

**REVIEW OF INPUT METHODOLOGIES:
CROSS SUBMISSION ON DRAFT DECISION ON LAND VALUATION METHODOLOGY
18 DECEMBER 2015**

Introduction

1. This is the New Zealand Airports Association ("**NZ Airports**") cross submission on the Commerce Commission's draft decision on input methodologies for the application of land valuation methodology ("**draft decision**").¹ Auckland International Airport, Christchurch International Airport and Wellington International Airport have been involved in the preparation of this submission.
2. The NZ Airports contact for matters regarding this submission is:

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Executive summary

3. NZ Airports has reviewed BARNZ's submission, and the accompanying expert report provided by Covec. We disagree that the Commission's draft decision:
 - (a) represents a fundamental change in approach on zoning costs and will justify higher valuations. As we explained in our submission, we believe the Commission has sought to clarify and confirm the existing treatment of zoning costs under Schedule A; and/or
 - (b) is inconsistent with the relevant purpose statements and the opportunity cost concept. To the contrary, we believe the draft decision best meets the relevant statutory requirements.
4. A note prepared for NZ Airports by Sapere Research Group, and attached at **Appendix One**, responds to the Covec report submitted with BARNZ's submission.
5. For this cross-submission we have further reflected on the need for Schedule A to provide certainty on how the zoning most likely to be in place if the airport did not exist should be determined, and have suggested some further refinements to the amendments proposed in our submission. These further refinements respond to BARNZ's submissions around the need to minimise subjectivity and uncertainty in determining the zoning starting assumption, which NZ Airports agrees is important. Our refinements focus on implementing the principle that the valuer should, based on objective evidence, seek to determine the zoning that the local authority would be most likely to apply if the airport did not exist. Further, the correct position will remain that:
 - (a) costs to move away from airport zoning to the zoning most likely to be in place if the airport did not exist should be ignored; and

¹ Commerce Commission, Draft decision, 10 November 2015

- (b) if the airport proposes a land use that requires a zoning that is different to that most likely to be in place if the airport did not exist, then the costs of changing the zoning should be factored into the MVAU.

Draft decision is a confirmation of current MVAU approach

6. BARNZ argues that the draft decision is a "*fundamental change to both the underlying philosophy of the current valuation guidelines as well as the practical directions to the valuer of how to carry out the valuation*".² BARNZ's concern applies particularly to the Special Assumption that determines the cost of re-zoning land away from use for airport activities to notionally vacant is not required to be accounted for in the MVAU valuation.
7. NZ Airports disagrees. As outlined in NZ Airports' submission,³ we understand the draft decision to confirm the Commission's existing approach to zoning costs under MVAU. It is a clarification of the current position - not a fundamental change in approach. This point is emphasised several times in the draft decision:⁴

This chapter outlines our proposed amendments to Schedule A to **clarify** how costs associated with re-zoning land are treated in the MVAU land valuations. (emphasis added)

We propose amending Schedule A of the airports IMs to...**clarify** that costs associated with re-zoning land to its alternative use are to be accounted for in the estimated value of the land in its alternative use...(emphasis added)

We therefore propose amending the IMs to **clarify** that costs associated with re-zoning land to its alternative use are to be accounted for in the estimated value of the land in its alternative use...(emphasis added)

8. BARNZ (and Covec) also incorrectly assert that the draft decision will "*result in material increases to airport valuations*".⁵ NZ Airports interprets the draft decision and Special Assumptions as representing a continuation of Schedule A's existing treatment of zoning under MVAU valuations, meaning the draft decision will not cause increases in airport valuations.
9. The draft decision should not be interpreted as a departure from the current policy and directions in Schedule A. Therefore, we disagree with BARNZ's submission that the clarification provided by the Special Assumptions needs to be justified according to the Commission's criteria set out in its Decision-Making Framework Discussion Paper.⁶ The absence of such a discussion in the draft decision affirms our view that the Commission's intention was to retain and clarify the existing approach.

