It provides the inhabitants with a pleasant, warm, quiet and healthy environment and at the same time reduces CO₂ emissions.

Passive house design and construction is no doubt more expensive than regular design and construction, but the benefits (tangible, environmental, health-related and comfort) can well outweigh the costs. The health of the occupier, the constant comfortable temperature, the very low power bills to heat or cool, the renewable construction materials, the use of solar gain and the retention of heat means a passive house is the smart house choice.

Looking forward, it is easy to see a future where most (if not all) homes and many other building structures constructed in New Zealand will be passive. This standard will not only mean the costs of construction will reduce with market volume and efficiencies, but the CO₂ levels in this country will also reduce, and the cost of ownership will be less. A good result for everyone.

Passive homes and buildings. Can we afford not to embrace them?

Acknowledgements

Thanks are due to Jason Macquet of Mac Architecture Ltd, a certified passive house designer who was generous with his time and information for this article. Also to Jason Quinn from Sustainable Engineering Ltd whose online publication *Passive House for New Zealand* was invaluable 🙏



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COOLSTORE RENTAL ANALYSIS

PAUL
HIGSON

Coolstore assessment is a specialised field requiring an understanding of this asset. This article defines the term 'coolstore', describes typical rental analysis methods (including their pros and cons) and discusses the factors that can affect coolstore rentals.

Coolstores vs coldstores

The terms coolstore, coldstore and chiller are all broad descriptions used in New Zealand for refrigerated buildings that cool or freeze product. Coolstores are rooms that are capable of refrigeration, and are typically constructed from metal-coated insulation panels with polystyrene-type insulation.

Coolstores will regularly cool the stored product down to or just above 0°C. Modern refrigeration systems tend to use ammonia. In general, coolstores are used to hold product between 0°C and 10°C. Coldstores by contrast are capable of operating between -40°C and 0°C. They require some different construction and the dynamics are also slightly different to coolstores.

Most coolstorage in New Zealand is used for the storage of fruit, specifically kiwifruit, apples and avocados, and such uses are seasonal. While kiwifruit can be stored for many months, avocados for instance, cannot usually be coolstored longer than 40 days. Some stores therefore are reused for other products in the off-season or alternatively are turned off and used for dry storage.

Rental analysis and assessment methods

Rents for coolstores can be analysed under two main methods, with there also being a third method specific to kiwifruit coolstorage. These methods are:

- **Per square metre.** This form of analysis is widely used, but becomes less efficient where there are noticeable differences in ceiling stud heights.
- **Per cubic metre.** This is based on volume and is considered a more efficient method of analysis than the area basis. One disadvantage is that small differences in the cubic rental rate can lead to significant changes in projected rentals. Cubic meterage is generally taken to the lowest internal ceiling height and from there at right angles. This is because fruit cannot be stored to the top of the ceiling as this space is required for the condensers and for air circulation space.
- **Per tray.** This third method is specific to the kiwifruit industry. It is based on the static tray capacity for kiwifruit storage (how many trays can be stored in the room at any one time). While this method is widely used for kiwifruit, accurate estimates of static tray capacities are not always known and can be open to subjectivity.

Each of these methods has advantages and disadvantages. By assessing the subject on at least the first two methods, a clearer assessment of total rental can be gained. If the subject coolstore is involved in kiwifruit storage, I recommend also using the third method as this is often a commonly quoted metric in this industry.

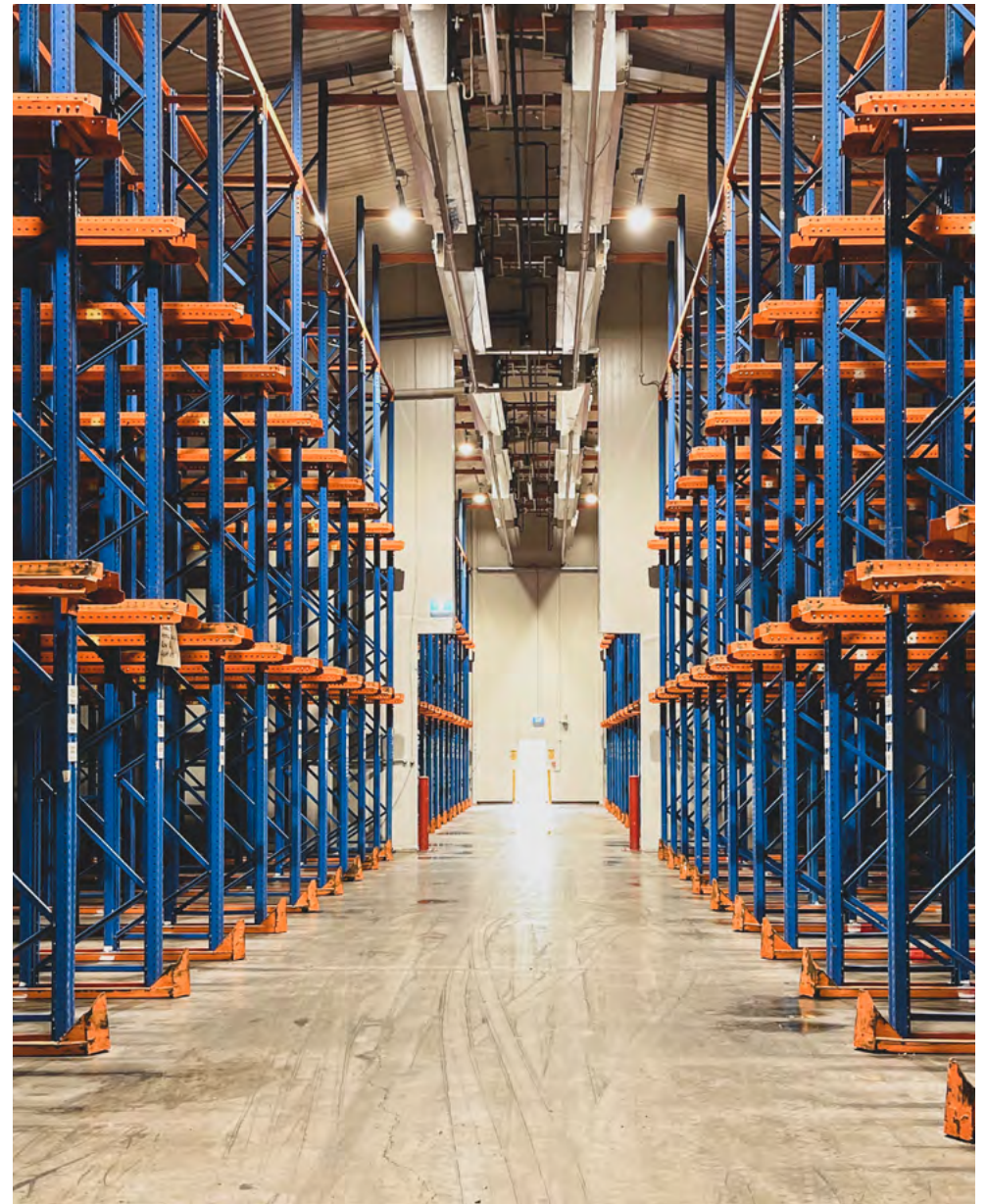
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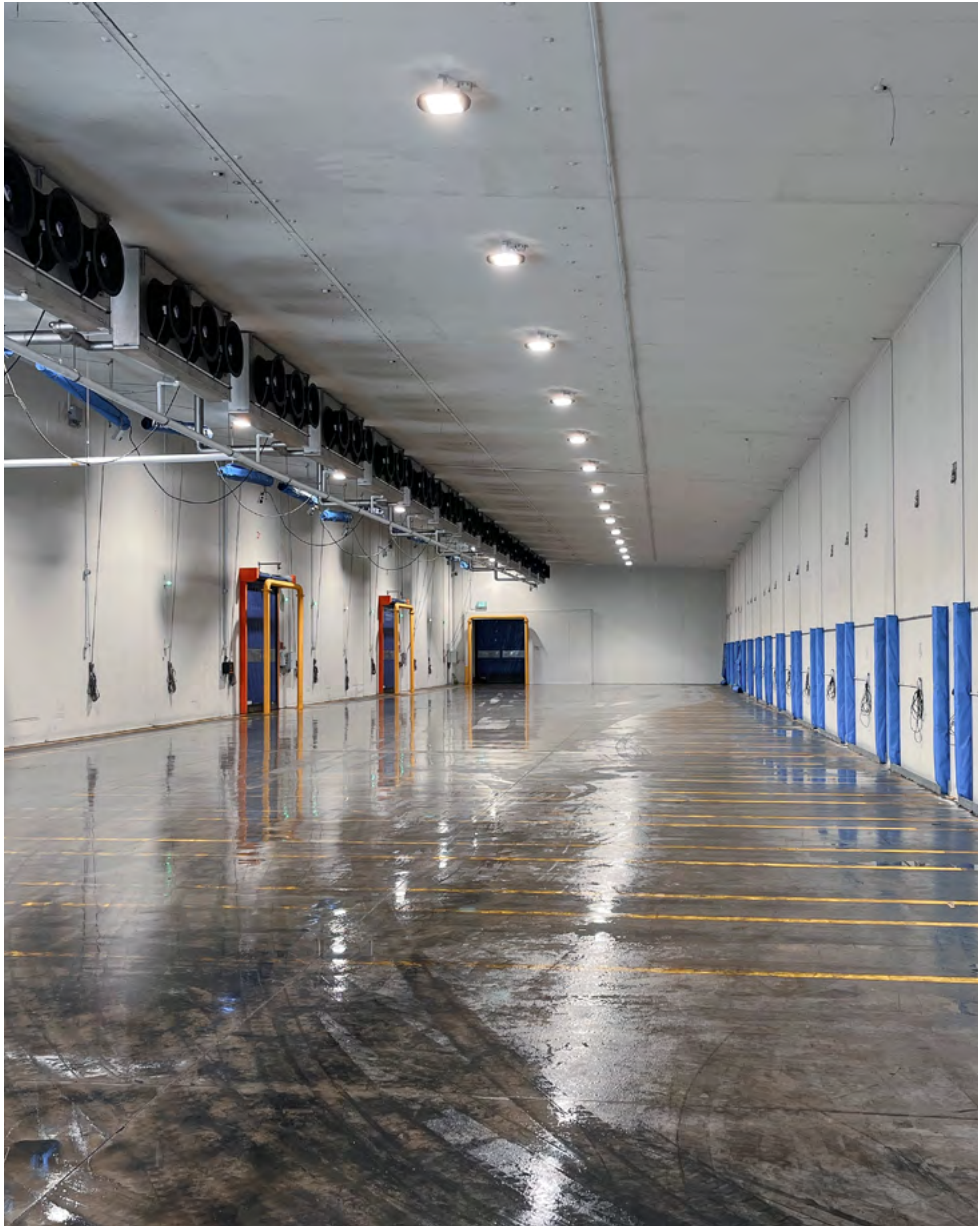
Attributes of coolstores and factors affecting rent

