



3 September 2024

New Zealand Competition Commission
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Review of Auckland Airport's 2022-2027 price setting event

The Qantas Group welcomes the opportunity to address the Commission's review of Auckland Airport's PSE4 proposals.

Auckland airport is a critical piece of New Zealand's national infrastructure. The Qantas Group supports investment and re-development but the proposed capital plan far exceeds what is needed, adding significant pressure in an already high-cost New Zealand operating environment. This is compounded by the airport's over-collection on Building Block inputs, resulting in an over-recovery of \$295m (present value) during PSE4.

The airport's current investment plan is inefficient and results in unacceptable pricing increases that will materially affect demand. Under PSE4 and PSE5 capital plans, we expect pricing to rise from \$6.73 in FY23 to \$30.30 in FY32 for domestic passengers and from \$23.39 in FY23 to \$79.95 in FY32 for international passengers under AIAL's proposed plan and pricing. There is a further risk of those prices rising to \$34.74 and \$91.66¹ respectively. FY32 pricing (PSE5) should be no greater than \$16.42 for domestic passengers and \$43.13 for international passengers, with further reductions possible through careful planning and diligent consultation.

This sharp escalation in prices results from a monopoly infrastructure provider over-investing and over-charging under a capital plan and design that exceeds industry requirements. This is further exacerbated by the airport's incorrect application of the Building Block Model.

It has instead announced an inflated footprint and cost-estimate and not moved from its design at any point despite years of feedback from airlines.

¹ Includes demand reductions arising in accordance and Qantas capital estimates to complete AIAL's Vision 2030 and 2extrapolated BIS Oxford Economics

[REDACTED]

Coupled with AIAL's incorrect use of Building Block inputs, the net result is an over-collection of revenue of \$295m (present value) over PSE4. The Qantas Group estimates that this will lead to a >1.5m reduction p.a. in passenger demand in AKL by FY32² - with flow on effects to other domestic airports and wider economic activity, including loss of jobs, tourism spend and a material reduction in GDP.³

The current regulatory regime is failing airlines and consumers. Neither airline customers nor the New Zealand economy should wear the burden of conscious over-investment or over-collection on Building Block inputs. Given the quantum of investment and the PSE4 and PSE5 price path, it is critical that urgent steps are taken to ensure that the airport ceases further investment in the current design path and completes effective consultation.

The Qantas Group agrees with some aspects of the Commission's draft conclusions. In particular, we support:

- A post-tax WACC of 7.28%, as per the low range of the Commission's draft assessment; and
- A tilted annuity depreciation model, as recommended by the commission.

However, our submission disagrees with other parts of the Commission's draft conclusions. In particular, we note that:

- AIAL's forecast capital expenditure is not reasonable; and
- AIAL has also over-recovered on other aspects of Building Block inputs - including with regard to opex, sunk costs and other aspects of depreciation.

We therefore ask that the Commission considers further action as part of this PSE4 review, including:

- Additional adjustments to Building Block pricing inputs;
- Conducting a section 56 review; and
- Strengthening regulatory controls, including moving Auckland Airport to a Price Control regime for PSE4 and PSE5 and requiring a genuine consultation with regard to the airport's investment plans.

Our substantive submission is set out in Attachment A to this letter.

Yours sincerely,

[REDACTED]

² Based on demand study complete by BIS Oxford Economics commissioned by BARNZ

³ The Importance of Air Transport to New Zealand (IATA), estimated air transport contribution of US\$20.7b to GDP [iata.org/en/iata-repository/publications/economic-reports/new-zealand--value-of-aviation/](https://www.iata.org/en/iata-repository/publications/economic-reports/new-zealand--value-of-aviation/)

Attachment A

Qantas Group Submission on review of AIAL's 2022-2027 price setting event

1. Summary

The Qantas Group supports further investment at Auckland Airport and acknowledges that even with efficient investment there may be an uplift in PSE4 pricing. However, we have the following material concerns regarding AIAL's PSE4 plan and pricing:

- The planned investment is inefficient and not fit for purpose, and the airport has built above industry standards (Refer Section 2);

- AIAL has sought to over-collect through incorrect application of BBM inputs (Refer Section 4); and
- Left unchecked, AIAL's pricing proposal will have a significant impact on consumers and the economy (Refer Section 5).

Qantas' response considers both PSE4 and PSE5 for the reasons listed in Attachment 5.

2. The planned investment is inefficient and not fit for purpose

2.1. The planned investment exceeds requirements for realistic demand projections

AIAL has assumed that unconstrained demand continues to rise at a standard rate. However, demand growth had already started slowing prior to the onset of COVID-19 and today demand remains well below pre-COVID levels. Furthermore, price elasticity analysis undertaken by BISOE for BARNZ demonstrates that the pricing impacts of AIAL's proposed capital plan will likely further dampen demand forecasts.

AIAL must use revised growth assumptions to re-assess investment requirements – having regard to slower than expected growth and demand implications of its proposed investment.

Auckland Airport experienced a short period of significant growth between 2014 to 2017. The growth rate then stabilised and started a downward trend suggesting that passenger numbers were about to plateau before COVID⁴. This is illustrated in the following charts (that have previously been shared with AIAL by the Qantas Group).

⁴ Data derived from DDS - IATA

Figure 1: AKL Pax Growth (FY09-FY26)

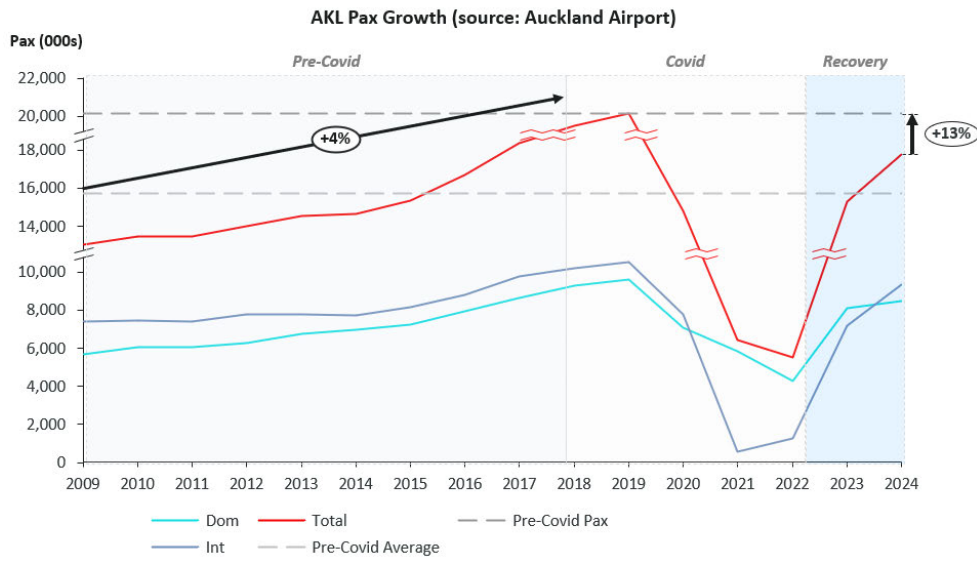


Figure 1.1: Contraction in Total AKL Pax Growth (Q1 2016 – Q3 2019)⁵

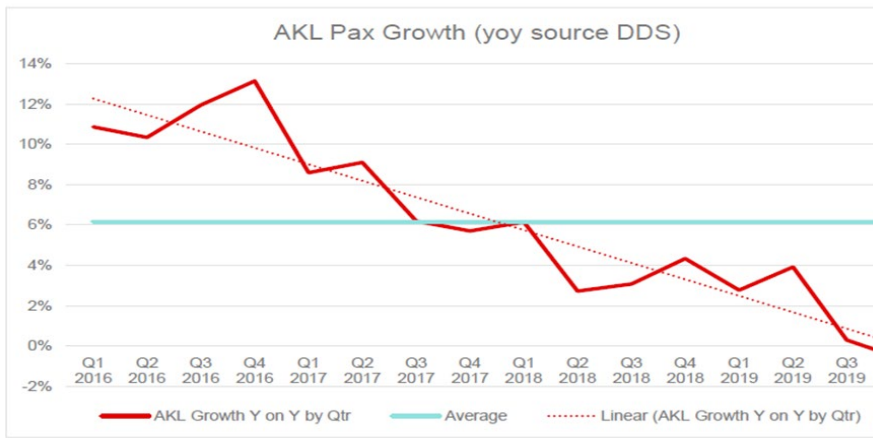
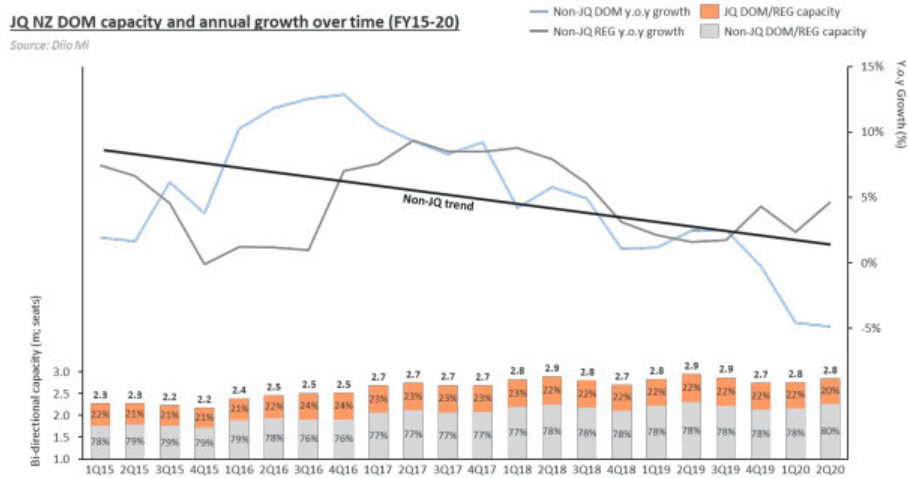


Figure 1.2: Contraction in AKL Pax Growth (Q1 2016 – Q3 2019)



⁵ Source: IATA DDS

2.2. The planned investment is inefficient

Under s52A(1) of the *Commerce Act 1986* airport development outcomes must promote efficiency, limit excessive profits, and deliver service improvements back to the customer⁶. The Qantas Group considers that, contrary to the Commission's initial findings, AIAL is not delivering its objectives efficiently. For instance:

- AIAL's project delivers minimal incremental capacity (one bay) by rebuilding all the existing domestic capacity. The project builds 12 gates at a cost of \$3.2bn, to get one additional gate beyond current;

A more efficient and less capital-intensive approach could be achieved through a combination of gate relocation, walk out bays and apron bussing; and

- The Qantas Group considers that retaining the domestic terminal and building the integrated terminal incrementally would defer a further ~\$600m of PSE4 investment; and potentially generate further reductions in PSE5 as the build-out of the terminal is phased.

2.2.1. Continued Operation of the Domestic Terminal

Two independent consultants have confirmed that the existing Domestic Terminal Building (DTB) can be maintained and used for domestic operations while the contingent runway is in operation - contrary to AIAL's position. As shown in figure 2 below, the apron can be built along Pier A1. These stands would be bussed operations from a new bus area in the DTB until the DTB is returned to normal operation after the runway works; or the new Arup-concept integrated terminal is built. This only requires construction of a bus bay.