Draft decision is consistent with Part 4 and the concept of opportunity cost

10. BARNZ's submission, relying on a report prepared by Covec⁷, argues that the proposed changes to the special assumptions in Schedule A, are:
- (a) inconsistent with the opportunity cost concept;⁸ and

² BARNZ submission, Commerce Commission Draft Decision Relating to Fast Track Review of Input Methodologies for the Application of Airport Land Valuation Methodology, 8 December 2015 ("**BARNZ submission**") at page 1

³ NZ Airports, Submission on Draft Decision on Land Valuation Methodology, 8 December 2015, at 6

⁴ Commerce Commission, draft decision, at 2.1, 2.2.1 and 2.13

⁵ BARNZ submission, page 4

⁶ Commerce Commission, Covering note: Developing decision-making frameworks for the current input methodologies review, Discussion Draft, 22 July 2015, at 16 and 17

⁷ Covec, Airport Land Valuation, 8 December 2015

⁸ BARNZ submission, page 3

- (b) in "direct conflict" with the overall objective of s52A of promoting outcomes consistent with outcomes in workably competitive markets.⁹
11. NZ Airports disagrees. As the short paper prepared by Sapere Research Group provided at **Appendix One** explains:
- (a) The assumptions relied upon by Covec in its assessment of opportunity cost, (that notionally vacant airport land should still be assumed to be zoned for airport use) are flawed and give rise to an inconceivable outcome whereby the land has a lower value as an airport than in an alternative use. Covec's analysis of opportunity cost is accordingly coloured by this erroneous assumption.
- (b) This results in a MVAU that is reduced by the cost of rezoning the land from an airport to allow the land to be used for an alternative use. If this value is then used in pricing, the land would earn a lower return on its use as an airport than it would earn in its best alternative use. Not only is this inconceivable, but it results in an outcome inconsistent with outcomes of workably competitive markets and so is contrary to the purpose of Part 4.
12. We have previously submitted why we believe the Commission's application of the opportunity cost concept best meets the purpose of Part 4. And we further note that the Commission specifically turned its mind to both of these issues in its draft decision.¹⁰
13. BARNZ's submission also advocates an alternative proposal of permitting arm's length transaction land acquisition costs above a Schedule A MVAU valuation to enter the RAB as a separate asset.
14. NZ Airports believes that the IMs already provide adequate rules for determining the cost of newly acquired land. As Sapere notes in its report¹¹, potentially allowing a 'premium' on land acquisition is a separate matter. The draft decision is appropriately focussed on clarifying rules for the application of MVAU to all airport land, which NZ Airports supports.

Uncertainty and purpose of IMs

15. BARNZ is of the view that the three options for determining a starting point for notionally vacant land (current zone, zone of surrounding land, or historic zone) will bring uncertainty to the valuation process. BARNZ have argued that this "*menu*" or "*suite*" of options runs counter to the purpose of IMs.¹²
16. NZ Airports disagrees. Despite BARNZ's views, we believe that the draft decision will meet the purpose of IMs under s52R of the Commerce Act 1986 because it will provide greater certainty on the rules applying to zoning when undertaking MVAU valuations.
17. Section 52R states that the purpose of IMs is to promote certainty of "*the rules, requirements, and processes*" applying to the regulation of goods or services under Part 4. The Commission's obligation is to provide certainty on the rules - not of *outcomes* when the rules are applied, as BARNZ's arguments suggest. This was made clear in the IM Reasons Paper:¹³

The Commission considers that IMs will promote certainty for the Airports and consumers of airport services by setting out, as clearly as possible, a number of the key

⁹ BARNZ submission, page 6

¹⁰ Commerce Commission, draft decision, at 1.3 and 2.9

¹¹ Sapere Research Group, Cross submission: Comment on Dr John Small's report and BARNZ's submission, at page 10

¹² BARNZ submission, page 6 and 8

¹³ IM Reasons Paper, 2010, at 2.2.6

'inputs', whether direct or indirect, to information disclosure regulation. As CRA International (CRA) submitted (on behalf of Unison), promoting certainty primarily requires that IMs are "well-specified to prevent, as far as possible, differences in interpretation by suppliers and regulators". **Certainty, however, does not necessarily dictate what the most appropriate methodology is. The Commission generally agrees with CRA that promoting certainty "has no direct implication for the choice of alternatives within each methodology".**

In addition, the **need to promote certainty does not dictate what the final numeric result will be in all cases.** That may depend on future data or circumstances, at the time the IM is applied (emphasis added)