There is a marked difference between the rental rates shown by tenancies located in rural areas and those in built-up/urban locations. This is due to the prevailing rental structure of the wider industrial market in such locations.

For the horticultural industry, there are strategic reasons to be located close to growers, so post-harvest facilities are commonly found situated in rural settings. The best rural locations are those that (in addition to being close to growers) are also close to arterial traffic routes and near towns. However, commercial imperatives often mean that some stores may also be located close to export ports, due to the competitive advantage of getting fruit onto container ships at very short notice.

Modern coolstores tend to be designed and constructed to fit the needs of containerisation. The most common stud heights are now either 5 to 6 metres or 8 to 9 metres, as this allows for pallets either two or three high to be stored in the coolstores. However, some new





Modern coolstores tend to be designed and constructed to fit the needs of containerisation.

coolstores are being constructed to be 11 to 16 metres high and allow pallets stacked up to five high.

Racking is now regularly being placed into new coolstores in the horticultural industry, as it allows for the more efficient storing of fruit within them. This does not necessarily mean maximising the quantity of fruit stored, rather the efficiency of obtaining that fruit for removal.

Some older coolstores have heights less than 5 metres and when the height is noticeably less than say 4 metres, the ability for modern fruit storage is impacted. There are also issues of potentially wasted space where stud heights fall between the multiple pallet stacking heights. However, these issues are more pertinent to the kiwifruit industry and are not a big factor where the product being packed has different requirements. Also, some space above the stored fruit is needed to provide for efficient air flows.

Coolstores have a shorter economic life than more standard assets (such as warehouses) and this contributes to a difference in rental rates between newer and older ones. New facilities tend to have more efficient cooling systems that exhibit a higher number of air changes per hour. This can provide far greater efficiency in the control

The construction of coolstores can have a bearing on rental rates.

of fruit and also lead to lower electricity and other running costs (such as maintenance). They are then often in more in demand than older stores with less efficient systems. Further, older coolstores may be using a refrigerant that is becoming obsolete and/or have higher ongoing maintenance/running costs.

The construction of coolstores can have a bearing on rental rates. For example, those with roofs constructed over them (as opposed to just the coolstore panels) are more expensive to build. However, they shield the stores from the sun and rain and therefore have longer economic lives, plus have the ability to maintain lower temperatures more efficiently.

The more expensive panels such as XFLAM are also considered the most fire retardant. Given that coolstores have an elevated fire risk, this construction should lower applicable insurance premiums

and the total occupancy cost to a tenant is reduced. In theory, this should be reflected in the rental.

Plant rooms are needed to house the cooling machinery and may be used to cool one coolstore, but when additional stores are constructed the same plant room may be used. Therefore, I do not add a separate rent for the plant rooms. Rather, all of our evidence is analysed over the coolstore floor areas.

Finally, large integrated sites are generally more sought after by occupiers. These allow efficiency of scale and such facilities are predominantly more modern 🏡



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This profile looks at the life and work of Claire Robinson, Valuations Risk Manager at Opteon in Dunedin and current NZIV representative on the Board.

Lincoln years

Claire was raised in Dunedin but was looking further afield for her first year of study. She came across Lincoln University at a local careers day and was fortunate to be granted a Future Leader Scholarship that would pay for her full tuition if she continued to meet certain criteria each year. This included community volunteer involvement, such as coordinating and participating in outdoor landscaping and gardening projects at Burwood Spinal Unit, becoming a peer support leader/buddy to newer students, and providing tours to students and their families at university open days.

Initially, she went to Lincoln with the intention of completing a Bachelor of Commerce in Hotel Management. However, she changed her mind on the day of registration when she realised a career in property was an option due to a personal interest in the property industry with her late father being a real estate agent.

In 2008, she graduated from Lincoln University with a Bachelor of Commerce (Valuation and Property Management). After door-knocking at local property-related companies to complete work experience during the university holidays, she was fortunate that Macpherson Valuation, which became TelferYoung (now CBRE), had a position available and so this began her journey as a valuer. In 2012, Claire became a Registered Valuer after training within the residential and commercial team under the guidance of Darren Bezett and Tim Dick.