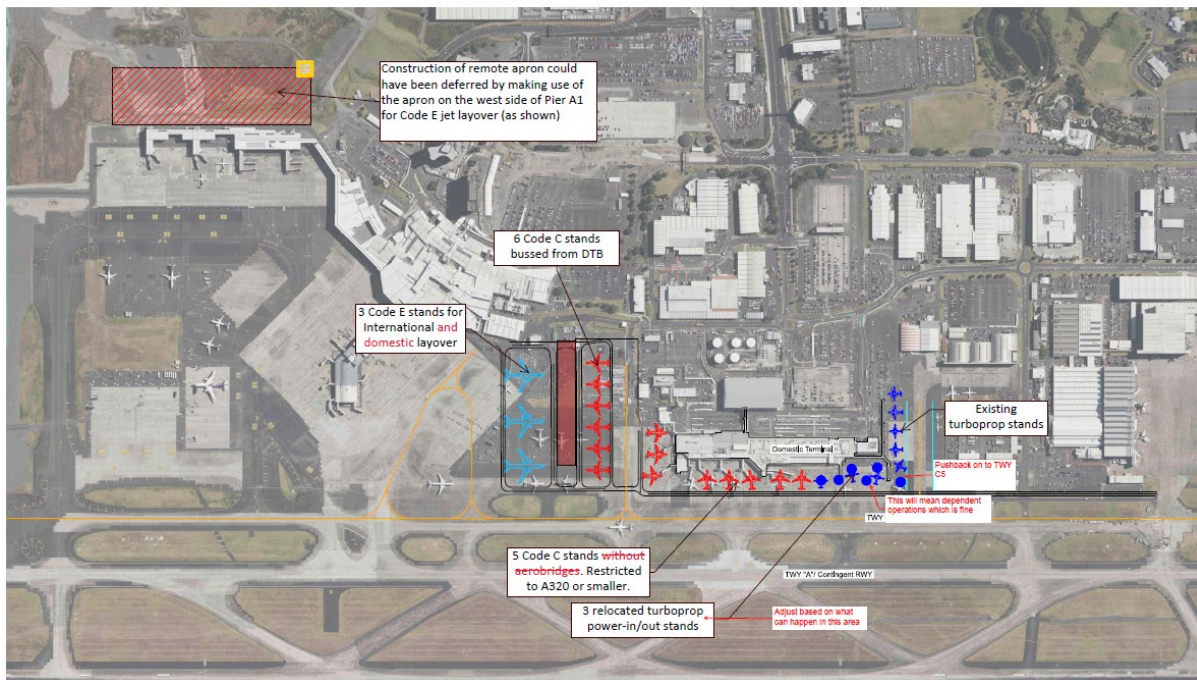
Our studies show that the stand demand can be achieved for 2028/29 and allow for AIAL's integration objectives and Arup's design in phased efficient steps rather than a premature wave of capex. Beyond 2028/2029, we endorse a phased progression towards an integrated terminal.

The Qantas Group is able to accommodate or work around the concerns raised so far by AIAL, and the plan enables significant savings by allowing a much more phased and gradual introduction of the new integrated terminal capacity. It also does not conflict with the integrated terminal as we can use later contact bays as remote bays for the domestic terminal.

Qantas has been unable to provide further detail on exact design and phasing in this response because AIAL was not willing to progress discussion on this concept. Qantas is committed to providing further detail as part of a further, genuine consultation as recommended below.

⁶ Commerce Act 1986, s.52A.

Figure 2: Continued use of the domestic terminal during contingent runway operation through bay alignment changes



2.2.2. Future state

The Qantas Group agrees with a phased approach to develop the Arup design concept provided by Air New Zealand. Our capital cost estimate is based on modifications to AIAL scope, footprint and costings to achieve a similar end state to Arup as laid out in Attachment 2.

2.3. The airport has built above industry standards

The Qantas Group recognises Auckland Airport is a critical gateway for New Zealand the need for material investment. However, the concept proposed by AIAL inefficiently exceeds industry benchmarks.

By way of example, Perth Airport and the Qantas Group recently announced a \$3bn spend which includes a new 3,000m runway, 11,500m of associated taxi lanes and taxiways and a new integrated terminal with over 50 aircraft parking positions (a mix of widebody and narrow body contact and remote positions).

AIAL's capital plan is two to three times the overall cost of the Perth Airport development. This is as a result of the design footprint being nearly twice the size necessary, and the costs of construction being nearly twice benchmark expectations. Comparisons of terminal sizes and total cost are set out below.

Industry comparisons

Table 1: Comparative footprints of different Airport footprints compared against capex spend

| Comparable | Size (sqm) | Cost \$bn | AKL Size Ratio | Unit Cost Ratio |
|----------------------------------|---------------------|-----------|----------------|-----------------|
| AKL Comparable | 80,000 ⁷ | 1986 | | |
| Perth Pier (a) | 40,000 | 544 | 200% | 183% |
| Arup counterfactual (Air NZ) (b) | 50,300 | 1400 | 159% | 89% |
| Aurecon Counterfactual (c) | 25,600 | 385 | 313% | 165% |

- A case study using the similar Perth domestic pier for Virgin, adjusted for New Zealand and 2028 construction costs with similar numbers of gates. Both are 12 gate brownfield domestic piers joined to international terminals.⁸
- An Arup counterfactual done by Air New Zealand that we broadly support as the absolute upper end of costs in replacement of the inefficient AIAL solution. The Qantas Group accepts the footprint, but notes that that the QS costings are above comparables.
- Estimates from our own quantity surveyor of the Aurecon counterfactual shared with AIAL in June 2022, suggesting a footprint 68% smaller than AIAL's.

Figure 3: Auckland Airport Development⁹ (left) & Perth Terminal (right) used for benchmarking overlaid – not to scale



Table 2: Gate Cost Comparison

| Port | Project | Year | Gates | Total Cost (FY25) | Cost per Gate |
|------|---|------|-------|----------------------------|---------------|
| MEL | T1 Domestic – B25 Gate lounge. (Code E) | 2024 | 1 | \$30m | \$30m |
| OOL | Southern Terminal Expansion | 2023 | 6 | \$260m for whole expansion | \$43m |
| NTL | International Terminal build | 2025 | 2 | \$110m for whole terminal | \$55m |
| PER | T1 Domestic Pier | 2015 | 8 | ~\$400m for whole terminal | \$50m |
| AKL | Proposed investment | 2028 | 12 | \$1.986bn | \$166m |

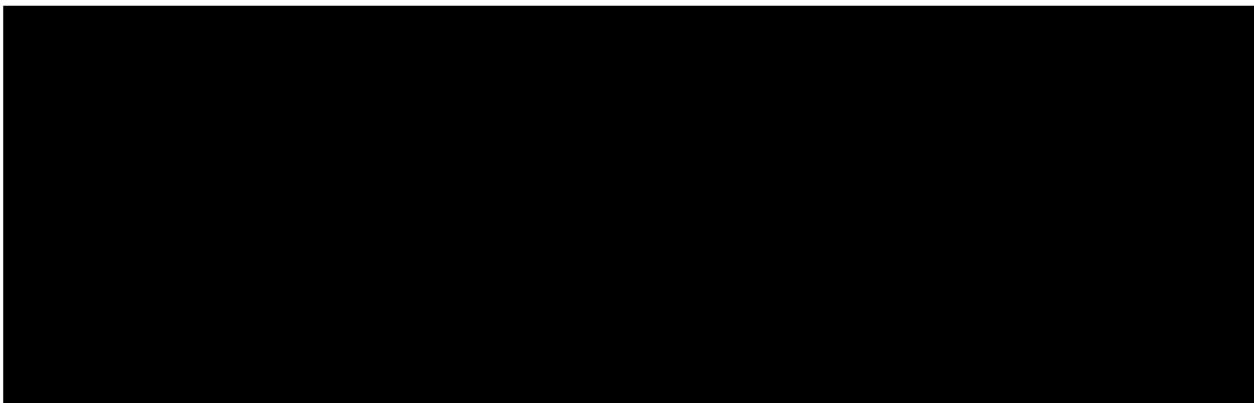
⁷ This figure includes some of the upgraded baggage belt to be used for international operations.

⁸ Qantas adjusted \$338m 2013 project cost for AUD/NZD at the time, the Arcadis 2014 construction cost index and NZ Construction Cost PPI with an exponential trendline from 2024 onwards, as well as confirming that the spike in Construction PPI escalation has abated using PPI growth trends.

⁹ Image from <https://www.urbanoutcomes.co.nz/auckland-airport>.

Table 3: Terminal Footprints

| Terminal | Footprint ¹⁰ | Current/Design Pax mppa (million pax per annum) | Gross Floor Area/mppa |
|----------|------------------------------------|---|-----------------------|
| SYD T2 | 80,000m ² | 15mppa ¹¹ | 5,333 |
| SYD T3 | 60,000m ² | 10mppa ¹² | 6,000 |
| MEL T4 | 28,500m ² | 10mppa ¹³ | 2,850 |
| PER T1D | 40,000m ² | 5-6mppa ¹⁴ | 7,200 |
| AKL New | 80,000m ² ¹⁵ | 8.3mppa | 8,674 |



2.3.1. Other matters

Standard industry planning principles used by airport consultants account for the dwell of passengers in one location i.e. gates or central 'call to gate'¹⁷.

In addition, a number of AIAL's proposed projects are not required in PSE4/5 and appear to be nice-to-have futureproofing. These are set out in further detail in Attachment 3

3. AIAL's consultation has not met acceptable standards

The characterisation of consultation as genuine by AIAL is not correct. Rather than genuine consultation, there has been a series of discussions designed to create the appearance of consultation.

¹⁰ Qantas external design consultant report 18 May 2023

¹¹ SYD Consultation documentation

¹² Qantas is the sole operator at this terminal – internal passenger statistics

¹³ https://www.dwc.com.au/projects/new-terminal-4-project_#:~:text=The%20new%20terminal%20has%20the,Superintendent

¹⁴ Qantas external design consultant report 18 May 2023

¹⁵ This figure includes some of the upgraded baggage belt to be used for international operations.

¹⁶ IATA/ACI Airport Development Reference Manual

¹⁷ Standard Planning described in IATA's ADRM

3.1. Failure to meet industry standards

[REDACTED]

3.2. Failure to adapt designs

[REDACTED]

3.3. Failure to properly consider material issues

[REDACTED]

The Qantas Group also laid out its concerns about the impacts on its operations and the economy repeatedly in writing as described in Attachment 4 -

[REDACTED]

¹⁸ <https://www.iata.org/en/programs/ops-infra/airport-infrastructure/airport-development/>

3.4. AIAL has rushed commencement of the build

Table 4: Qantas correspondence to AIAL regarding sunk costs .

| | 15-Apr-21 | 23-Nov-21 | 22-Feb-22 | 08-Apr-22 | 29-Jul-22 | 30-Aug-22 | 06-Jun-23 |
|--|--|--|--------------------------------|--|----------------------------|-----------------------|-------------------|
| | Auckland Airport Price Path and Domestic Development | Qantas Group's position on the proposed \$89m capex spend for the terminal integration program | Incomplete consultation letter | Auckland International Airport Limited | Inefficiency notice | Consultation Response | Combined Response |
| Email from Airline CEO | Yes | No | No | No | No | No | Yes |
| Raised issues with consultation | Yes | Yes | Yes | Yes | Yes | Indirect | Yes |
| Raised impact on passenger demand | Yes | No | Yes | Yes | Yes | Yes | Yes |
| Asking for AIAL to consider a lower cost option | Yes | No | Yes | Yes | Yes | Affordable options | Yes |
| Demanded a halt to progress | Yes | Yes | Indirect | Yes | Yes | No | Yes |
| Stressed that AIAL must not invest or invest at its own risk | No | Yes | Yes | Yes | Yes (shareholders risk) | Yes | Yes |

4. AIAL has sought to over-collect by incorrect use of BBM principles

It is clear that AIAL is over-collecting and earning monopoly rents on the overbuild by:

- Over-estimating its cost of capital as noted by the Commission;
- Over-estimating of opex against efficient options; and
- Misallocating assets between tills.

We agree with the Commission's recommendation that AIAL move to a tilted depreciation model to better match costs with activity.

4.1. Efficient pricing for AIAL

The Qantas Group's assessment of AIAL's PSE4 submission is underpinned by well-established economic efficiency principles set out in Part 42C of the *Commerce Act 1986*. We are concerned with AIAL's PSE4 approach, which appears to prioritise short-term profitability at the expense of long-term economic value.

Key inputs for the BBM, such as WACC, CAPEX, and OPEX, significantly deviate from international benchmarks and local regulatory precedents, resulting in substantial overstatements of allowable revenue. To mitigate sudden price shocks, we have implemented well-established mechanisms in the BBM that support a price path more closely aligned with periods of economic activity.

In our analysis we have isolated key BBM inputs to demonstrate the impact that each has to allowable revenue and pricing. In summary we have analysed key inputs:

1. **Return on Assets (Nominal post tax WACC):** Aligned to NZCC low range of 7.28%¹⁹ (refer to Section 4.2);
2. **CAPEX:** Designed a plan based on Arup's concept with further efficiencies (refer to Attachment 2);
3. **Return of Assets (Depreciation):** Applied tilted annuity depreciation methodology to long-term investments i.e. domestic processor (refer to Section 4.4); and

¹⁹ NZCC scenario 1 post tax WACC

4. OPEX: Aligned expenditure to terminals and airports of similar size and operational complexity (refer to Section 4.5).

