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## The credit crunch and valuations

The well-documented worldwide credit crunch has resulted in high profile company collapses, job losses and various forms of Government interventions. The effects were first felt in New Zealand when second tier lending organisations began to fold, freezing or, in some cases wiping out investments made by private investors. This included organisations that provided mezzanine lending to property developers.

Internationally, the high profile failure and bailouts of Wall Street organisations and car manufacturers in the US, nationalisation of UK Banks and job losses have become focal points of the current economic climate.

This activity has impacted on valuations carried out by Beca in late 2008 and into 2009. While a falling property market may be interpreted as a negative for business, it also presents opportunities. Outlined below are issues that have come to our notice while completing these valuations.

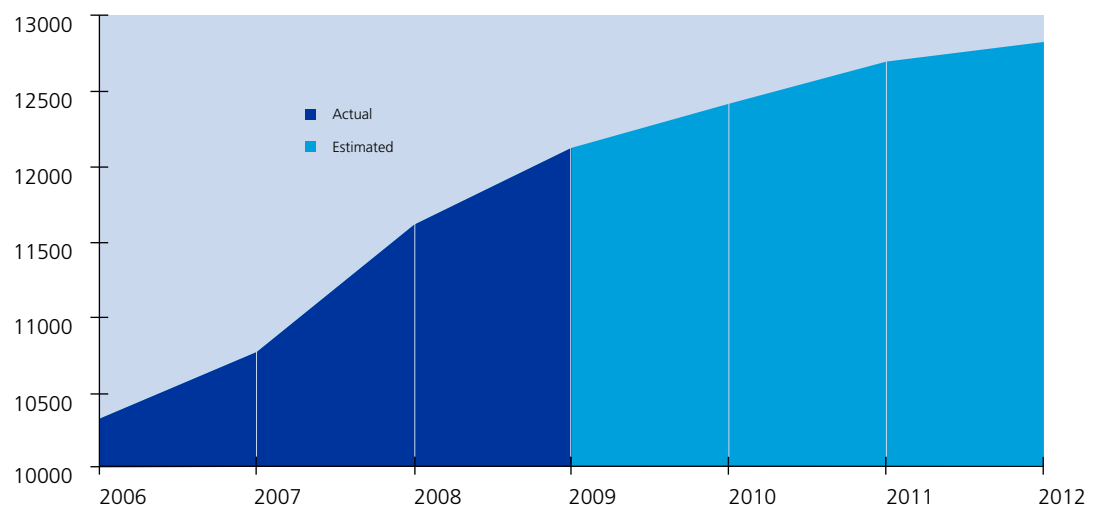
## Insurance

Beca assesses the indemnity value (IV) for fire service levy purposes of commercial properties when carrying out insurance valuations. Indemnity Value is defined by "A Guide to the New Zealand Fire Service Levy" as the replacement value of the property, less any depreciation on an age and condition basis.

While market values have been falling, this does not immediately appear to have been followed by reduced construction costs at the same rates. Beca's latest forecast figures estimate building costs will escalate at a lower rate over the next three years compared with the previous three years.

The graph below estimates the building cost index over a six year period. While costs have increased by 5%, 7% and 4% respectively for 2006 to 2009, it is forecast the rate of cost increase will come down to 2%, 2%, and 1 % for the coming three years.

Tracking and predicting changes in Building Cost Index



Commercial properties tend to have an average life of 60 years, and therefore depreciate on an annual straight-line basis of 1.66%, assuming no residual value. This, along with the assessment of condition, may have an impact on the amount of Fire Service levy due, as in previous years the increase in cost to replace assets was outstripping annual depreciation. It is advisable to ensure your company's insurance valuations and indemnity value assessments are up to date to benefit from any potential savings.

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Do we have your correct details?  
Contact us at: [value@beca.com](mailto:value@beca.com)

## Financial reporting



Financial reporting values of fixed assets are based on fair value. Where the asset can be traded on an open market and is deemed to be non-specialised, the fair value is based on the market value. Many of Beca's clients include real estate as part of their assets, the value of which is naturally affected by the economy.

The New Zealand equivalent to International Accounting Standard 16 states:

**“Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date”.**

During Beca's latest round of nationwide valuations, the Valuations team noticed the following trends in commercial office properties:

- Oversupply of available space, especially for B grade and below
- Where rent reviews are due, often there has been no increases, or the review is deferred for 12 months
- Difficulty in attracting tenants for larger spaces
- Yields for A grade tenants (like government agencies and banks) remaining level while buildings with riskier tenants are attracting higher yields, recognizing the risks associated with the income stream.

These factors indicate that a material change has occurred in the value of real estate asset bases.

## Mergers and acquisitions

The changing market is providing opportunities to acquire businesses at attractive rates. When doing so it is imperative to undertake a comprehensive due diligence process that covers the many facets of business operation. This includes the valuation of the business's fixed assets to get a clear representation of the asset value, forming part of the overall purchase amount. Beca has extensive experience in undertaking such valuations for purchasers.

This readily flows onto setting up opening book values for the client as well as insurance values at the same time, saving on valuation fees.

Please contact Marvin Clough on 64 9 300 9752 if you would like to discuss the impact of any of the topics covered on your assets and business, or for any other valuation related issues.

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