Opteon in Australia

She had always loved travel, so she relocated to Perth where she worked at Opteon for seven years under the guidance of well-regarded valuers Duncan Cameron and David Moore. Due to the unprecedented population growth Perth was experiencing because of the resources boom, she gained invaluable experience within the commercial and advisory sector.

This work involved valuing large-scale staged land subdivisions, medium-to-larger scale mixed-use built form developments, trading properties, taverns and shopping centres. She also travelled extensively throughout the north-west of Western Australia to provide valuations for childcare centres, caravan parks and Defence Housing portfolio assets. This time and experience in Western Australia were invaluable to her career, with her peers becoming mentors and good friends.

Due to the unprecedented population growth Perth was experiencing because of the resources boom, she gained invaluable experience within the commercial and advisory sector.

Claire made the most of her time upskilling and broadening her skills wherever possible to gain management and leadership experience. She was selected to participate in Leading Teams, which was an excellent programme that improved the overall culture, encouraged teamwork and broke down barriers between teams within Opteon.

During this time she became a Senior Valuer, followed by Associate Director managing a team of commercial valuers. Claire was nominated as the Western Australia representative, and following this Chairperson of Opteon's Youth Leader Programme, where she gained invaluable experience with senior management and valuers throughout the country. During her time over there she was also the recipient of the Australian Property Institute Young Professional Award in 2017 and the Opteon Emerging Professional of the Year Award in 2015.

Love of travel

In her spare time she was an active member and Treasurer of the Rotaract Club of Perth, with highlights including being rostered onto the Red Cross Soup Patrol and a volunteer trip to Cambodia building houses within a rural community. She has a love of travel, having backpacked through Europe, Cambodia, Vietnam, Thailand, North and East Africa, Uganda, Tanzania, South America, India and Malaysia in recent years. Highlights were seeing the Silverback gorillas in Uganda, trekking Machu Picchu, camping in the Sahara Desert and exploring the Amazon. When she's not working she enjoys camping, reading and exploring the outdoors.



Return to Dunedin

Relocating back to her hometown Dunedin in 2019 after a seven-month career break travelling with her sister, Claire has become a shareholder at Opteon and transitioned into a Valuations Risk Manager role within the Technical Services Team working across both New Zealand and Australia. Through this work, she ensures adherence of valuation standards by reviewing Opteon's New Zealand valuation report templates and content.

Her role is to ensure compliance with the valuation standards, providing training in valuation best practice, completing client on-boarding, the review of valuations for high-risk and high-value assets across Australia and New Zealand, and the promotion of consistent report content through internal lookups and comments. This Technical Services Team recently won the 2022 Australian Property Institute Excellence in Property Award Valuation Team of the Year Award, which was an excellent result given the high calibre of nominations.

Renovation bug

Purchasing her first house at age 20 was her first introduction to renovating. It was also a passion she found to be addictive, which has continued through two further renovations before purchasing a derelict 1905 villa positioned on a subdividable section when



she moved back to Dunedin in early 2019. Attracted by the traditional facade, large section and all-day sun, she never gave up on making the villa her own. Every single person told her to demolish the house due to its condition, but this was never a consideration.

The project became a great physical and mental challenge, with a 12-month turnaround while balancing work and renovating, with a goal to move in before Christmas 2019. Friends, family and neighbours provided endless support, especially through tough times when work or renovation deadlines were pressing and multiple decisions were required. YouTube videos were invaluable, showing how to demolish chimneys, putty a window, insulate walls and put in building paper etc.

The main concern was tying in the character at the front of the property to the modern extension at the rear, with a focus on reinstating or restoring original features, such as the original pressed tin ceiling in the lounge, arch in the hall, timber sash windows, running new skirtings and cornices to match the original profiles, and the filigree lacework on the veranda.

Interior design was identified early on as not one of her strengths so interior designer Nikita Hau assisted with colour palettes and lighting design. Claire started this project on her own, although now shares the home with her partner Cameron McLellan – a friend's brother who came to help with the painting towards the end of the project – and their two-year-old Lyla (with another baby on the way this July).

Claire feels that becoming a property valuer has been a great career choice and is now well suited to raising a young family. It provides a flexible work environment that ensures a good work-life

balance, with the added benefit of being out in the field most days which keeps the job interesting. She also has a passion for graduate and female mentorship. Claire feels it is essential in a male-dominated industry to provide women with guidance on navigating their careers, advice on skill development and ongoing support.

Current trends and issues in the valuation industry

Claire believes that an increasing reliance on technology within the property profession is always at the forefront of current issues, but you cannot replace the benefit of a valuer's eyes and ears on the ground through a physical inspection of a property. While the valuation industry will be interesting over the next few years, with unprecedented challenges across most sectors due to economic and environmental factors, she feels valuations are critical to clients who are navigating uncertainty and relying on our profession for their advice.

Claire believes that you cannot replace the benefit of a valuer's eyes and ears on the ground through a physical inspection of a property.

She also notes we are already seeing a focus on the quality of valuation reports. This is to ensure market, environmental and building risks are highlighted, along with a well-researched property value and conclusion so clients can make informed decisions.

Another area of focus for the industry through the coming years is energy efficient and sustainably designed and constructed buildings, whether it be passive houses or Green Star rated commercial buildings, with the Government also releasing policy with a plan for a carbon neutral non-residential public sector by 2025. Claire wishes to gain further experience in this sector, with millennials in particular incorporating sustainability and environmentally-friendly preferences into their buying and investment decisions.

This appears to be an ever-evolving sector, with increasing demand for innovation to develop ways to be more sustainable, have a positive effect on the economy, and reduce the impact on the environment from construction through to the lifespan of the building.

PINZ and NZIV involvement

Claire has been an active local branch committee member since 2019 when she relocated back to Dunedin. She started with a passion to encourage engagement and communication between property professionals in the local area, and play an active part to ensure a variety of valuable CPD events and networking opportunities were provided within the local branch. Otago has an active branch with many enthusiastic members, mentors and high attendance rates at events. This is particularly important given the high number of valuers looking to retire in the coming years.

She was recently appointed to fill the Southern Region Casual Vacancy on the NZIV Council, represents NZIV on the PINZ Board, and is actively involved with the NZIV Education Subcommittee. Claire is keen to utilise her corporate leadership skills, experience within the property industry, and give time to an industry that she is passionate about, and which has had a tremendous impact on her life to date 🏡

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SEISMIC ISSUES IN COMMERCIAL LEASES

potential
faultline
for lessors
and lessees

NICK WILSON
& VIOLA LAM

Seismic issues that arise during the term of a commercial lease can be problematic for lessors and lessees. This article looks at the impact on a lease when a building is deemed earthquake prone.



Risk allocation between a lessor and lessee

A recent article in the *New Zealand Herald* provided details about the Ministry of Education's lease of Mātauranga House in Wellington's CBD. It noted that the Ministry has paid more than \$2 million of rent and outgoings for that building over a period of four months, but unusually had vacated all of its staff from those premises some months before. This is because it has determined the premises to be unsafe following an earthquake risk assessment.

That situation is symptomatic of an issue that has become a more prevalent negotiating point in lease negotiation in New Zealand in recent years, especially since the 2011 Canterbury earthquakes. This is the risk allocation between a lessor and lessee where a leased premises is discovered to have seismic issues during the lease.