To determine the full effect on passenger prices we have recreated a BBM that extends beyond PSE4 to illustrate the lagging effect of committed capital from PSE4. Within this model, we have constructed several scenarios that encompasses AIAL’s submission and Qantas Group’s recommendation under different WACC, CAPEX, OPEX and depreciation scenarios.

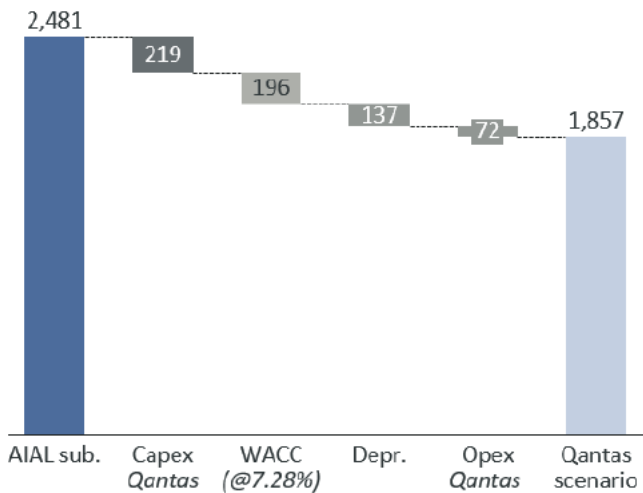
Table 5 Table of Presented Scenarios

| Scenario title | CAPEX | Annuity/ Straight. Depr. | WACC ²⁰ | OPEX | Pax |
|-------------------------|------------------------|--------------------------|--------------------|------------------------|---|
| AIAL Baseline | | Straight | 8.73% | | |
| AIAL Annuity - 8.73% | As per AIAL submission | Annuity | 8.73% | As per AIAL submission | <i>As per AIAL’s pax forecast in submission</i> |
| AIAL Annuity - 7.28% | | Annuity | 7.28% | | |
| Qantas Baseline - 7.28% | Qantas’ approach | Straight | 7.28% | Qantas’ approach | |
| Qantas Annuity - 7.28% | | Annuity | 7.28% | | |

For simplicity, we have excluded all demand related passenger impacts from aeronautical passenger price increases in the analysis. As discussed in section 2.1 we do not consider this is a realistic position given demand elasticity analysis.

From the analysis, we believe AIAL PSE4 submission will result in an overcollection of allowable revenue of ~\$463m with a larger residual impact of \$2.4bn in PSE5. It is important to note that over the long term both methods will deliver similar NPV capital costs. See Figure 4 and Figure 4.1. Further reductions in capex inputs will be possible once we are able to conclude a genuine consultation on continued use of the domestic terminal.

Figure 4: Total allowable revenue waterfall between AIAL submission and Qantas scenario for PSE4 (FY23-FY27)

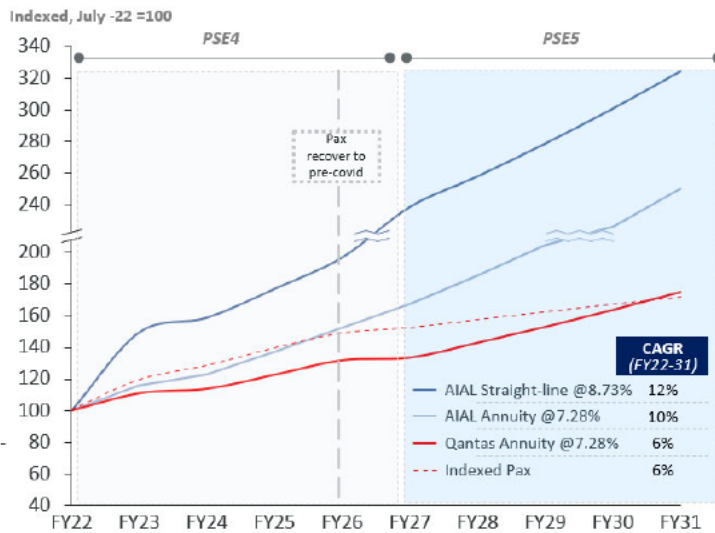


In Figure 4.1, there is a significant divergence observed in AIAL’s pricing submission during PSE4 and PSE5. Specifically, allowable revenue is growing at 2 times that of passenger growth over this period, indicating a substantial departure from underlying economic activity.

²⁰ Post tax WACC

This disparity is particularly concerning when considering that AIAL passenger numbers are not expected to return to pre-COVID levels until FY26. As a result, the gap between revenue growth and passenger activity could become even more pronounced.

Figure 4.1 Indexed real allowable revenue growth Vs passenger growth across PSE4/5 (FY23-FY32)



Conversely, Qantas' scenario²¹ smooths price increases across PSE4/5 with allowable revenue CAGR of 9% and 6% respectively. This means that consumers will pay a more consistent amount over time.

On absolute terms, AIAL's proposed PSE4/PSE5 aeronautical charges will see total weighted passenger fees increase from \$14 on to \$56 on average.²² In comparison, the Qantas Group's recommended approach will see prices rise to \$30 by FY32. Please refer to Table 6 and Table 7 for a summary of the pricing comparisons.

Table 6 Allowable Revenue Before and After Adjustments

| Entity | Scenario approach (WACC %) ²³ | PSE4 | | | | PSE5 | | | | |
|---------------------------------|--|-------------------|----------------------|---------------------|-------------------------------|-------------------|--------|-------|-------------------------------|--------------------------------------|
| | | Allowable revenue | % Var. ²⁴ | CAPEX ²⁵ | \$ per pax CAGR ²⁶ | Allowable revenue | % Var. | CAPEX | \$ per pax CAGR ¹⁰ | 10 year \$per pax CAGR ¹⁰ |
| AIAL (PSE5 based on Qantas BBM) | Submission - straight-line at 8.73% | 2,481 | - | | 21% | 5,383 | - | | 10% | 15% |
| | Annuity - 8.73% | 2,192 | (12%) | 2,575 | 16% | 4,373 | (19%) | 3,107 | 11% | 14% |
| | Annuity - 7.28% | 2,053 | (17%) | | 14% | 3,912 | (27%) | | 13% | 13% |
| Qantas | Straight-line - 7.28% | 1,994 | (20%) | 1,782 | 12% | 3,425 | (38%) | 1,466 | 13% | 12% |

²¹ Baseline scenario reflects Qantas views on CAPEX, OPEX, WACC and depreciation as per table 6

²² Weighted average price across regionals, domestic and international aeronautical charges

²³ Nominal post tax WACC and 3.2% (see section 4.4) tilt factor in the annuity depreciation calculation

²⁴ Measured against AKLs proposal with straight-line depreciation encompassing a 13.33% Pre-tax WACC (8.73% post tax)

²⁵ AIAL's Commissioned CAPEX based on Auckland airports Aeronautical Pricing decision; Qantas view is outlined in section

2

²⁶ CAGRs based of price path scenarios on a real basis

Annuity – 1,857 (25%) 10% 2,952 (47%) 9% 9%
7.28%

Table 7 Summary of passenger charges between AIAL’s submission and Qantas’ annuity scenario

| BBM ²⁷ | Dep | Mkt | PSE4 | | | | | | | PSE5 | | |
|-------------------|-----------------------|-----|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | | | FY23 | FY24 | FY25 | FY26 | FY27 | FY28 | FY29 | FY30 | FY31 | FY32 |
| AIAL | Straight-line - 8.73% | Reg | 4.43 | 7.10 | 8.14 | 9.33 | 10.70 | 13.33 | 14.93 | 16.72 | 18.72 | 20.97 |
| | | Dom | 6.73 | 10.25 | 11.75 | 13.47 | 15.46 | 19.26 | 21.57 | 24.15 | 27.05 | 30.30 |
| | | Int | 23.39 | 32.78 | 36.70 | 41.13 | 46.13 | 56.14 | 61.38 | 67.08 | 73.25 | 79.95 |
| QF | Annuity - 7.28% | Reg | 4.43 | 4.79 | 5.37 | 6.01 | 6.73 | 6.87 | 7.69 | 8.61 | 9.65 | 10.80 |
| | | Dom | 6.73 | 7.28 | 8.16 | 9.14 | 10.23 | 10.44 | 11.69 | 13.09 | 14.66 | 16.42 |
| | | Int | 23.39 | 24.67 | 26.65 | 28.78 | 31.08 | 31.70 | 34.24 | 36.98 | 39.94 | 43.13 |

4.2. WACC

The Qantas Group agrees with the Commission’s approach on setting a cost of capital that is aligned to the appropriate IM determination period. PSE4 falls within the 2016 IM assessment period which covers December 2016 to December 2023.

Instead, AIAL has sought to ‘cherry pick’ inputs across regulatory IM periods, which is at odds with Part 4 of the *Commerce Act 1986* and historic price setting decisions - including the most recent 2024 Christchurch PSE4 determination.

The Qantas Group supports applying the NZCC recommended (scenario 1- low range) post tax WACC of 7.28% (11.24% pre-tax). For consistency, we agree that the inputs used in the formulation of WACC should align to the most relevant 2022 Christchurch PSE4 decision.

4.3. Wash-ups

4.3.1. Passenger Wash-Up

²⁷ Qantas PSE4/5 & AIAL PSE5 prices have been smoothed to reduce fluctuations and match AIAL’s PSE4 submission where appropriate

4.4. Asset base and depreciation

As discussed in Section 2.1, the timing of demand must drive both the phasing and scale of long-term capital projects proposed by AIAL in PSE4. We concur with the Commission and Christchurch Airport that an annuity depreciation model is more appropriate than a straight-line model. Accordingly, we believe a tilted annuity model has a strong case for adoption within AIAL PSE4 BBM.

Due to the complexity of a tilted annuity depreciation method, we have detailed our key input assumptions used in our analysis:

1. *Tilt factor*
2. *CAPEX definitions*
3. *Useful life of the asset*
4. *WACC applied to tilt annuity*

Tilt factor:

The 'tilt factor' is a critical component in an annuity model and is typically driven by a combination of inputs such as expected passenger and inflation growth. This allows for a balanced approach to depreciation, matching the asset's cost recovery with revenue generation and increased economic usage over time. It is notable that the expected growth in AIAL's passengers may not be a useful indicator of growth as it would include elements of post-COVID passenger recovery.

Christchurch Airport has adopted a tilted annuity approach with an expected growth factor (CPI) of 1.5% for the entirety of the pricing event window resulting in a back-ended recovery of capital costs. This has been endorsed by the Commission as part of Christchurch PSE4 (Ending in FY27).

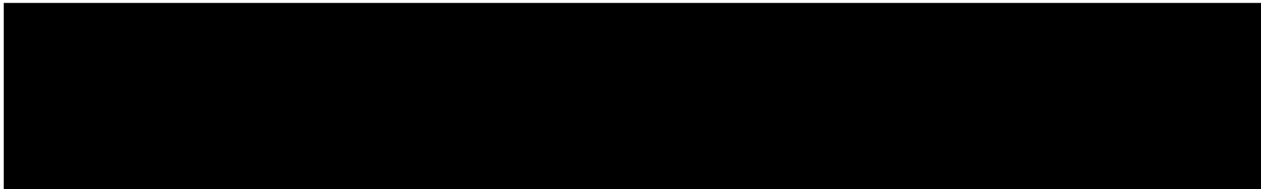
For a balanced approach, we have used the average of Qantas' and AIAL's New Zealand CPI forecast to determine a tilt factor of **3.2%** for the for PSE4/5.

