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Dear John and Hamish

Treatment of re-zoning costs in airport Schedule A land revaluations

The key outstanding issue to emerge from the airport land valuations workshop held on 2 October was the treatment within the valuation process of the costs of hypothetically rezoning airport land in order to move to the next best alternative use. Two presentations were tabled and talked to at the workshop (one by BARNZ and one by Mr Kieran Murray) and the Commission staff agreed to provide attendees with the opportunity to respond further in writing.

Current Schedule A provisions

BARNZ considers that Schedule A, as it currently exists, is quite clear that the costs of any changes necessary to hypothetically rezone the land from its existing underlying zoning and aeronautical designations to the zoning required to enable the hypothetical next best alternative use to be achieved are costs which must be taken into account in determining the valuation of the land.

Section A9 of Schedule A which sets out the Practical Valuation Requirements states that in undertaking an MVAU valuation the valuer must ...

(b) have regard to designation, zoning and other district plan and legal requirements applying to the land.

The explanatory notes to A9 expand this requirement as follows:

(4) The land is likely to be designated or zoned for the various aeronautical activities of the airport owner. In addition to considering the likely alternative uses for the land, the valuer should also consider the likelihood of the designation being uplifted or the land rezoned, and costs (if any) likely to be involved in this. (emphasis added)

Also relevant is Section A10, which sets out the MVAU Valuation Steps, and states that in undertaking an MVAU valuation the valuer must:

(c) Determine the existing or underlying zoning of the land or designations and the likely zoning of the land for the highest and best alternative use, including the likelihood of zoning change or uplifting designations.

Schedule A specifically directs that the valuation must exclude any allowance for remediation expenditure or the costs required to convert the land into supply for specified airport services. There is a very detailed list of costs which must be excluded, or not be taken into account, when determining the valuation in paragraphs 13 and 15 of section A9.

Consistent with the fact that the valuer is expressly directed in A9 and A10 to take into account the costs and likelihood of the land being rezoned and designations uplifted, zoning and designation changes and costs are not included in the lists in A9 of specific matters to be excluded.

We therefore consider that there is a very clear direction in Schedule A for the costs of obtaining any zoning changes from the existing zoning and designations, which are necessary to undertake the selected next best alternative use, to be taken into account as part of the applicable development costs, and therefore to be deducted from the expected gross realisation of the land.

Zoning costs have been reflected in airport valuations

The valuations undertaken on behalf of all three regulated airports to date have reflected some, or all, of the costs of obtaining the necessary zoning changes to their existing zones to enable the hypothetical development of the airport land to occur. None of the valuations have completely excluded the costs of obtaining the necessary zoning changes, which is the approach being advocated by Mr Murray.

Attachment A to this letter contains a table setting out in summary form the current zoning for each airport, what changes would be needed to move to the next best alternative land use, the allowance made by the airport valuers to reflect this cost and the advice provided to BARNZ by its advisers as to the reasonableness of the allowance by the airport valuers.

In essence, all three airports included costs for obtaining zoning changes as part of the development costs deducted from the gross realisation of the land.

This is not to say that BARNZ's advisers necessarily agreed with the allowances made for rezoning.

The advice BARNZ received was that:

- the 12 month allowance by Auckland Airport's valuers was 6 to 12 months too short, with 18 months to 2 years being a more appropriate estimate for the proposed alternative development;
- the 9 month allowance by Wellington Airport's valuers was significantly too short, with 2 to 3 years being a more likely allowance for the proposed intensive development, which included a new town centre replacing Kilbirnie, thus (as noted by Wellington Airport's planner) creating the need for an entire review of the planning of Southern Wellington;
- the 3 ½ years allowed by Christchurch Airport's valuers for the completion of all regulatory planning processes was appropriate.

It is axiomatic that the allowance for the time and costs of obtaining the necessary planning changes needs to be consistent with the alternative land use plan being proposed. Some land uses will reflect uses permitted under existing zoning, thus not needing any planning changes. Other uses may require moderate or uncontroversial changes to planning frameworks where a relatively short time allowance for obtaining rezoning is appropriate. However, where the alternative land use is one which would significantly affect the planning rules for the surrounding area, or undermine existing commercial centres, then a longer period for obtaining the necessary consents will be required. The context of the proposed alternative land use is therefore fundamental to determining the appropriate allowance which must be made for obtaining the relevant planning changes.

Opportunity cost requires rezoning costs to be taken into account

Opportunity cost is the fundamental concept underlying the Commission's approach to land valuation under Part 4. The concept of opportunity cost value requires any costs of moving to that next best alternative use to be taken into account, or else the resulting value is not a true measure of the net opportunity cost to the land owner. This is reflected in the MVAU definition at the beginning of Schedule A, where MVAU is defined as the

Gross realisations or estimated value of the land – allowance for applicable development costs.