This article focuses on the impact on a commercial lease when a building is deemed earthquake prone during the term of a lease. It discusses:

- How commercial leases can deal with the seismic ratings of a building
- The recent trends we have seen (or are likely to see) in lease negotiations regarding a building's seismic rating
- The tension between the lessor's and lessee's positions
- Factors that might affect each parties' negotiation position when considering leasing commercial premises.

Commercial leases In New Zealand

A lease records the agreement between a lessor and a lessee about the relevant premises and prescribes each party's obligations. A commercial lease can, in some instances, span decades and the rent payable during the lease term could be one of the most costly expenses for a lessee and an important source of income for a lessor.

For these reasons (and many more), a commercial lease is a significant relationship between a lessor and a lessee. When disputes arise due to seismic issues that are discovered during the term of a lease this can significantly impact both lessor and lessee, and both parties could be locked into litigation for many years to resolve them.

Leases for commercial property in New Zealand are recorded in many different forms. However, whether a lease is recorded on the commonly used and widely accepted Auckland District Law Society Form (ADLS Lease), or a bespoke form of lease, one common aspect among most leases is their general silence on what happens when the leased premises is determined to have seismic issues.

Seismic issues – what are earthquake prone buildings?

After the Canterbury earthquakes in 2011 the issue of the seismic strength of buildings became a stronger focus for lessors and lessees. However, even before these earthquakes the concept of an 'earthquake prone building' had been defined under section 122 of the Building Act 2004 (now repealed).

Further legislation, such as the Building (Earthquake prone Buildings) Amendment Act 2016 (the Amendment Act 2016) and various amendments to the general terms of the ADLS Lease have

One common aspect among most leases is their general silence on what happens when the leased premises is determined to have seismic issues.

been introduced to address situations where a local authority has deemed a building to be 'earthquake prone'.

The Amendment Act 2016 defines a building as earthquake prone if, in the event of a moderate earthquake, the building is:

- a. likely to exceed its ultimate capacity; and
- b. if any part of the building were to collapse, it is likely to cause injury or death to persons in or near the building or cause damage to any other property.

Whether a building is earthquake prone is determined by the relevant local authority. Generally, a building is considered earthquake prone if it has a seismic rating of less than 34% New Building Standard (NBS). The seismic rating of a building is typically assessed by a structural engineer who takes into account various aspects of the building to determine how it will perform in the event of an earthquake, as compared to a new building that has been constructed

A building is considered earthquake prone if it has a seismic rating of less than 34% New Building Standard (NBS).

in accordance with the current earthquake building code (NZS 1170.5:2004). There is a public register of earthquake prone buildings available online at epbr.building.govt.nz

If a local authority determines a building to be earthquake prone, to the extent that the building is at imminent risk of collapse or likely to cause immediate danger to persons or property, the local authority is empowered by the Amendment Act 2016 to fence it off and issue a notice restricting entry to it. If that happens then the usual 'no-access' provisions of a lease (if any) would apply, which would mean a rent abatement would apply and if access is not available by the end of the 'no-access period' the lease could be terminated.

If a building is determined to be earthquake prone, but not at imminent risk of collapse or likely to cause immediate danger, the owner of the building is required to undertake strengthening and remedial works to bring it up to current standards. Depending on the location of that building, and assuming it is not a 'priority building' as defined by the Amendment Act 2016 (such as a hospital or

school), the owner has between 15 years to 35 years to complete the necessary seismic works.

So what happens in the intervening period if the building is subject to a lease? What are the lessee's rights if they find out after their lease has already commenced that the building they occupy is earthquake prone? Is there anything a lessor or a lessee can do to minimise their commercial risks when negotiating a lease?

What are the lessee's rights?

What are the lessee's rights if they find out after their lease has already commenced that the building they occupy is earthquake prone?

As alluded to earlier, this is a topical issue in the leasing industry in the wake of the 2011 Canterbury earthquakes. Although the more recent editions of the ADLS Lease contain clauses that apply if access to a building is temporarily or permanently affected, it is unlikely they could be relied on to provide relief to a lessee if the lessor has decades to undertake remediation works to the building. In that case, there is no legal restriction from preventing entry and so the no-access clause would just not apply. In our experience, most leases do not contain any specific provisions requiring the seismic strength of a building to remain at a specific standard.

The Property Law Act 2007 contains a standard warranty that a lessee may terminate its lease if it is unable to lawfully use the premises for the purpose specified in the lease (otherwise known as its 'permitted use'). This warranty would apply if the premises are determined to be a dangerous building and the lessee's access to the premises is permanently prevented. However, nothing in the

Amendment Act 2016 provides that prior to the requisite seismic works being completed, an earthquake prone building cannot be lawfully occupied.

Most lessors are unwilling to insert specific warranties about the seismic strength of a building they are intending to lease, as such warranties increases their burden and obligations. Larger corporations and organisations (such as the major banks and the Crown) are, however, mostly insisting on lessors negotiating this aspect of a lease. Anecdotally, we understand that the Crown now requires at least 80% NBS to be maintained for any new leases that it enters.

Lessee vs lessor – opposing interests

In the absence of any specific warranties about the seismic strength of a building, a lessee is unlikely to be able to cancel the lease if the building is determined to be earthquake prone. Until the lease is cancelled or expires, the lessee is required to continue performing its obligations under the lease, which includes payment of rent, outgoings (i.e. utilities, cleaning fees, body corporate levies, if applicable) and also meeting the lessee's maintenance requirements.

Most lessees will also be classified as a Person Conducting a Business or Undertaking (PCBU) by the Health and Safety at Work Act 2015 so will have a duty of care to their employees to provide a safe working environment. This obligation requires a PCBU to actively mitigate risks and undertake regular assessment of the working environment to ensure safety for its workers at all times.

In the event that a lessee's leased premises becomes an earthquake prone building during the term of the lease, there will

Most leases do not contain any specific provisions requiring the seismic strength of a building to remain at a specific standard.

potentially be tension between the lessee's lease obligations and its duties (as employer) under the Health and Safety at Work Act 2015. As shown in the Ministry of Education's example noted above, the Government (as PCBU) determined Mātauranga House to be 'unsafe' for occupation by its workers and ceased occupation of the building. However, it was still required to continue paying rent to its lessor until the parties can either agree to a resolution or the current term of that lease expires.

From the lessor's perspective, full payment of rent would in most instances be absolutely critical. If a building is deemed to be earthquake prone then the owner of the building is required to complete the seismic works within the timeframes specified. Some older versions of the ADLS Lease or bespoke leases do contain an 'improvement rent' provision requiring lessees to contribute a certain percentage towards the cost of any works that a lessor is required by law to undertake.

Unless a lease contains those provisions, a lessor is unlikely to be able to pass on the cost of any such remedial works to the lessee. Lessors are therefore likely to enforce a lessee's obligation to pay rent and outgoings, and defer the strengthening works for as long as possible as a means to 'claw back' some of the cost of undertaking the seismic strengthening works required.

Lease negotiations

It is possible to negate some of the uncertainties discussed above by inserting specific provisions into a lease. There is little incentive for a lessor or lessee to agree to variations to a lease that may detrimentally affect their position, so a prudent lessor or lessee should turn their mind to such negotiation when entering into discussions for a new lease.