Table 8: Tilt factor input overview for tilted annuity depreciation

| Scenario approach | PSE4 | | | | | PSE5 | | |
|---------------------------------|-------|-------|-------|-------|-------|---------|------|------|
| | FY23 | FY24 | FY25 | FY26 | FY27 | Average | | |
| AIAL CPI forecast ¹ | 6.20% | 3.30% | 2.60% | 2.30% | 2.10% | 3.30% | 2.5% | 2.5% |
| CIAL – Growth rate ² | 1.5% | 1.5% | 1.5% | 1.5% | 1.5% | 1.5% | | |
| AIAL pax growth ³ | - | 19% | 80% | 9% | 7% | 11% | 2% | 3% |
| Qantas CPI ⁴ | 5.7% | 3.1% | 2.5% | 2.4% | 2.1% | 3.16% | 2.0% | 2.0% |

1. Review of Auckland Airport's 2022-2027 Price Setting Event (p40) 2. Review of Christchurch Airport's 2022-2027 Price Setting Event (p38) 3. AIAL PSE4 Profitability Analysis for consulting paper 4. International Monetary Fund

CAPEX definition:

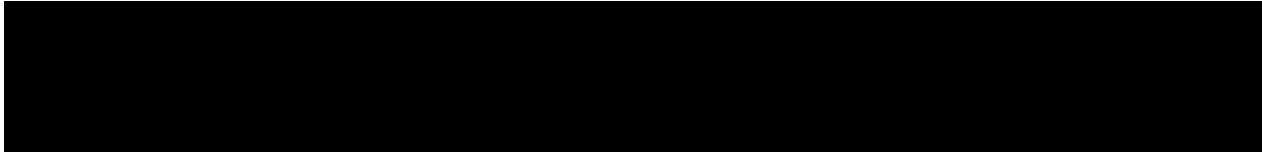
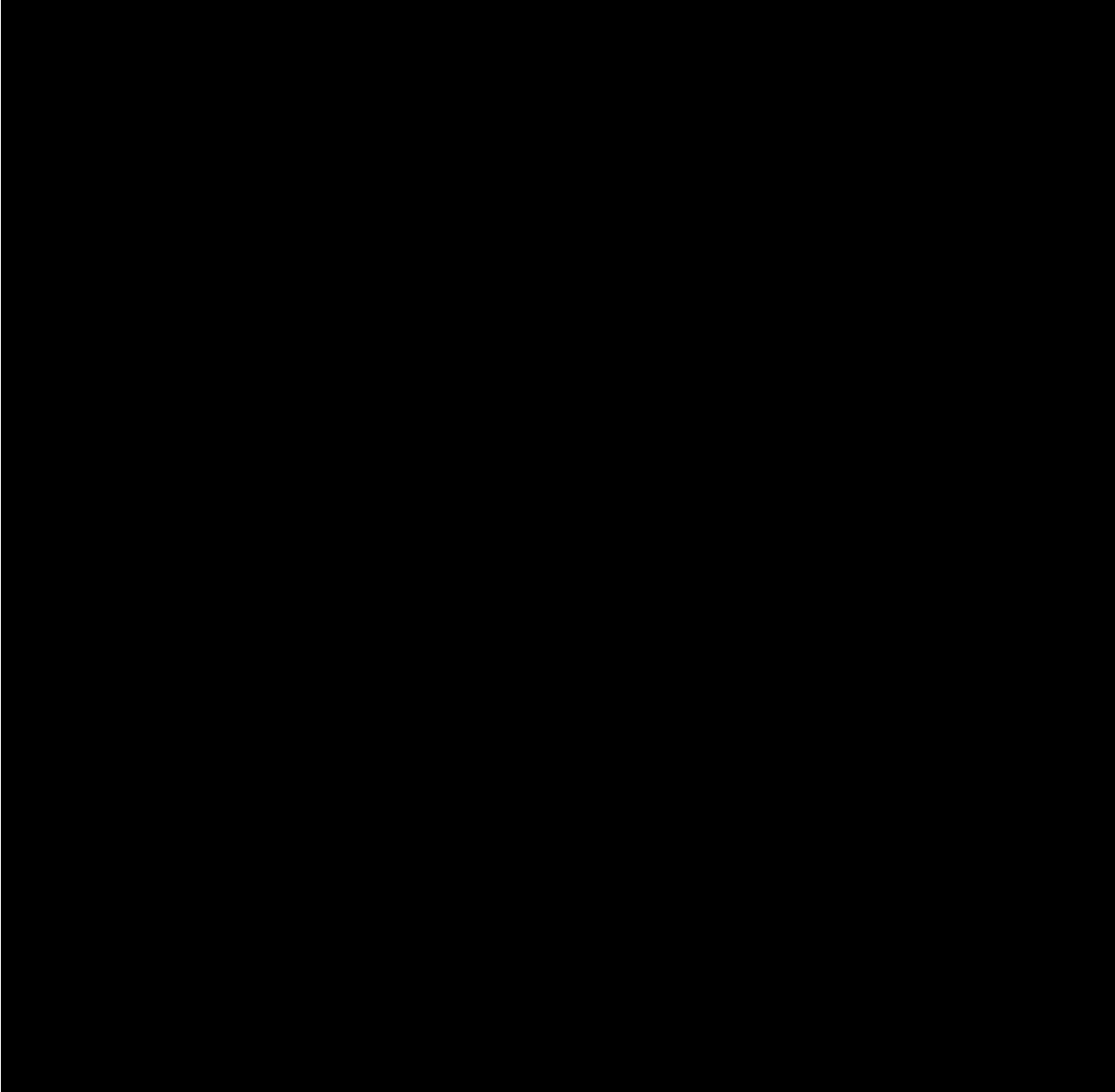


- 3. Excludes opening regulatory asset base and prior PSE committed CAPEX; and
- 4. Maintenance on existing and new CAPEX should be depreciated under a straight-line methodology.

Based on these guiding principles we have allocated capital projects into one of two categories:

- 1) New non major CAPEX, which applies straight line depreciation; and
- 2) New major CAPEX, which applies tilted annuity depreciation.





WACC applied to tilt annuity

For consistency we have used a pre-tax nominal WACC in all tilted annuity depreciation estimates (See Section 4.2).

Analysis

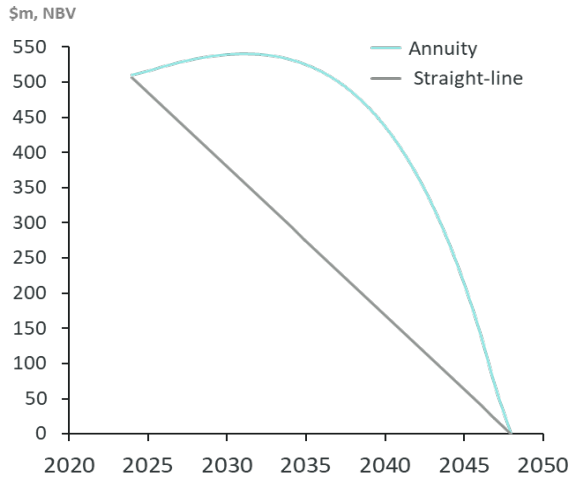
An important underlying assumption of straight-line depreciation within a BBM is that consumers will pay a consistent price (non-inflation adjusted) over an asset's useful life. The tilted depreciation looks to address this by effectively smoothing the cost to match the economic activity and utilisation; and

²⁸ Productivity Commission: Perth Airport Pricing Methodology October 2017 (p8)



delivers close to NPV neutral²⁹ outcomes when compared to straight line methodology for both the supplier and the customer over the life of the asset. See Figure 5.

Figure 5: Illustrative tilted annuity Vs straight line net book values over 24 years useful life³⁰



For simplicity purposes, when analysing the impacts of tilted annuity and straightline depreciation methodologies, we have separated capital cost components (return of capital and return on capital) to illustrate long term cost interactions.

Figure 6: Total tilted annuity Vs Straight line depreciation method yearly depreciation expense (FY23-FY42)

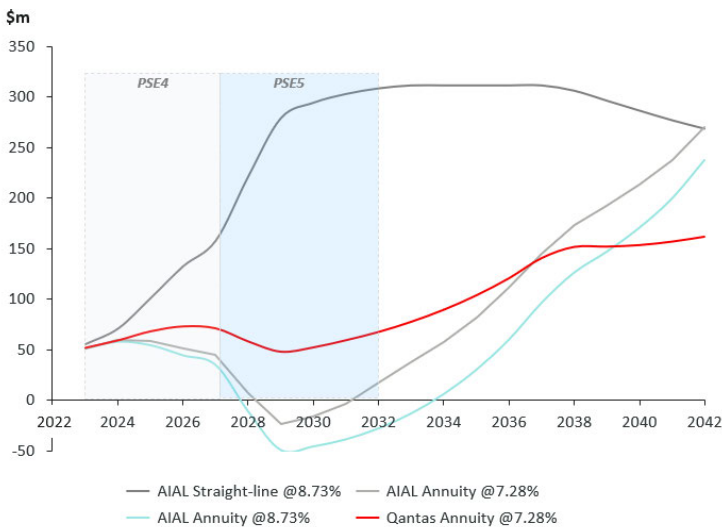


Figure 6 illustrates actual differences between a straight line and tilt annuity depreciation expense over PSE4/5. During this period, there is an ~\$1.8bn difference between AIAL’s submission and a scenario where the annuity is set at 8.73% WACC³¹. Since the capital plan is only fully deployed at the end of PSE5 in FY32, across all scenarios, the trends through this period are particularly pronounced. Overall, the depreciation expense between tilted annuity and straight line are the same over the long run.

²⁹ Depending on the tilt factor and time horizon, there may be slight differences in NPV

³⁰ Assumed \$506m NBV, WACC 7.28%, 1.5% CPI

³¹ Nominal post tax WACC equates to a pre-tax WACC of 13.33%; CPI is set at 3.2%



For return on capital, Figure 7 demonstrates the opposite effect. The capital cost under a tilted annuity is elevated in the short-term until the net book value begins to normalise. Over the long run the total capital cost between straight line and tilted annuity model is ~\$400m PV³² (see Figure 8). When overlaying passenger demand growth to total cost of capital we see that a tilt annuity has a closer fit to economic activity vs a straight-line method.

Figure 7: Tilted annuity Vs Straight line depreciation method return on capital (FY23-FY42)