18. NZ Airports believes that the draft decision will implement the requirement to provide certainty, as it provides clarification as to the rules for approaching an MVAU valuation. Any ambiguity around the treatment and determination of cost allowances for re-zoning land required for the HBAU was the biggest driver of valuation differences in the past. This is now resolved by the draft decision.¹⁴
19. The suggestion by BARNZ that the Commission should decide the starting point for zoning for each airport in order to create certainty¹⁵ is inappropriate in this context. It is not necessary to promote the purpose of IMs, and instead represents an unjustified departure from the established position and policy that using independent and professional valuers is the best way to establish appropriate land valuations for each airport. Such a material change in approach would require the Commission to apply its decision-making framework (which BARNZ has not sought to do in this instance).
20. We nevertheless acknowledge the importance of the IMs providing certainty on how zoning is to be determined when undertaking MVAU valuations. The suggested revisions to the Special Assumptions in NZ Airports' mark-up to Schedule A sought to provide:
 - (a) greater clarity and certainty as to how a valuer would determine the most likely zoning if the airport did not exist; and
 - (b) assurance within the IM that the valuer must have regard to relevant factors that will appropriately guide and limit that decision.
21. In light of BARNZ's submissions on the need for certainty and objectivity, we have further reflected on the need for the revised IM to meet the above criteria, and have refined our suggested revisions to the special assumptions (see below at 24). We believe that with those revisions a valuer will have sufficient direction on objective factors to inform the determination of the likely zoning of the airport land in its notionally vacant state.
22. As explained in NZ Airports' submission, the proposed mechanisms in draft Schedule A for determining the zoning most likely to apply if the airport did not exist are unlikely to allow a valuer to arrive at the conceptual outcome intended by the draft decision - the zoning that would most likely apply if the airport did not exist, because:
 - (a) the current zoning will be for use as an airport, which would not prevail if the airport did not exist;
 - (b) the zoning that applied prior to the land being zoned for aeronautical use will, other than for recently acquired parcels of land, be too historic; and

¹⁴ Commerce Commission, draft decision, at 2.3

¹⁵ BARNZ submission, page 8

- (c) as was articulated in our submission,¹⁶ NZ Airports agrees with BARNZ's view that the existing zoning of the land in the area surrounding the airport (as proposed in the draft decision), risks being influenced by the provision of regulated airport services.
23. The conceptual question a valuer is required to consider can best be determined with reference to the evidence and factors a local authority would consider when determining the appropriate zoning. Adding that to clause A4, as we proposed in the mark-up of draft Schedule A we provided with our submission, introduces relevant objective criteria into draft Schedule A, which directly affect the likelihood of alternative zoning if the airport did not exist. It ensures that valuers have an appropriate methodology for determining the conceptual question, but also within a limited and defined set of criteria.
24. Our proposed amendments to Clause A4 of Schedule A have been further refined in **Appendix Two**, to improve clarity and certainty. Specifically, clause A4(d) has been revised to limit the criteria a valuer will have regard to, to the factors and criteria the relevant local authority would consider. While that is likely to include many of the factors previously proposed by NZ Airports, eg anticipated population growth, supply and demand etc, by making the assessment through the lens of the relevant local authority it provides greater certainty and objectivity as to how a valuer should factor in those considerations.
25. We expect that the Commission will have its own views on how the proposed clause could be appropriately drafted. Key from NZ Airports' perspective is for the Commission to accept our underlying concern that the Commission's draft Schedule A risks not implementing the Commission's draft decision that starting zoning can be that most likely to be in place if the airport did not exist.

Purpose of Information Disclosure

26. BARNZ also asserts that the draft decision is inconsistent with the purpose of Information Disclosure ("**ID**") as it will not produce a valuation that provides sufficient information to interested persons to assess whether the section 52A purpose is being met. According to BARNZ, this is also due to what Covec describes as the "menu" or "suite" zoning options, which pose a challenge for interested persons that "*is an order of magnitude greater than that which valuers will face under the Commission's proposal*".¹⁷
27. This argument ignores the fact that:
- (a) draft Schedule A requires that a valuer must, where appropriate, set out in the valuation report how they determined the special assumption for land zoning;¹⁸ and
- (b) the land valuer's report must be disclosed in the airport's information disclosures.¹⁹
28. Moreover, the further refinements to clause A4 (Special Assumptions) of Schedule A (provided at **Appendix Two**) suggested by NZ Airports would mean that interested persons will be clear on the criteria that were required to be taken into account by the valuer when determining the likely zoning of the airport in its notionally vacant state.