Some examples of lessee-friendly provisions could include:

- A warranty from the lessor that the building is not an earthquake prone building or is at a set NBS% (i.e. 100%) as at the commencement date of the lease (and that it will continue to remain so during the term of the lease)
- A process that may be triggered by the lessee if the NBS% changes (i.e. after physical damage to the building or due to a re-evaluation of the Building Code), where the lessee may either cancel the lease or require the lessor to undertake a seismic reassessment and/or remediation works. This process will need to be clear about:



- when the lessee can commence this process
- the timeframes for when assessments and/or remediation works must be completed
- who will bear the costs
- whether any rent or outgoings abatement will apply during periods of remedial works.

A lessor, on the other hand, may seek to include these clauses within its lease:

- an express 'no representation' clause providing that the lessee has undertaken its own due diligence in terms of the seismic strength of the building prior to entering into the lease and the lessor makes no warranties as to the seismic rating of the premises (noting that the standard ADLS Lease already includes a general 'no representation' clause)
- inserting a provision requiring the lessee to contribute toward the cost of any remediation works required during the term of the lease. Clauses of this type will need to be clear about the:
 - type and extent of remediation works that will be included
 - percentage of the total cost the lessee is required to contribute
 - process and timeframe for payment.

Whether or not the parties are able to negotiate clauses that are more beneficial to them regarding the seismic strength of the premises will depend on a number of factors. As always, the principles of supply and demand will dictate the relative parties' strength when negotiating a lease. Some relevant factors include:

- **Location of the building** – smaller urban centres or rural locations may have limited buildings that are suitable to a lessee, depending on its requirements and the type of business it operates, so in those areas a lessee may find themselves with limited premises that are suitable for their needs
- **Type of building** – there is currently less demand for office premises as a result of slower uptake in staff returning to work in the office full-time following COVID lockdowns. This is particularly true of city centres where parking and length of commute are considerations for most office workers. Lessees negotiating leases of this type may therefore have more negotiating power where premises are sitting empty
- **Appeal/desirability of lessee** – lessees who are considered more desirable to the lessor may have stronger bargaining power. For example, lessors are more likely to negotiate with lessees who have the potential to attract customers to the building (known as 'anchor tenants') if the lessor has a multi-tenanted building or premises (i.e. shopping centres). Similarly, those lessees who are known for their strong financial position (such as banks, government entities, local authorities) may be more desirable for the lessor.

The principles of supply and demand will dictate the relative parties' strength when negotiating a lease.

Where to from here?

We anticipate the seismic strength of commercial premises is a topic that will continue to be relevant for many years to come. As the due date for the completion of seismic works for those buildings deemed earthquake prone looms closer, more consideration will need to be placed on professionals advising their clients on the obligations, costs and risks involved for all parties regarding those works. Focus will also need to be on negotiating appropriate lease terms to address issues about the seismic strength of the building that may arise during the term of the lease 🏠



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EMPIRICAL ANALYSIS OF LESSOR'S INTEREST SALES AND INTEREST RATES

REID QUINLAN

This article looks at what is meant by a lessor's interest market, the investment approach used by New Zealand valuers in this area, and a comparison of equivalent yields to interest rates.

Lessor's interest market

New Zealand has a unique market sector where investors can buy and sell land subject to long-term ground leases, known as lessor's interests. Portfolios of ground leases were previously only held by councils, central government agencies, iwi, charities and church trusts. During the 1990s, various portfolios were sold to private investors and they have continued to create new leases. There is now an ongoing market for lessor's interests, and sales occur regularly.

Many ground leases remain on the historic Glasgow lease format, which is governed by the Public Bodies Leases Act 1969. These leases provide for 21-year terms, perpetual rights of renewal exercisable by the lessee, and a rent review to a fair annual rent for the land disregarding the improvements. Rent reviews are most commonly assessed by valuers using the traditional approach, whereby a ground rental rate (a percentage return) is applied to the current highest and best use land value. Those rates have typically ranged from 5% to 7.5% in most leases for many decades.

Rent reviews were historically conducted only every 21 years on renewal, but over time many review clauses have been altered to specify rent reviews every five or seven years. However, we also see a

few leases with review periods of two, three, four, 10, 11 or 14 years. More frequent reviews are less of a shock to lessees and lessor's incomes do not fall so far behind market levels.

Primary investment characteristics of these assets include:

- Extremely secure income – lease defaults are very rare
- Low-income yields unsuited to the yield-driven listed property sector
- Predictable timing of rent reviews
- Market rent reviews track land values, providing a hedge against inflation
- No capital reinvestment to replace depreciating buildings
- No vacancies or re-letting risk
- Little management requirement as tenants pay all the outgoings directly.

New Zealand has a unique market sector where investors can buy and sell land subject to long-term ground leases, known as lessor's interests.

This article examines trends evident from analysing a sales dataset of 132 lessor's interests for commercial/industrial land in the Auckland region recorded from an in-house database of Seagars, over a 28-year period from 1994 to 2022. This dataset includes:

- Objective inputs – sale date, price, contract rent and term to rent review
- Subjective inputs – valuers' estimates of freehold land values, and expected market rents, at the time of sale.

The 132 sales of lessor's interests over a period of 28 years have been analysed to show equivalent yields, which are highly correlated to 10-year bond yields, lagged 12-18 months.

Percentage of vacant land value

A ground lease alters the ownership rights of land from an asset which could be sold or developed, to the right to receive income and review that income periodically. The landowner might also receive the land back in future if the lease expires or is not renewed. Just like developed buildings, a lease therefore affects who is the likely buyer, and it modifies the value of the landowner's interest from the vacant land value.

A comparison of lessor's interest to vacant land value has been used as a simplistic valuation measure in the past. The sales data has been analysed to identify trends in this relative value measure.

For consistency, leases with predetermined ground rental rates that modify lessor's interest values more than leases with 'market' rent reviews have been excluded from the analysis. Of the sales

A ground lease alters the ownership rights of land from an asset which could be sold or developed, to the right to receive income and review that income periodically.

analysed, 95 sites had a typical market-based rent review mechanism. The relationship between lessor's interest prices and estimated land values in the dataset is shown in **Chart 1**.

Observations from Chart 1:

1. Lessor's interests seldom sell at estimated current land value. Adopting the land value, or a fixed ratio to land value, would provide a poor level of accuracy when assessing lessor's interest values.
2. Sales before about 2002 were typically at a discount to land value, they averaged close to land value from about 2008-2013, and since 2013 most sales have been at a premium to land values.
3. The ratio of lessor's interest sale price to land value has been increasing.

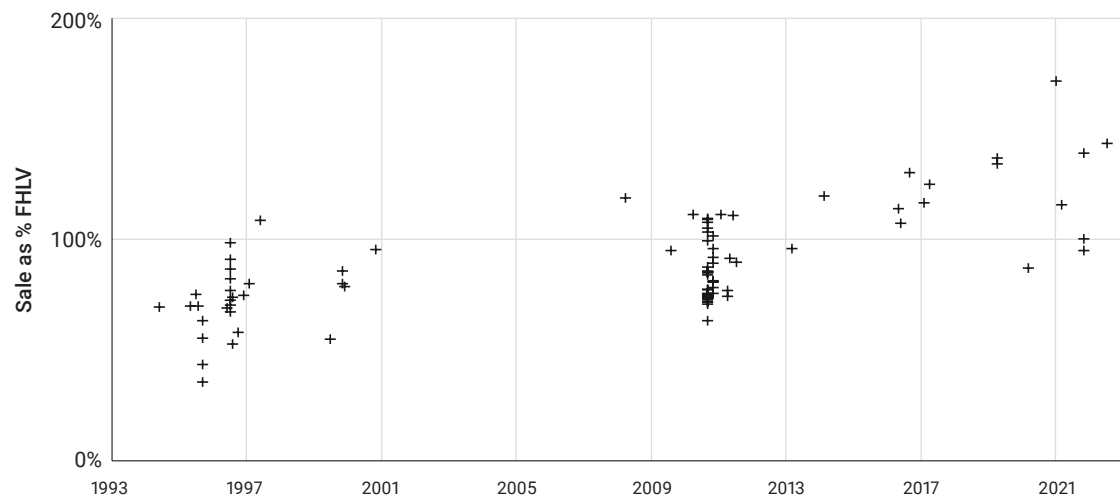


Chart 1: Lessor's interest price as % FHLV (excluding preset ground rental rates)