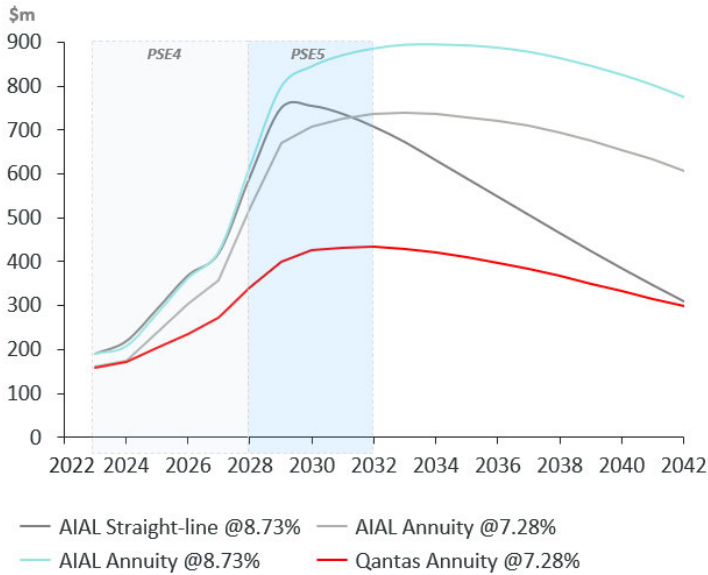
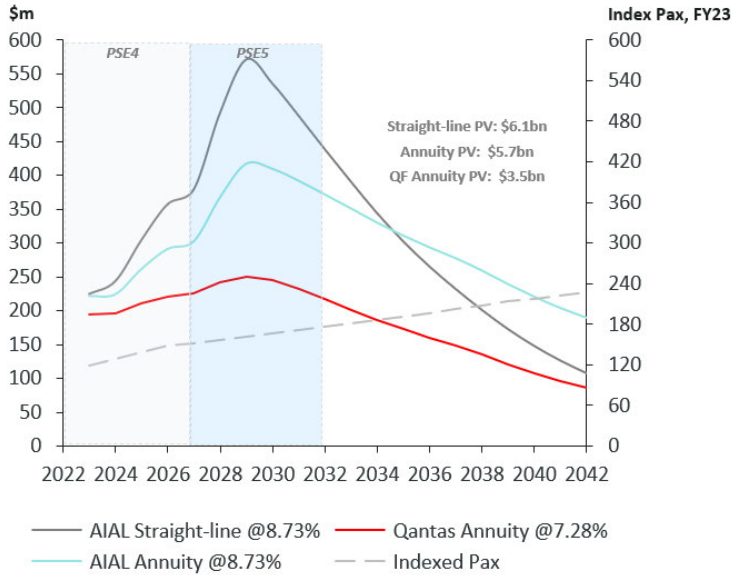
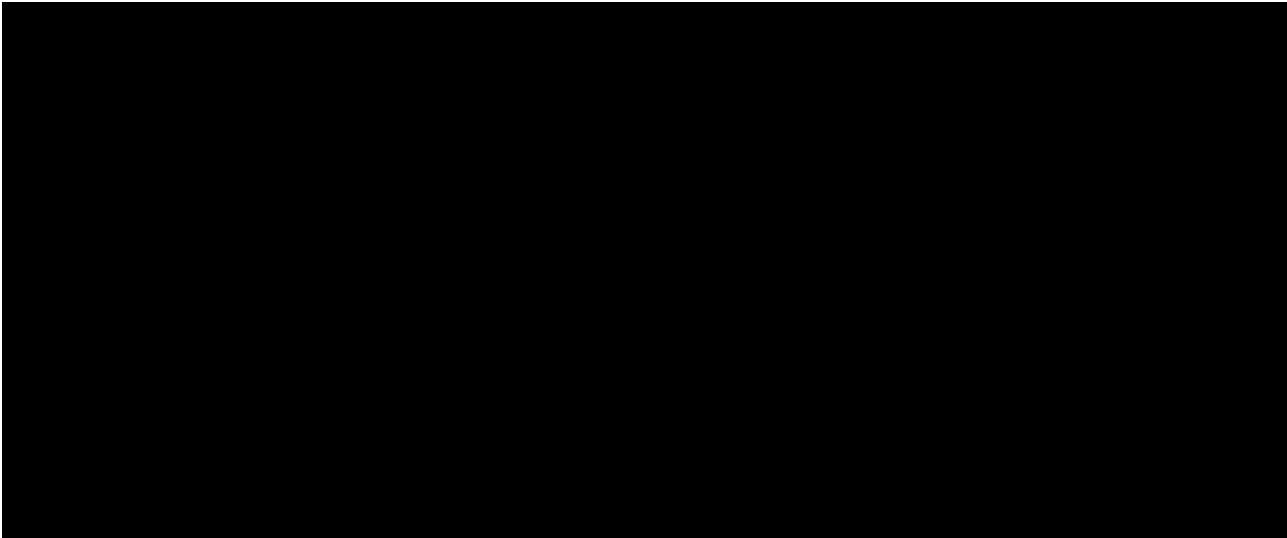


Figure 8: Total capital costs over time ³³(FY23-FY42)

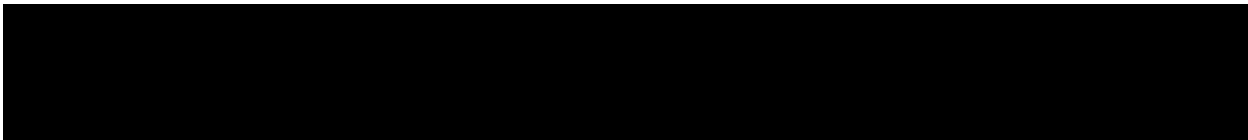


³² The long-term PV differences are heavily dependent on tilt factor

³³ Reflects both return on capital and return of capital



4.4.1. Sunk and wasted costs



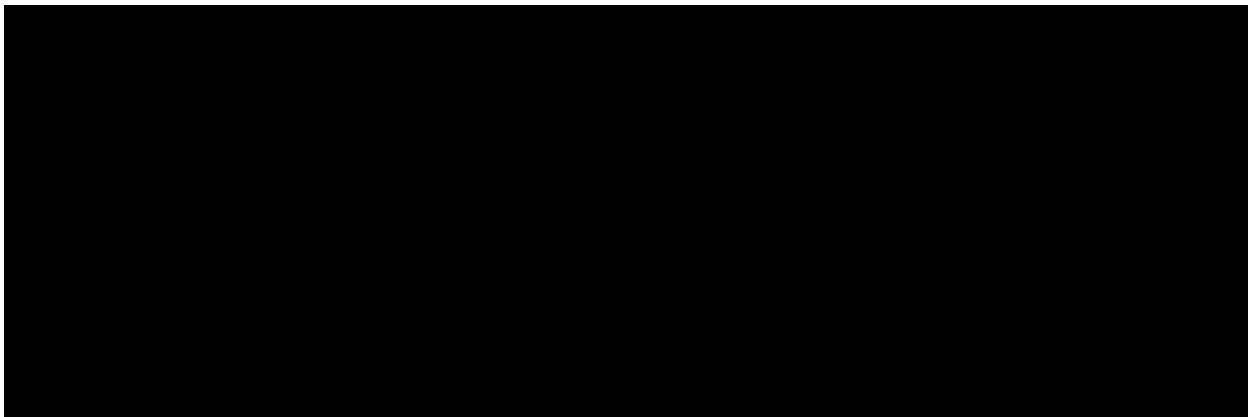
4.4.2. Inefficient costs

Only assets that are efficient should be included in the regulatory asset base. This means that inefficient investments do not go on to the asset base unless or until they become efficient, regardless of whether they have been acquired by AIAL.

4.4.3. Accelerated depreciation of the DTB

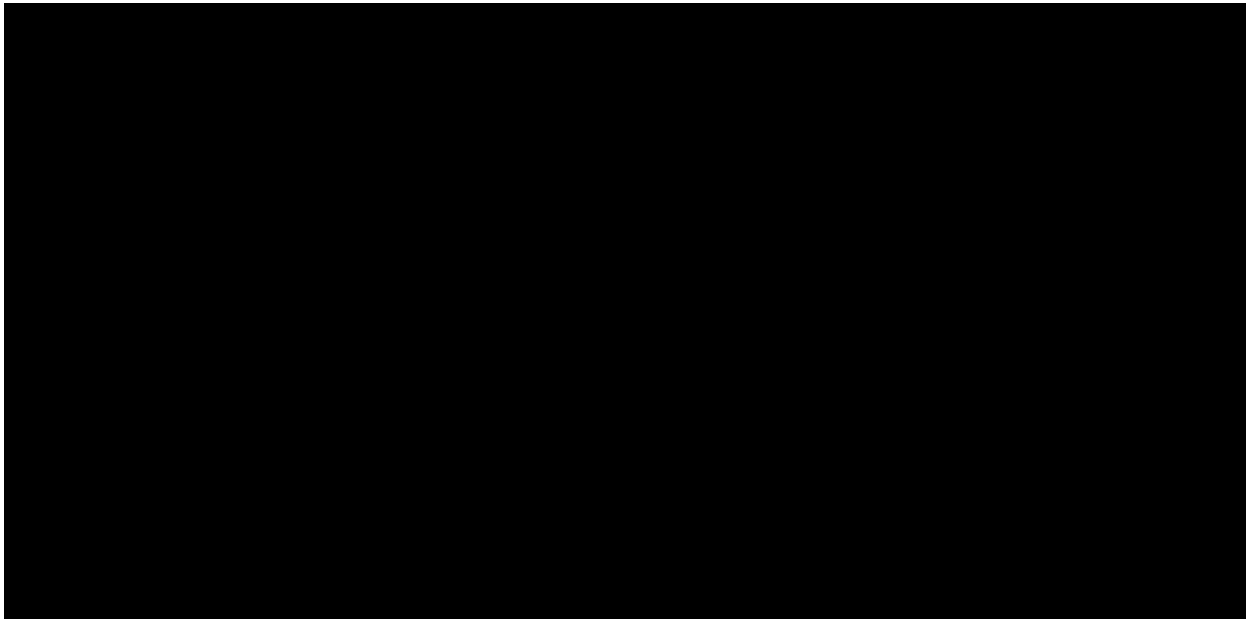
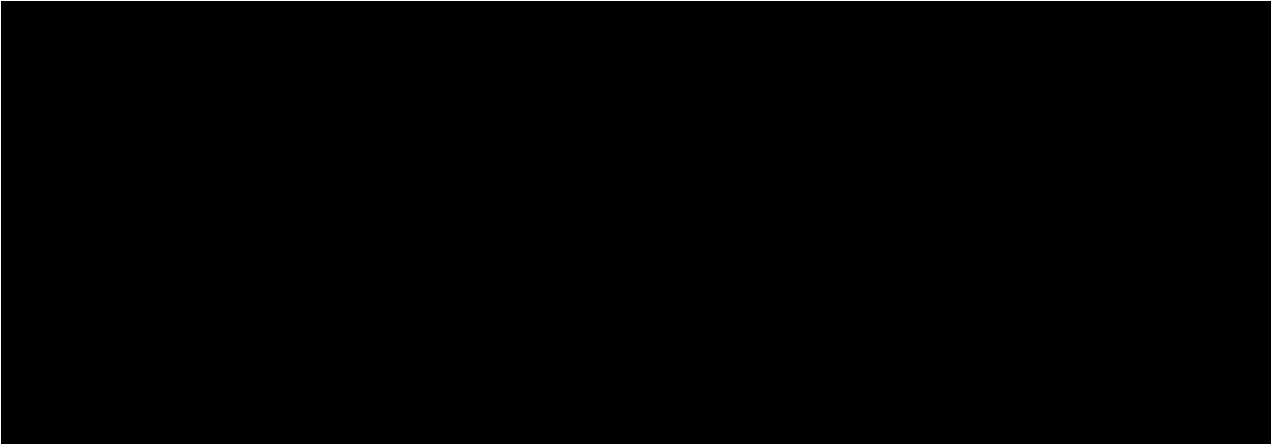
The domestic terminal is not obsolete. It does not need to be partially or wholly decommissioned for the temporary contingent runway operation. The Qantas Group considers that decision to be discretionary and inefficient decision by AIAL. The domestic terminal can continue to operate during a transition period as the home for low-fares airlines and other point-to-point domestic markets, obviating the need to accommodate those flights in the integrated terminal.

4.5. Opex



³⁴ Qantas has looked to match AIAL's assumptions where possible, however variances in timing of asset depreciation and return on capital may be observed

³⁵ Measured against AIALs proposal with straight-line depreciation at 13.33% Pre-tax WACC



Additional clarity above that provided by AIAL to date would be required to complete a more comprehensive review. We encourage the Commission to undertake a more comprehensive review.

It is important to note that the Qantas Group forecast would reduce further and require a recalibration in the event that the Commission confirms the suggested Qantas capital plan for PSE4 and at the conclusion of consultation regarding phasing in of the integrated terminal.

4.5.1. Opex Benchmarks

AIAL asserts that *“benchmarking indicates that operational costs at Auckland Airport are very efficient”* with reference to a Jacobs Airport Performance study conducted in 2022 where they were 43rd on the list. The Qantas Group does not consider that 2022 is a useful benchmark year. In 2022 passenger volumes continued to be restricted whilst opex was naturally stickier due to the level of essential maintenance requirements post-COVID.

³⁶ Financial table provided the breakdown of \$79m provided in attachment 10.

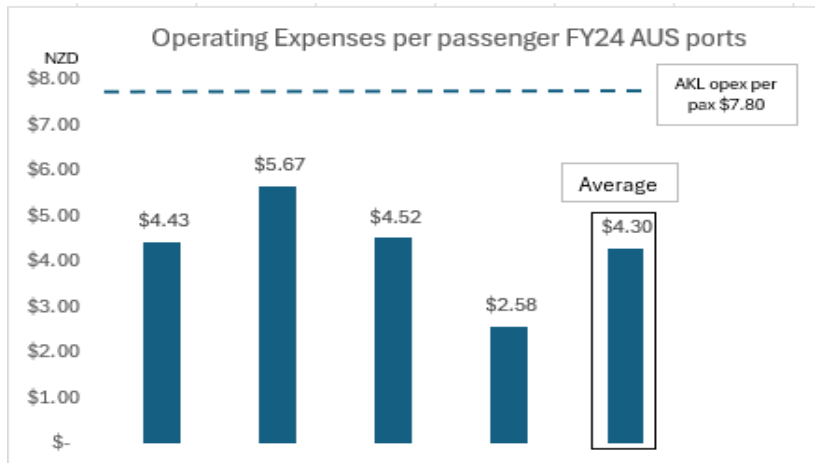
³⁷ Perth Airport Pty Ltd vs Qantas Airways Ltd [No 3] [2022] WASC 51.