BARNZ requested Dr John Small to review the paper authored by Mr Murray provided to the Commission by NZ Airports. Dr Small's paper is being provided to the Commission at the same time as this letter.

Dr Small has advised that in competitive markets the opportunity cost of the relevant assets would be determined by deducting rezoning costs. In the present instance the principle being applied by the Commission was that an airport company would retain the land unless it expected higher profits from selling it, hence the land should be valued at the net amount which would be received from selling it. Because it may be necessary to rezone the land in order to realise the greatest profit from its disposal, the current value must reflect the maximum value in that best alternative use after any rezoning costs.

Dr Small has noted that if there are any additional costs of converting newly acquired land (as opposed to the existing airport land already owned by the airport) into use as part of the airport, then the solution is to enter those costs into the RAB as a distinct asset, which recognises such expenditure if and when it occurs. Dr Small considers that to be consistent with the broader aims of the Part 4 regime.

With respect to the fact that under Schedule A valuers are directed to exclude remediation costs, Dr Small notes that from an economic perspective, this is an outlier, and if there is an issue about inconsistency between treatment of remediation costs and rezoning costs, then the most economically efficient response is to write down airport assets for remediation costs.

Concluding remarks

Land valuation matters were the subject of extensive debate and consideration during the development of the input methodologies. Schedule A was reviewed by valuation experts for the Commission, airports and airlines. Opportunity cost is the net cost of what could be realised by selling an asset for its next best alternative use. That is, the gross realisation of the asset less the costs of converting it to that alternative use. This principle is well established in competitive markets, and should also apply when determining the value of land used for an airport under Part 4.

All airport valuers, as well as the valuer the Commission appointed to undertake peer reviews of the airport valuations, have, to varying degrees, made allowances for the costs of obtaining the necessary zoning changes when undertaking valuations under Schedule A.

The argument put forward by Mr Murray that the land should be assumed to already have been rezoned to reflect the zoning of surrounding land uses, would result in a valuation which is significantly higher than the opportunity cost to the airports of retaining that land in its existing use as an airport, due to Mr Murray's approach not reflecting the costs of converting the land to that alternative use. The resulting higher valuations would prevent interested persons from being able to accurately assess the reasonableness of the level of returns being targeted by the airports and would enable airports to target returns above those expected in competitive markets.

Yours sincerely



John Beckett

Executive Director

SUMMARY OF CURRENT PLANNING RULES FOR AIRPORT LAND AND NECESSARY CHANGES REQUIRED FOR ALTERNATIVE USE PLANS

Airport	Current zoning	Alternative land use proposed by airport planner	Zoning changes required for airport's proposed alternative land use	Time and cost allowance made by airport valuers for zoning changes	Advice provided by BARNZ advisers on reasonableness of airport allowance for zoning
Auckland Colliers 2011	Manukau - Airport Activities Zone (allows airport related activities, commercial and some retail) Mangere – Puhinui Rural Zone & Puhinui Heritage Zone Plus Designation 231 overlays the zones	Mixed use precinct development x 10 Each precinct incorporates residential, commercial, and other uses.	Structure plan New residential zoning	Colliers allowed one year Costs not expressly shown	Zomac & Market Economics advised that it would take between 1.5 to 2 years to obtain the necessary planning approvals to undertake the HBAU development. Further once the planning approvals have been obtained it would take approximately 1 year for detailed design and construction to commence. Zomac advised rezoning would cost \$2.5m
Wellington Telfer Young 2013	Airport and Golf Course Precinct (allows recreational, airport related activities and identified commercial activities)	Mixed use urban , office, retail, industrial and residential	Structure plan New residential zoning New town centre Revision of planning rules for wider Southern Wellington region	Telfer Young adopted 9 months. Planning and resource consent costs stated to be included in the general construction costs but were not separately broken out	On the basis of requirements for new structure plans, extensive public consultation and possible Environment Court appeals, Zomac and an independent RMA barrister advised that it would most likely take between 2 and 3 years to obtain the necessary approvals. Property Advisory made allowance in holdings costs for an additional 15 months to obtain necessary planning changes (total allowance including TV 9 months therefore 24 months).
Christchurch Seagars 2009 and 2011	Special Purpose Airport Zone & Airport Designation (allows airport related activities and commercial/retail activities that serve the airport workforce or passengers)	Mixed use retail , office, industrial, and residential	Structure plan New residential zoning Expanded commercial zoning	3 ½ years allowed for the various regulatory processes to be completed. Identified by Seagars to amount to \$50m for the time, costs and risk of obtaining the necessary planning changes	Zomac advised that Planit's HBAU master plan for identified CIAL land is fair and reasonable and the time allowed for zoning changes was appropriate.