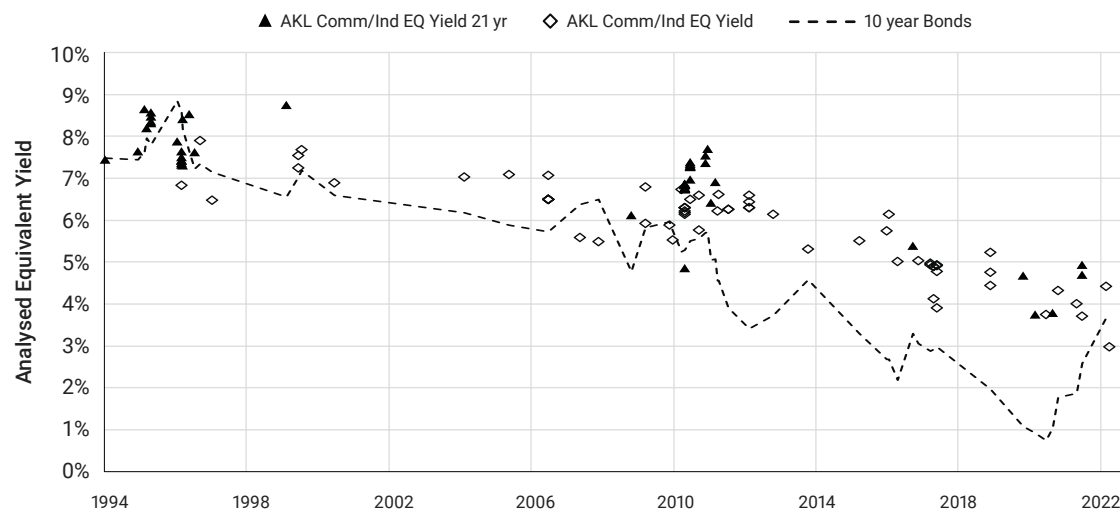


Chart 2: Equivalent yield vs 10-year bond yield

Investment approach

Lessor's interests provide a measurable percentage income return on price, so the primary valuation approach used by New Zealand valuers is the investment approach. However, a feature of these assets is that the current rental income is frequently out of date and initial yields (current rent ÷ sale price) are a poor indicator of value.

Just like other leased assets with non-current rents, the preferred approach is therefore to base future income expectations on the expected 'market' income having regard to other rent reviews or lease renewals in the area at the time of sale.

Valuers will typically use some way to allow for the shortfall and catch-up to market rates, and that can be either an equivalent yield (capitalised current rent, plus market rent reversion capitalised and deferred to next review date, at a universal yield), or a full discounted cash flow (DCF) approach.

Additional complexity in valuation methods tends to require compounding assumptions that are unprovable and yet affect the analysis, particularly the growth rate in DCF models. This article relies on analysed equivalent yields, as they are a basic and widely-used measure to allow for obvious under-renting and the time to the next rent review. In practice, the writer's experience has been that equivalent yields are a consistent valuation

measure, and more detailed analysis (i.e. a full DCF) tends to make little real difference to the observable market trends.

Rents for 21-year rent reviews tend to be set at a premium over more regular reviews (i.e. historically 7.5% as opposed to 6.5%), which directly affects equivalent yields. In this analysis, the longer-term 21-year review terms have been separated from sales with more regular rent reviews (usually five to seven years but referenced as '5-year' in charts for simplicity).

Comparing equivalent yields to interest rates

Property income returns are widely considered to be affected by changes in interest rates. This arises because investors typically leverage income returns, and returns must compete with other asset classes.

Chart 2 shows analysed equivalent yields from the full dataset over the past 28 years. Regular rent reviews are shown as diamond datapoints and the 21-year reviews are identified as black triangles. [Note year is not yearly]. The chart also includes 10-year government bond yields as a dashed line, as a proxy for long-term interest rates and long-term investment returns generally.

Observations from Chart 2:

1. Long-term interest rates have been in a prolonged fall from the late 1990s to the end of 2020 across multiple business cycles.
2. The analysed yields have been consistently at or above 10-year government bond yields.

3. The correlation coefficient between analysed yields and 10-year government bond yields (at sale date) was 0.76 for regular rent reviews and 0.85 for 21-year leases, meaning there is a strong association between yields and this interest rate series.

It is not uncommon for property value changes to lag financial market indicators, as investors may take a wait-and-see approach to whether short-term changes are longer-term impacts or irrelevant 'market noise'. To test this, the correlation coefficient was measured between analysed equivalent yields and both five-year and 10-year government bond yields from the date of sale until as much as 24 months prior. The results are shown in **Chart 3**.

It is not uncommon for property value changes to lag financial market indicators, as investors may take a wait-and-see approach to whether short-term changes are longer-term impacts or irrelevant 'market noise'.

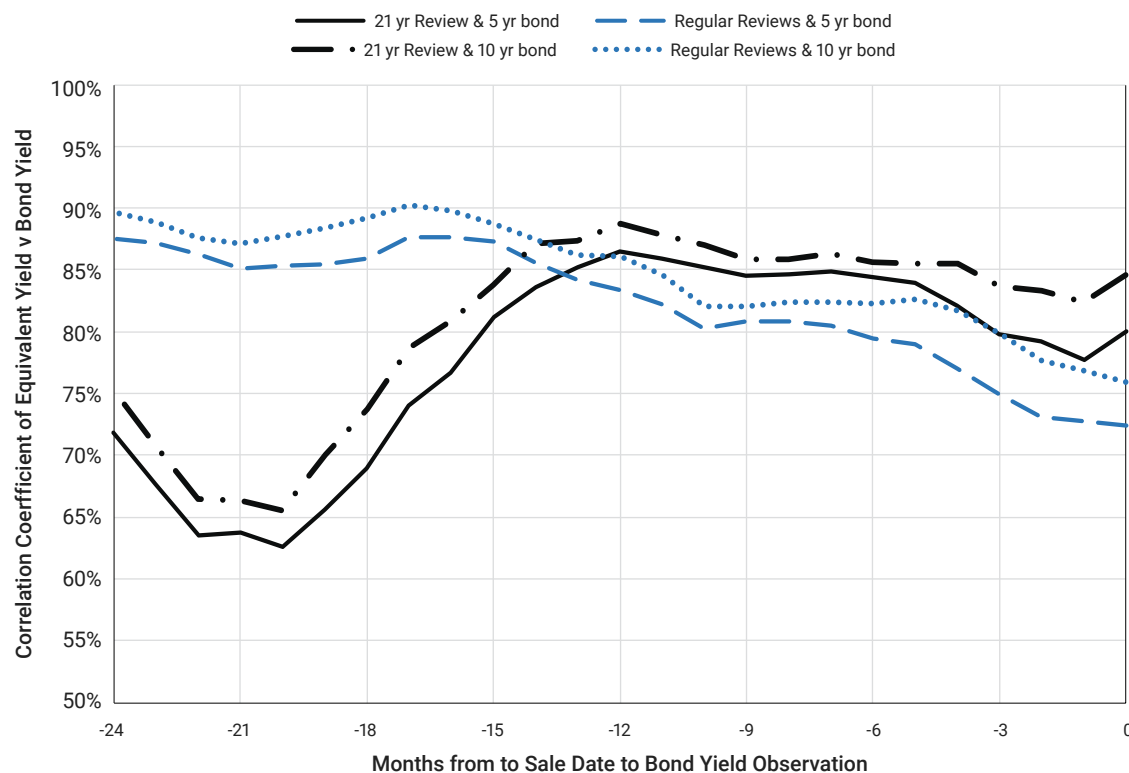


Chart 3: Correlation between lagged equivalent yields and bond yields

Observations from Chart 3:

Findings included:

1. The equivalent yields showed a uniformly higher correlation to 10-year bond yields than to five-year bond yields.
2. There is an obvious lag in the effect of interest rates and yields. Equivalent yields from 21-year leases had the highest correlation (0.89) when compared to 10-year bond yields observable 12 months before the sale date. Equivalent yields from leases with regular reviews correlated most highly (0.90) when compared to 10-year bond yields 17 months before the sale date.

These measures of market lag should be treated as indicative, because the recorded 'sale date' quoted by valuers is imperfect data and known to have inconsistencies, depending on the source. Sale dates are variously quoted as the date the price was agreed, the unconditional date, or in some cases the settlement date if the agreement date is not known. The term of the lag will be systemically underestimated to the degree that data is imperfect.

An analysis of overall yield changes relative to interest rates can be formulated. Analysing all the lessor's interest sales of leases with regular

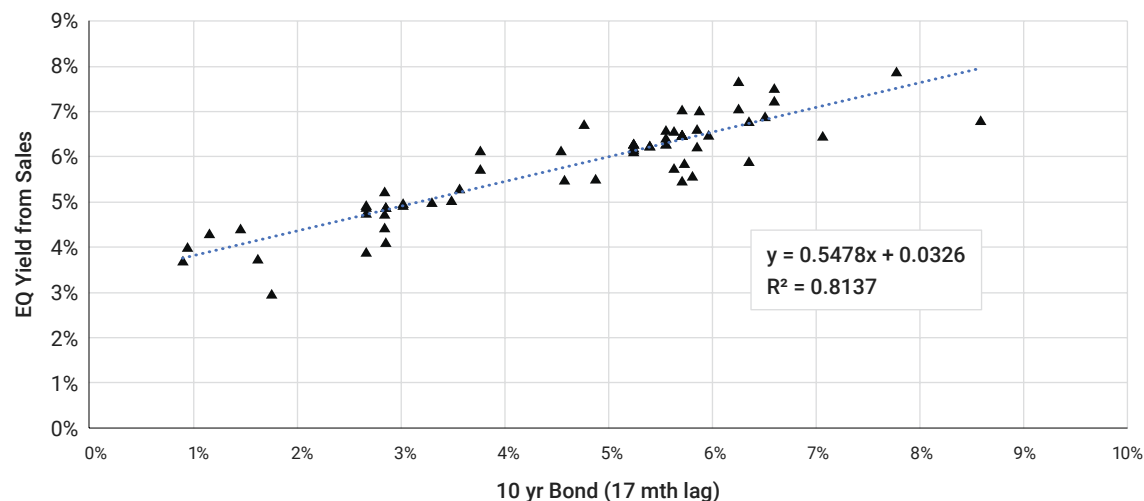


Chart 4: Auckland Comm/Ind Eeq Yields vs 10 yr bonds (17 mth lag)

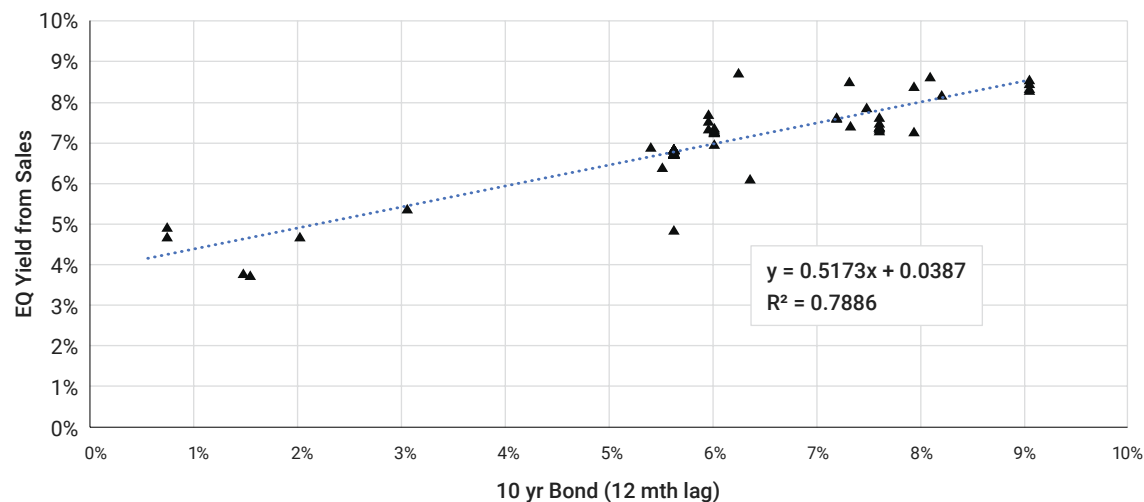


Chart 5: Auckland 21-yr Comm/Ind Eeq Yields vs 10 yr bonds (12 mth lag)

rent reviews in **Chart 4** shows a fairly consistent relationship to 10-year bond yields (lagged 17 months).

Equivalent yields from lessor's interests with 21-year reviews are compared to 10-year bond yields lagged 12 months in **Chart 5**.

Observations from Charts 4 and 5:

1. There is a clear association between analysed yields and interest rates. The r^2 value for regular reviews is 0.8137, while for 21-year reviews it is 0.7886. This indicates that most of the movement of yields is explained by interest rates, but still with some unexplained variation in the data.
2. Using Microsoft Excel's built-in linear regression analysis confirms the equivalent yield conforms to the following formulae:
 - For regular reviews:
EQ Yield = 3.26% + 0.5478 × 10 yr bond yield (lagged 17 months)
 - For 21-year reviews:
EQ Yield = 3.87% + 0.5173 × 10 yr bond yield (lagged 12 months).

Interest rate changes have a lagged effect on yields, ranging between 12 and 18 months.

Conclusions

There has been a strong relationship between equivalent yields on lessor's interests and 10-year bond yields, with interest rates explaining approximately 80% of the change in yields observed over the past 28 years. In round terms, interest rate changes have a lagged effect on yields, ranging between 12 and 18 months.

This analysis provides valuers with an empirical basis for adjusting equivalent yields when there have been major changes in interest rates, but when there are few current transactions to measure the market impact of those changes 🏠



Reid Quinlan is a Director of Seagars Auckland who specialises in commercial leasehold valuations.

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Join us at the 2023 National Property Conference

Registrations have now opened for this year's big 2023 National Property Conference being held at the Te Pae Convention Centre in Christchurch on 7–9 June.

On that web page property professionals can also get up-to-date information about the programme, the confirmed speakers, and investigate our new Awards format, which includes a new Business Category.