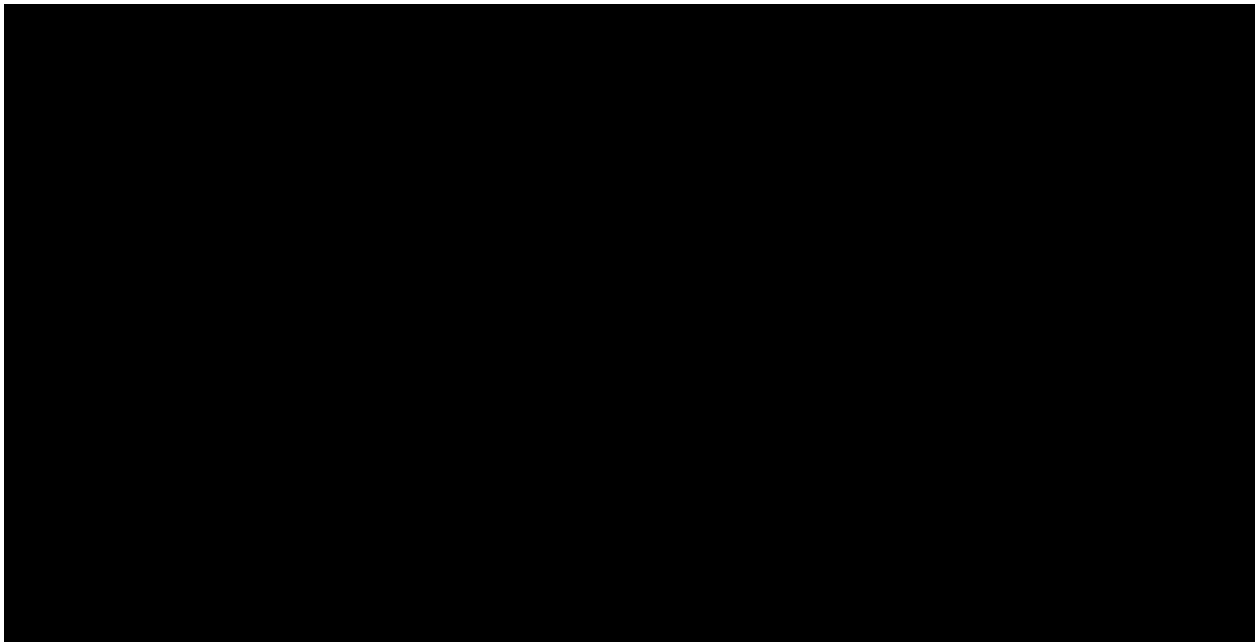
Referencing the 2023 Jacobs Airport Performance report³⁸ instead of the 2022 report, Auckland Airport has moved up to 26th spot out of 48 Airports (from 43rd). Once the 46% increase in operating expenses by FY27 is applied, Auckland would be expected to rise again.

The average aeronautical operating cost on-charged to airlines in comparable Australian ports in FY24³⁹ was ~NZD\$4.30 per passenger vs. NZD\$7.80 proposed by AIAL. Figure 9 shows key port costs per passenger without the airport names. The charges proposed by AIAL represent a variance of ~180%- this is largely before any additional infrastructure comes online.

Figure 9: Operating Expenses per Passenger



4.6. Aero allocations



³⁸ 2023 Jacobs Airport Performance report.

³⁹ Based on efficient operating expenditure on-charged as part of the passenger charge from four comparable AUS ports

5. Left unchecked, AIAL's pricing proposal will have a significant impact on consumers and the economy

The project as currently defined will have a very significant impact on the aviation sector, consumers and the New Zealand economy.

The impact of PSE4 and PSE5 on demand is expected to be 6%⁴⁰ and GDP by 1%⁴¹, before cyclical and flow-on effects are considered such as [REDACTED] the compounding effect of price rises on demand and subsequent price-setting events at airports connected to Auckland.

6. Steps to Resolve

6.1. Application of Building Block principles for pricing

We ask that the Commission consider modification to the Building Block inputs to reflect the following:

Table 13: Qantas Building Block Positions

| Input | Qantas Position | Reference |
|-----------------------|--|--------------|
| WACC | 7.28% | 4.2 |
| Efficient Capex | \$3,248m @per Qantas plan ⁴² | Attachment 2 |
| Sunk Costs | Not recoverable | 4.4.1 |
| Depreciation | Tilted Annuity Depreciation No accelerated Depreciation | 4.4 |
| Operating Expenditure | \$665m over PSE4 ³¹ | 4.5 |
| Passenger Washup | Not permitted | 4.3.1 |
| One Way Capex Washup | Permitted to partially mitigate high unit cost assumptions | 4.3.2 |

6.2. A section 56 review of the method of regulation for Auckland Airport

AIAL has failed its investors, the industry, and New Zealand under the current regulations. Significant funds have been invested in an inefficient design that cannot be allowed to proceed for the health of New Zealand aviation and the wider economy. Significant time has been wasted instead of delivering the hub that Auckland needs. The industry has had to invest three years of its resources in addressing the overspend, and the Commission must now address a problem that would not exist if the regulatory system provided sufficient controls on gold-plating.

⁴⁰ Based on demand study complete by BIS Oxford Economics commissioned by BARNZ.

⁴¹ The Importance of Air Transport to New Zealand (IATA), estimated air transport contribution of US\$20.7b to GDP iata.org/en/iata-repository/publications/economic-reports/new-zealand-value-of-aviation/. Economic impacts of air transport have been pro-rated for the lost passengers.

⁴² This is a holding maximum position without consideration of re-use of the domestic terminal. Qantas acknowledges that further consultation will be required to revise opex and capex amounts.

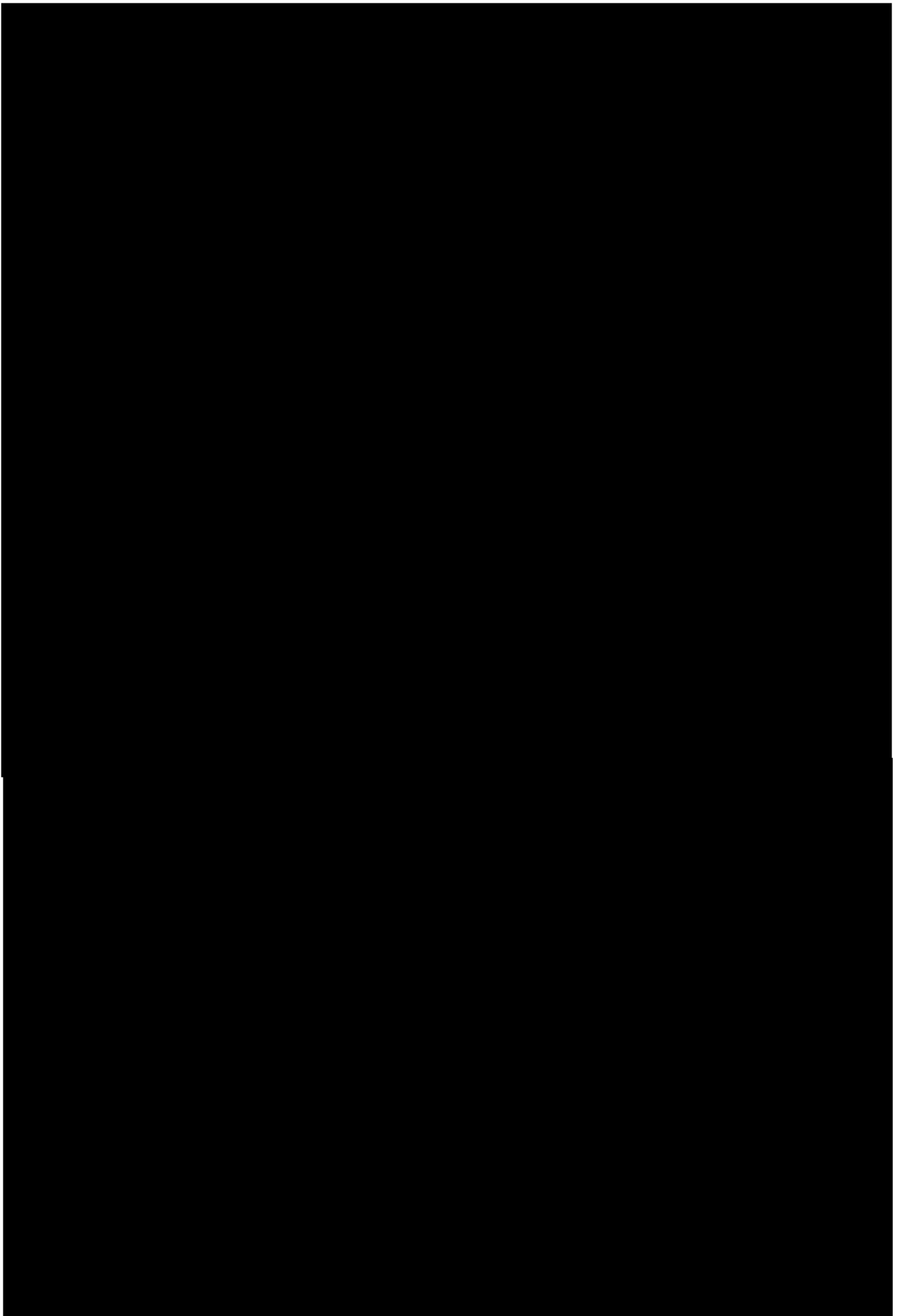
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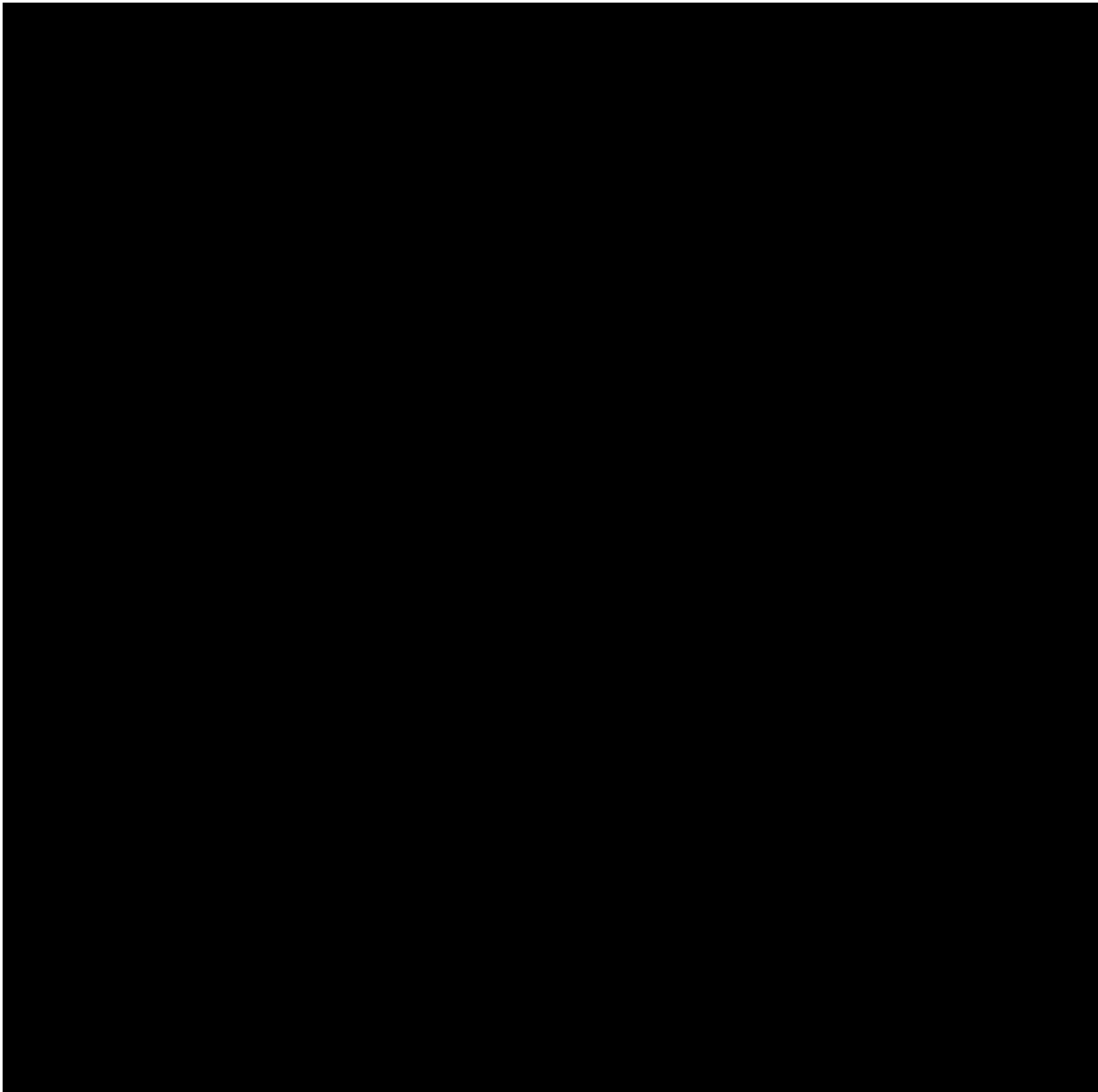
The Qantas Group therefore recommends an immediate review of the method of regulation of Auckland Airport under section 56. Such a review could also consider ways to avoid similar challenges at other airports through improvements to regulations targeted at major capital investment programs.

