

Review of Christchurch and Auckland Airports' pricing decisions July 2017- June 2022

Final reports

1 November 2018

Deputy Chair Sue Begg



Overview

- Second review of Auckland Airport's (AIAL) and Christchurch Airport's (CIAL) pricing decisions since information disclosure requirements came in under Part 4 of the Commerce Act
- In this review we focussed on:
 - reasonableness of target returns
 - efficiency of pricing
 - AIAL's investment plans



Conclusions are broadly unchanged from draft reports

- No significant concerns on expenditure forecasts, demand forecasts or efficiency of pricing structures
- Returns on other regulated services are likely to be better assessed over a longer timeframe
- Improvements compared to PSE2

Christchurch

- Broadly satisfied CIAL not targeting excessive profits
- Target returns on priced services are reasonable

Auckland

- We remain concerned AIAL's target return and resulting overall profit is too high
- We are not satisfied AIAL has sufficiently justified its asset beta

Framework for considering target returns

- Airports do not have to apply our cost of capital estimate when setting prices
- We use our mid-point estimate as our starting point for assessing whether expected returns are appropriate
- The IMs require an airport to provide evidence to explain difference between its target return and our mid-point estimate



Targeted returns

Commission mid-point post-tax WACC estimate = 6.41%

Christchurch Airport	Targeted return	% of regulated services
Priced services	6.44%	85%
Other regulated services	7.87%	15%
Overall return	6.65%	100%

Auckland Airport	Targeted return	% of regulated services
Priced services	6.99%	92%
Other regulated services	7.90%	8%
Overall return	7.06%	100%



CIAL conclusions

Targeted return on priced services

- We are satisfied that its targeted return on priced services of 6.44% is reasonable
- We have focused on CIAL's targeted return, which is below its own estimated WACC of 6.82%
- Consider CIAL has sufficiently justified its use of a slightly higher cost of debt estimate than we used
- A higher debt premium estimate of 1.84% is reasonable in CIAL's specific circumstances

CIAL conclusions (ctd)

Improved transparency & pricing structure

- Improved process compared to PSE2 – greater transparency on expected depreciation, forecast WACC, targeted return and its reasoning
- Constructive engagement with customers – though could have released more information on some topics (pricing structure and route incentive payments)
- New charging structure does not raise significant efficiency concerns in our view
- No significant concerns with demand or expenditure forecasts

AIAL conclusions

Targeted return on priced services

- AIAL's targeted return is in line with its estimated WACC of 6.99%
- It submitted that the higher return is needed to safeguard against the risks and costs of under-investment in the airport sector
- We are not persuaded its targeted return promotes the long-term benefits of consumers
- Compared to our mid-point WACC estimate, consumers will pay up to \$53m more on priced services – \$37m in post-tax profit
- Not all of that profit is necessarily excessive

AIAL conclusions (ctd)

Asset beta

- The difference between AIAL's target return and our mid-point WACC estimate for priced services is nearly all due to its use of a higher asset beta
- Estimating an appropriate asset beta is difficult, however we are not satisfied AIAL has sufficiently justified its 0.08 asset beta uplift
- AIAL's significant capital expenditure programme may affect its asset beta, but any effect is likely to be smaller than the uplift AIAL has built in
- The market estimate of AIAL's asset beta reflects its entire business, not just regulated services, and is likely to be subject to significant estimation error

AIAL conclusions (ctd)

Improvements in pricing efficiency

- AIAL has introduced differential charges which reduce the likelihood of cross subsidisation
- Differentiated charges also increase ability for airlines to make price-quality trade-offs (eg, check-in service options)
- New parking charges for planes to improve airfield efficiency
- AIAL should have given greater consideration to peak/off-peak charges as it may be efficient to recover a higher proportion of fixed costs from peak users



AIAL conclusions (ctd)

Capex forecasts

- We have no significant concerns with the cost, timing or consultation for the planned \$1.8 billion redevelopment
- Strong passenger growth year-on-year is putting pressure on expenditure and infrastructure
- No concerns with forecasts for demand and operating expenditure



AIAL conclusions (ctd)

Contingent runway land charge (RLC)

- The objective of the RLC is to mitigate price shocks at the time of commissioning the second runway
- The RLC does not raise significant concerns given AIAL's intention to offset any revenue from the RLC against the value of the land being held for the runway
- If it does not offset revenue in this way, or abandons the project after introducing the RLC, we can comment in future

Conclusions on other regulated services

- We consider that an airport's returns on other regulated services are likely to be better assessed over a longer timeframe
- We do not consider that CIAL or AIAL have sufficiently justified their expected returns on their other regulated services
- However these contracts are affected by a range of factors that make it difficult to determine whether returns are appropriate during a 5-year pricing period

Summary

Big improvements compared to PSE2

- Still room for improvement in some areas
- Transparency improved since IM review
- Targeted return gone down
- We will review Wellington Airport's price setting next
- We then intend to do an overall review of performance across all airports



Airport regulation

We regulate certain key facilities and services to get people and cargo on and off aeroplanes at New Zealand's three major airports.



Regulated services

Airfield

This includes: runways, taxiways, plane apron parking; air and ground traffic control facilities; airfield maintenance, safety and emergency services.

Passenger terminal activities

This includes: check-in and baggage handling; security, customs, immigration and quarantine facilities; passenger facilities, seating, and duty-free collection areas.

Aircraft and freight

This includes: aircraft servicing, refuelling, maintenance and hangar facilities; freight handling and storage, security, customs and quarantine services.

Services *not* regulated

This includes: retail facilities; car parking; and access for taxis, shuttles and buses.

Information disclosure regulation

The Commission does not regulate airport *prices*. We review airport pricing decisions to promote greater understanding of their performance.