Of course, the event is a special one this year due to New Zealand's hosting of the IVSC/WAVO Global Valuation Conference.

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BRANCH CHAIRS

This is the first of a four-part series showcasing the talent and experience of the Property Institute's branch chairs throughout New Zealand. Branches are at the heart of everything we do. At a grassroots level, our network of branches helps set PINZ apart from many other similar organisations, keeping us ahead of local issues and in touch with members at the frontline. We thank our volunteers for their commitment and their dedication to the Property Institute, the professions we serve and our members.

MATTHEW FENTON

Tauranga Branch

After completing my property valuation degree at Massey University, I spent nine years living in Europe where I developed a short but exciting career on-board super-yachts. During my time on-board I was appointed as Chief Officer, which came with great responsibility and challenged me everyday to deal with a large multicultural crew at sea and fastidious clients/owners.

Since being back in New Zealand, my wife Jenna and I have settled into life in Tauranga where I have rekindled my career as a property valuer. I am now an Associate Director at Preston Rowe Paterson (PRP) Tauranga and head up the Commercial Advisory Team. My work largely comprises of industrial and commercial valuations, with more specialist work in post-harvest facilities, supermarkets and development work.

I joined the local branch committee in 2018 and was appointed as secretary in 2019, and then went on to be branch chair in 2021. Being involved in the branch committee is a fantastic opportunity to give back to the profession, develop relationships with valuers outside of your organisation and further develop your career.

One of the greatest benefits of being involved with the branch is networking. Tauranga is a small town, in which we have a great bunch of property valuers and consultants. Networking events put on by the branch help to strengthen these relationships and provide opportunities for valuers to dissect the market among valuers. This is more important in an uncertain market.

As a committee, we are committed to further developing our local CPD events and providing a range of events for all assets classes. We plan to hold more frequent planning discussions as this is a continuously evolving landscape. We also want to build on our Future Leader networking events and hope to have a representative from the Future Leader programme join the committee in 2023.

Being involved in the branch committee is a fantastic opportunity to give back to the profession, develop relationships with valuers outside of your organisation and further develop your career.

A portrait of Ashton Gibbard, a man with short brown hair, wearing a light blue patterned button-down shirt and dark trousers with a black belt. He is standing in front of a window with vertical blinds.

ASHTON GIBBARD

Northland Branch

After university, I started my career in the residential property management industry at Property Brokers Palmerston North. I worked there for around 12 months before embarking on my valuation career at QV as a Rating Valuer across the Manawatu. In my time there, I was provided with excellent opportunities to progress my knowledge and skills across the rating industry, marketing valuations, asset and advisory work, and so on.

In 2016, a position became available in Whangarei, so I jumped at the chance to move to a more coastal environment where I could enjoy the fishing and diving Northland is renowned for. In early 2020, I accepted a role with Opteon as an Associate Director. This has helped me grow as a manager and a valuer, with new opportunities and providing guidance and mentoring to other valuers within the company.

I have been involved in various roles within the Property Institute, from being on the Manawatu Branch committee, then as secretary, and then joining the Northland Branch when I relocated in 2016, through to now being the branch committee chairperson. For me, it

has been a great way to develop and build relationships with valuers outside of my regular work circle and bridge the divide between companies, while also contributing to the industry with relevant events and supporting the progression of members to advancement of membership status.

With the property market being a dynamic environment, it is important to have contacts throughout the industry, which enables valuers to stay up to date with the current state of play. Being an active member of the Northland Branch has given me opportunities to mix with a diverse range of members and affiliated professionals across the district. While this has benefited me in having a wide base of people to reach out to for information, it also enables me to offer the public alternate options for advice when requests come in for valuation services or advice that others would be better suited to provide.

With the past few years now behind us the committee is looking to refocus on providing quality CPD events that give members the continued opportunities to explore new developments and buildings, and get first-hand knowledge from those in positions to shape how our district will develop in the coming years.

It has been a great way to bridge the divide between companies, while also contributing to the industry with relevant events.

A portrait of Matt Straka, a man with short brown hair and a light beard, smiling. He is wearing a dark blue suit jacket over a light blue and white checkered shirt and a striped tie. The background is a plain, light grey.

MATT STRAKA

Waikato Branch

Having completed a Bachelor of Business Studies at Massey University in Auckland in 2007, I began working as a graduate property valuer with TelferYoung in Auckland where I obtained valuer's registration in 2010. Having spent seven years as a commercial property valuer for JLL in Auckland, I joined Bayleys in 2018 and relocated to Hamilton. Here I set up the Bayleys Waikato Valuation Team, now consisting of three Registered Valuers and a Graduate Valuer.

I served on the Auckland Branch committee of both PINZ and NZIV for some five to six years, where my primary role was organising networking events for the younger members of the wider property industry in Auckland. Soon after relocating to Hamilton, I joined the Waikato Branch committee of PINZ and NZIV.

As in any profession, relationships are everything. Branch involvement over the years has been an excellent way to meet like-minded professionals in my industry and form strong networks. As valuers, we are all competing with each other in some form or another. However, I have always believed that we need one another to do our

jobs properly, and it would be extremely difficult to operate effectively and efficiently in isolation.

Forming strong connections with other valuers in our region is critical for data sharing and even sound-boarding methodologies. This can help keep us out of trouble too. Being a member of the committee has provided me with the opportunity to form and maintain these relationships through regular contact.

Being on the committee also gives me the opportunity to have my say and make a difference to our members, through organising relevant local events including educational sessions, site tours and social functions. It's also a great way to foster my own engagement and stay ahead of the challenges and changes facing our profession. If I may say, it is also a cost-effective way of obtaining my first five CPD points each year!

Over the coming year, my objectives are to maintain a committee of dedicated members, representing the different firms and professions that make up our membership, and deliver several relevant CPD events where our members can socialise and – with any luck – learn something new.

Forming strong connections with other valuers in our region is critical for data sharing and even sound-boarding methodologies.



AVELLA TAYLOR

Auckland Branch

I have been working within the property valuation industry for almost 10 years, starting my career in Perth, Western Australia as a Graduate Valuer where I became a qualified valuer and subsequently relocated to New Zealand in 2017. I have worked across both the private and public sectors, completing valuations for mortgage security purposes, financial reporting, and more recently managing the procurement and delivery of rating valuation contracts for councils throughout New Zealand.

I am a big believer in creating meaningful connections with like-minded professionals within our industry. Being a member of the Institute provides me with the opportunity to build on my network and develop as a property professional.

I've really enjoyed getting to know the different committee members and working with the team on delivering meaningful events for our members. It has been a challenging couple of years, particularly impacting face-to-face events and meetings, and the way that the branch has navigated these challenges has been commendable. It is a team effort, and I can't speak highly enough of

the Auckland Branch committee and the work they put into supporting our community.

My motivation to join the branch was to expand my network, build my experience in governance, and to contribute to the wider property community through the delivery of outcomes and events for our members.

Networking is fun! It provides the opportunity to engage with professionals who you might not usually deal with in your day-to-day role. This can expand your thinking, assist in building your own knowledge base, and build your personal brand within the industry which can lead to all kind of opportunities.

As we navigate what is expected to be another challenging year for our members, we endeavour to provide valuable content and events that will assist them in not only their professional but personal circumstances. Knowledge is power and being able to engage with our wider network to deliver content and events will hopefully provide meaningful guidance and support to our members 🏡

It has been a challenging couple of years, particularly impacting face-to-face events and meetings.

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