6.3. A rapid consultation to be run under a Price Control regime

The industry must be allowed to conclude a real consultation on the efficient way forward. That consultation should not be held back by existing investments. The customer community itself is able to develop efficient solutions like those provided to AIAL and the Commission, but requires an independent party to reconcile competing design needs and prices to finalise a way forward. Given past consultation failures, and the strong sunk-cost disincentive to consider new options, this cannot be left to AIAL.

The Qantas Group considers that the only practical outcome is to accelerate the move of Auckland Airport to Price Control for PSE4 and PSE5, and for the Commission to run a consultation to derive a view on efficient investment and pricing. If AIAL elects to continue with a different investment path, it will do so with a clear understanding of the costs recoverable from the airline sector.





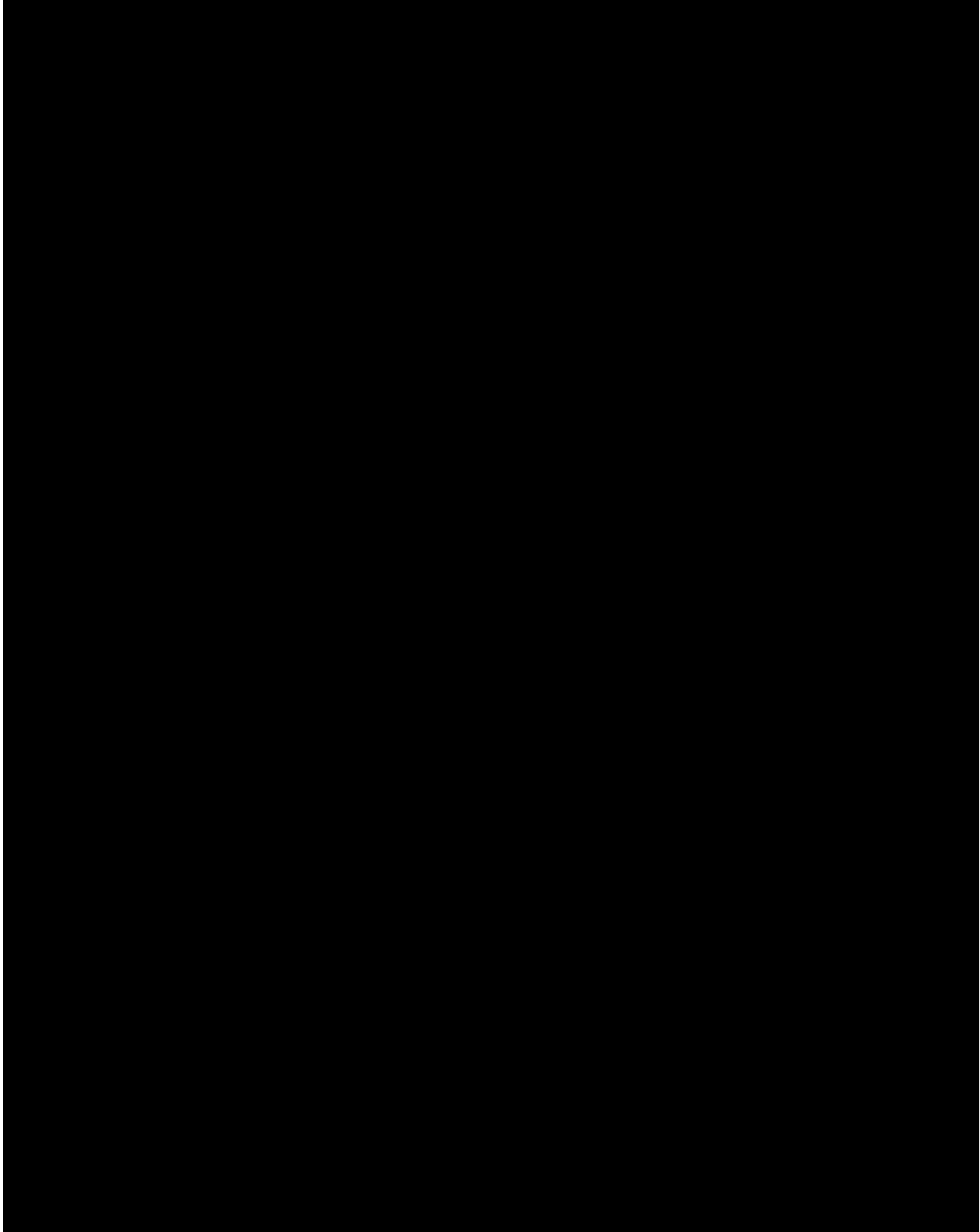
Core Elasticity Table for Intervistas for Reference

| | Route/Market Level | | National Level | | Pan-National Level | |
|---|--------------------|-----------|----------------|-----------|--------------------|-----------|
| | Short-haul | Long-haul | Short-haul | Long-haul | Short-haul | Long-haul |
| Intra North America | -1.54 | -1.40 | -0.88 | -0.80 | -0.66 | -0.60 |
| Intra Europe | -1.96* | -1.96 | -1.23 | -1.12 | -0.92 | -0.84 |
| Intra Asia | -1.46 | -1.33 | -0.84 | -0.76 | -0.63 | -0.57 |
| Intra Sub-Sahara Africa | -0.92 | -0.84 | -0.53 | -0.48 | -0.40 | -0.36 |
| Intra South America | -1.93 | -1.75 | -1.10 | -1.00 | -0.83 | -0.75 |
| Trans Atlantic (North America – Europe) | -1.85 | -1.68 | -1.06 | -0.96 | -0.79 | -0.72 |
| Trans Pacific (North America – Asia) | -0.92 | -0.84 | -0.53 | -0.48 | -0.40 | -0.36 |
| Europe-Asia | -1.39 | -1.26 | -0.79 | -0.72 | -0.59 | -0.54 |

*The short-haul adjustor has not been applied to the Intra Europe short-haul elasticity in order to maintain elasticities below 2.0

Attachment 2 - Capex and Opex Inputs

Capex Inputs – Summary of Capex Items



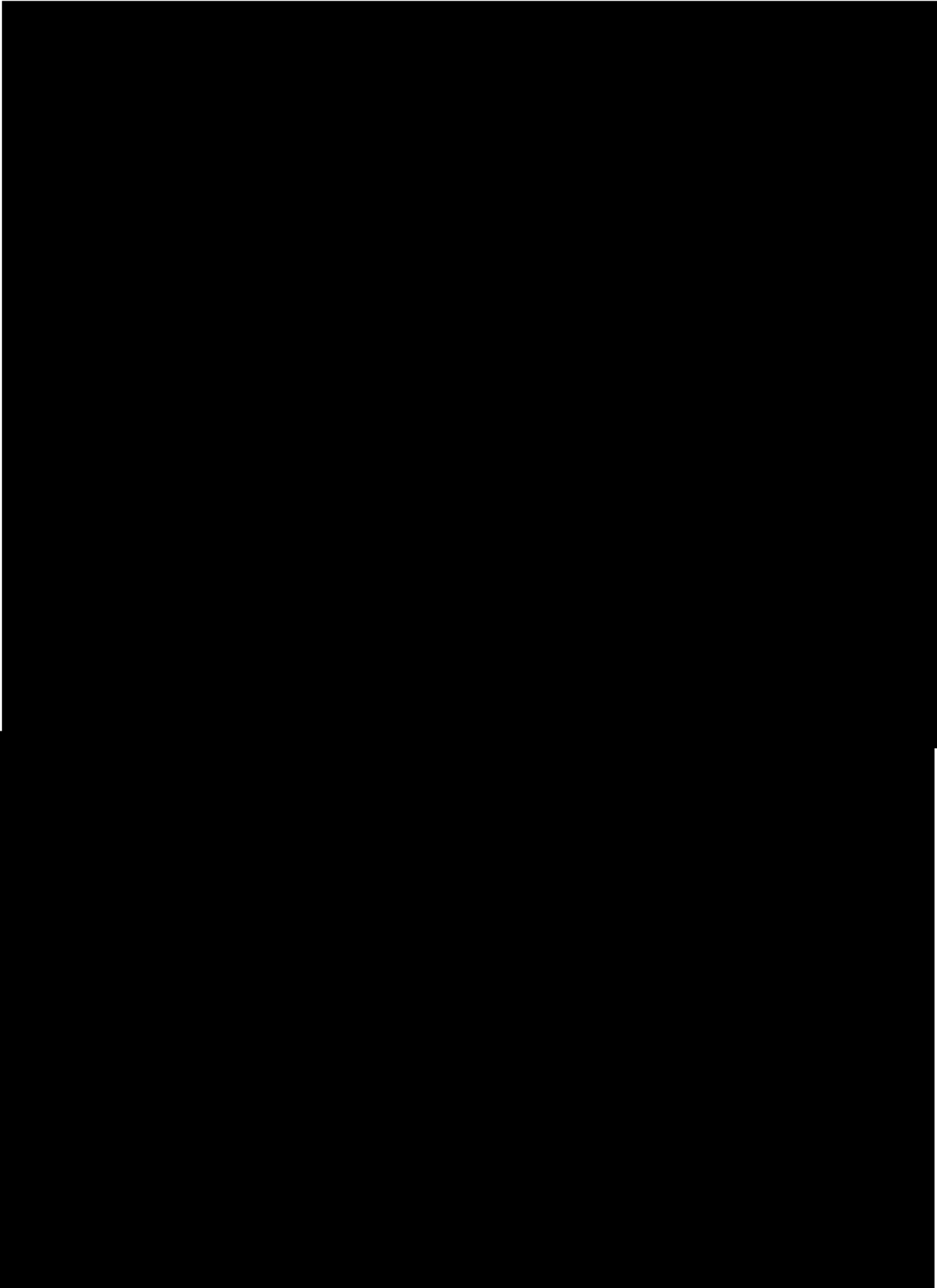
[REDACTED]

[Redacted]

| QAG Reasonable Opex Estimate (\$m) | FY23 | FY24 | FY25 | FY26 | FY27 | Y.O.Y Growth % | | | | FY23-27 | Adj. |
|---|--------------|--------------|--------------|--------------|--------------|-----------------------|------------|------------|------------|----------------|-------------|
| Personnel Costs | 39.6 | 44.7 | 46.2 | 49.1 | 51.7 | +13% | +3% | +6% | +5% | +31% | 2 |
| Other Staff | 3.5 | 4.2 | 4.6 | 4.8 | 5.0 | +20% | +10% | +4% | +4% | +43% | |
| Outsourced Operations | 14.6 | 15.2 | 15.9 | 16.5 | 17.3 | +4% | +5% | +4% | +5% | +18% | 3 |
| Repairs and Maintenance | 12.7 | 20.7 | 23.1 | 24.7 | 26.6 | +63% | +12% | +7% | +8% | +109% | 3 |
| Utilities | 6.0 | 6.7 | 7.4 | 7.9 | 8.8 | +11% | +11% | +7% | +11% | +47% | 3 |
| Cleaning | 8.6 | 9.3 | 9.9 | 10.5 | 11.2 | +8% | +6% | +6% | +7% | +30% | |
| Telecom and Computer | 11.6 | 13.0 | 13.4 | 13.7 | 14.1 | +12% | +3% | +2% | +3% | +22% | |
| District Plan Noise Obligation | - | - | - | - | - | - | - | - | - | - | |
| Rates | 3.1 | 3.3 | 3.6 | 3.7 | 3.8 | +6% | +9% | +3% | +3% | +23% | |
| Insurance | 4.0 | 5.1 | 5.2 | 5.4 | 5.5 | +28% | +2% | +4% | +2% | +38% | |
| Marketing Promotions and PR | - | - | - | - | - | - | - | - | - | - | 4 |
| Consultancy | - | - | - | - | - | - | - | - | - | - | 4 |
| Shareholder Expenses | - | - | - | - | - | - | - | - | - | - | 4 |
| Other Expenses | 3.2 | 7.6 | 8.3 | 4.4 | 6.3 | +138% | +9% | -47% | +43% | +97% | 5 |
| Total | 106.9 | 129.8 | 137.6 | 140.7 | 150.3 | +21% | +6% | +2% | +7% | +41% | |





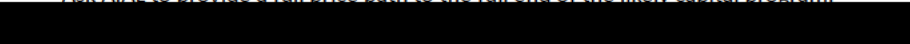
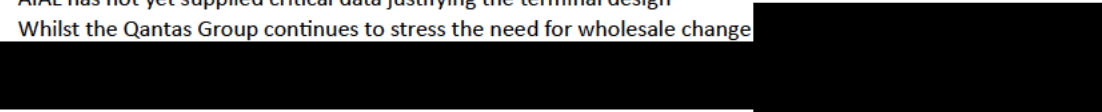
Attachment 3 - Unnecessary Projects



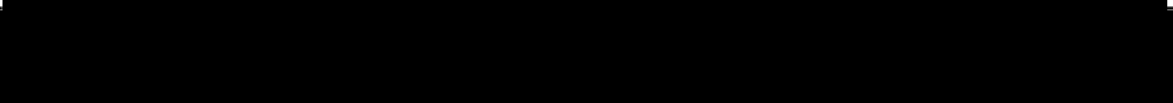

Attachment 4 - Correspondence Timeline

| Date | Communication | QFG main feedback |
|---------------|--|--|
| 10 Feb 2017 | Letter to AIAL - providing feedback on proposed capital plan | <ul style="list-style-type: none"> • Cost of domestic processor is excessive • Question if this level of investment is acceptable to the industry • Cost savings needs to be identified |
| 28 Aug 2019 | Letter to AIAL - providing feedback on revised capex plan shared by AIAL on 9 August 2019 | <ul style="list-style-type: none"> • Continue to have concerns over the high capital forecast and the impact on charges and demand • Committed to support fit for purpose at AKL airport |
| 15 April 2021 | Qantas Letter from JQ CEO to AIAL | <ul style="list-style-type: none"> • Capex unaffordable • Lower cost terminal has not been entertained by AIAL • Need to Work together for a mutually acceptable solution |
| 5 May 2021 | Email to AIAL regarding Paheko East | <ul style="list-style-type: none"> • Paheko East direction of build preferred option however noting that it still remains too large and too expensive |
| 10 Aug 2021 | QFG / AIAL session | <ul style="list-style-type: none"> • QFG provided benchmarking footprint proposed by AIAL showing its significantly larger and more expensive than comparative terminal providing similar gates. • Also requested a breakdown of cost to better understand project spend • Also suggested a staged transition |
| 26 Aug 2021 | QFG Feedback to pack from session 10 th of Aug | <ul style="list-style-type: none"> • QFG are raising questions about Scope - oversized, cost - excessive and Timing – need to consider staging • Also give examples of where opportunities are to reduce scope/area and therefore cost |
| 23 Nov 2021 | Letter to AIAL – Regarding Proposed \$89m early capex spend on IDT while PSE4 being on hold for a year | <ul style="list-style-type: none"> • QFG does not support capex to progress the DTI • Consultation needs to be concluded before any more funds being spent • Any investment must be at AIAL's risk |
| 22 Feb 2022 | Letter to AIAL - Incomplete consultation | <ul style="list-style-type: none"> • Qantas does not accept that genuine consultation has happened • The Qantas Group insists no further capital is spent until consultation has completed, including (more in letter): <ul style="list-style-type: none"> ○ A long term pricing approach and price path that takes into account the long term nature of the investment ○ The design, including adequately assessing alternative lower cost options • Any capex spend incurred prior to the completion of genuine consultation should be considered at AIAL's risk |
| 8 April 2022 | Letter to AIAL – Terminal design | <ul style="list-style-type: none"> • Whilst we agree there is a need for additional capacity, we believe the current design is not fit-for purpose and is inefficient. • No construction should take place on the proposed terminal design until all aspects of consultation are complete |



| | | |
|------------------|---|---|
| | | <ul style="list-style-type: none">• We must have a full, clear and through disclosure and discussion on all relevant information (going through in detail in letter)  |
| 29 Jul 2022 | Inefficiency notice sent to AIAL | <ul style="list-style-type: none">• We are attaching an Inefficiency Notice for the aspects of the plan discussed.• The Qantas Group will not pay for inefficient capital.• We could all waste a lot of time reviewing additional information on the non-terminal capex and discussing  <ul style="list-style-type: none">• Continuing down this pathway where AIAL announces spend, appears to listen and then keeps marching on with its plan will not deliver positive outcomes for any of us.• We do not believe this is efficient, and we will act against this with all of the tools available.• We believe the best next step is for Auckland to simply halt this process and spend some time developing realistic growth forecasts and a realistic capital plan.• This rush-to-spend is, at best, going to create extensive disputes, stalled growth and wasted expenditure that AIAL shareholders will ultimately absorb. |
| 30 Aug 2022 | Letter to AIAL -Consultation response | <ul style="list-style-type: none">• Additional feedback provided including on affordability, IDT design and Paheko East pathway• Ask AIAL to provide a full price path to the full end of the likely capital program.  <ul style="list-style-type: none">• Cannot accept that a consultation that fails to address such material issues as those raised above can have been• Continue to insist that expenditure must cease and note again that if it continues it will not be recoverable undertaken in the manner contemplated by the Airports Authorities Act. |
| 12 December 2022 | Letter to AIAL – Why detailed design should not proceed | <ul style="list-style-type: none">• Qantas Group gives reasons why it doesn't believe the detailed design should proceed• Do not believe consultation to date has been genuine and we do not believe draft pricing can be released in February given the required steps for a genuine consultation• Have been relaying our concerns to AIAL for more than a year about the excessive capex planned, yet the proposed capex plan continues to increase with only minor changes in recent weeks.• AIAL has not yet supplied critical data justifying the terminal design• Whilst the Qantas Group continues to stress the need for wholesale change  <ul style="list-style-type: none">• Please consider this letter as a formal request for:• 1. Full justification information on the capital program and six months to review.• 2. (Requesting again) A full design-review process with AIAL's consultants tasked to deliver efficient capacity in collaboration with airlines |

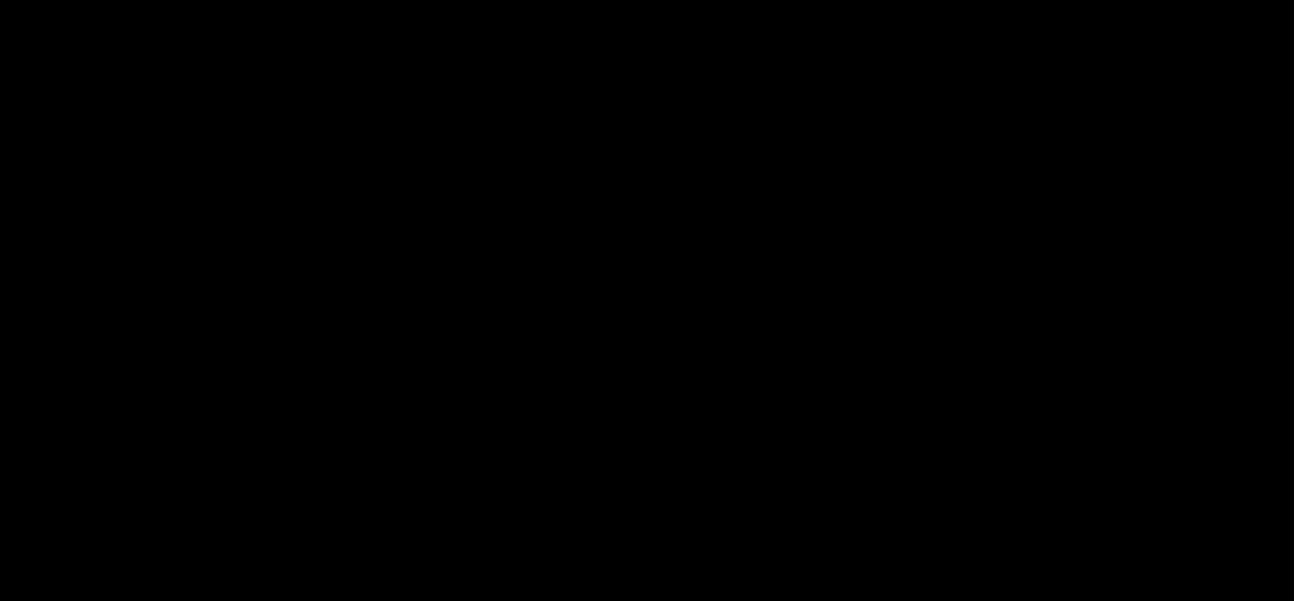


| | | |
|--------------|---|--|
| 6 Jun 2023 | Joint Letter from QF Dom and Int CEO and JQ CEO to AIAL |  <ul style="list-style-type: none">• Analysis shows the integrated domestic terminal is close to three times the size of our Aurecon estimates of a reasonable requirement• The excess capacity should not be funded by airlines or their passengers• We remain of the view that there has not been genuine consultation from AIAL• Imperative that AIAL stops this capital development process and re-embarks on genuine consultation with realistic objectives |
| 22 June 2023 | Joint Letter from QF Dom and Int CEO and JQ CEO to AIAL | <ul style="list-style-type: none">• Do not intend to reply in detail to the letter, as most of the content within the letter was either not relevant to the key points we have made, or has simply generated more questions.• Not enough information or engagement from AIAL to even 'agree to disagree', and still do not understand the rationale for most of the work or the costings, why our passenger forecasts are so divergent or what AIAL's design parameters are• The integrated terminal remains more than twice the size than it needs to be, and its cost per square metre is 40% higher• The capital program delivers no quantifiable benefits for Qantas or Jetstar International.• • Refers to BISOE demand impact• Insist AIAL pauses work and engages in a genuine consultation to deliver a reasonable and affordable capital program• This is essential to sustain the health of the aviation industry in New Zealand. |

Attachment 5 - PSE4 connection to PSE5

Of the total \$5.6b attributed to the aeronautical till for the 10 years covered in PSE4 and PSE5, \$1.4b (25%) is assigned to works solely within PSE4, \$3b (54%) is attributed to works which are proposed to commence in PSE4 and continue into PSE5 and the remaining \$1.2b (21%) is attributed to works solely within PSE5. 49% of PSE4 expenditure is only commissioned and so only visible in PSE5 pricing.

Contrary to AIAL's statement that no commitments have been made, both of these are material commitments that undermine any consultation for PSE5 if not consulted on now.



Qantas disagrees with AIAL's claim that it is not possible to provide an estimate for the next pricing period. It has spelled out its view of PSE5 capex and has submitted its estimates and the supporting BBM.

As PSE4 provides minimal capacity increase in both terminal and stands (one additional aircraft bay), we also expect PSE4 and PSE5 to be followed by further demand for capital expenditure to provide actual growth capacity beyond the numbers.

AIAL's Vision 2030 lists a further five projects in this PSE4/PSE5 period, which we estimate to cost ~\$2bn and to be called for by AIAL once these works are complete. These include:

- Second Runway
- Extended taxiway
- Northern Terminal Extension incl Pier C stage 1
- Pier B Extension
- Roading Programme