BARNZ's other proposed amendments to Schedule A

29. Having consulted with its expert valuers, NZ Airports' views on BARNZ's other proposed amendments to the Commission's draft Schedule A are as follows:

¹⁶ NZ Airports, Submission on Draft Decision on Land Valuation Methodology, 8 December 2015, at 17

¹⁷ BARNZ submission, page 6

¹⁸ Draft Schedule A, A3(3)

¹⁹ Commerce Act (Specified Airport Services Information Disclosure) Determination 2010, clause 2.3(3)

- (a) BARNZ is concerned that the definition of MVAU is not carried forward into the draft Schedule A, alleging this will "*rip out the heart of Schedule A.*"²⁰ In reality, the Commission is simply removing unnecessary aspects of Schedule A. BARNZ's re-introduction of these definitions as a whole new section in the draft Schedule A would seem to undermine the Commission's effort to remove undesirable duplication and repetition. This is because the definition of MVAU remains incorporated throughout the draft Schedule A, in particular in the MVAU valuation steps a valuer must take. For example:
- (i) under the MVAU valuation steps, the valuer must:²¹
 - (aa) consider and determine the highest and best alternative use;
 - (bb) undertake market research and obtain comparable sales information to support the alternate land uses; and
 - (cc) apply suitable adjusted market evidence to airport land as required; and
 - (ii) the treatment of construction, conversion and remediation costs are dealt with under Special Assumptions A4 (5) and (6) (which the valuer must determine in the MVAU valuation steps).
- (b) BARNZ has included a definition of HBAU in proposed clause A2(4), which is inconsistent with the definition in clause 1 of the IM (which should remain).
- (c) Further, BARNZ has partially repeated the definition of HBAU later in draft Schedule A in the MVAU valuation steps,²² specifically the words "*physically possible, appropriately justified, legally permissible, credible and financially feasible*". However, this is only part of the definition of HBAU and includes the word "credible", which is absent from the existing definition.
- (d) BARNZ has added a list of appropriate methods and techniques to use when estimating the value of the land.²³ This is simply restating approaches that are well recognised by valuers and so appears unnecessary.
- (e) BARNZ has suggested that the zoning for notionally vacant land is the current underlying zoning or designation of the land (this is their first alternative, the second being that the Commission should specify the precise land zoning for each of the three airports, which is inappropriate as outlined above). As reflected in the NZ Airports' mark-up of Schedule A at Appendix Two, that is only appropriate to the extent it is one non-mandatory criterion that a valuer may have regard to in determining the likely zoning of the airport land in its notionally vacant state.

²⁰ BARNZ submission, page 9

²¹ Draft Schedule A, A5(d) (h) and (i)

²² BARNZ submission, Attachment A, Proposed input methodology amendments, at A6(1)(d)

²³ Ibid, at A3(5)(b)

Appendix One
Sapere report
[enclosed separately]

Appendix Two

NZ Airports' amendments to draft Schedule A

SCHEDULE A – AIRPORT LAND VALUATION METHODOLOGY

A1 Overview

(1) This schedule sets out the mandatory requirements for a **valuer** to apply when undertaking a valuation of **land** held by an **airport** for the purposes of this determination.

(2) This schedule contains the following clauses

Clause	Content
A1	Overview
A2	Professional valuation framework
A3	Valuation requirements
A4	Special assumptions
A5	MVAU valuation steps

A2 Professional valuation framework

(1) Subject to subclauses (2), (3) and (4), **valuers** must undertake an **MVAU** valuation in accordance with the **valuation and property standards**, subject to any modifications, additions, or variations to those standards specified in this Schedule.

(2) **Valuation standards** with ‘mandatory practice’ status must be adhered to by **valuers**.

(3) **Valuation guidance** with ‘best/good practice’ status must be adhered to by **valuers** when reasonably practicable.

(4) An **MVAU** valuation must be prepared by a **valuer**.

(5) The **valuer** must -

(a) base the estimate of value on data and circumstances appropriate to the valuation;

(b) use appropriate methods and techniques for the estimate of value; and

(c) develop the MVAU valuation with sufficient information to fully support the analysis and conclusions.

(6) Where the **valuer** is not appropriately experienced or qualified to provide expert opinion on key components of the MVAU valuation then the **valuer** must obtain advice from relevant independent experts.

A3 Valuation requirements

(1) In undertaking an **MVAU** valuation, the **valuer** must make the **special assumptions** set out in clause A4.

(2) The valuer must, where appropriate, include the likelihood, timing and costs (both direct and indirect if any) of moving from the **special assumption** for land zoning to the zoning required for the development of the land in its **highest and best alternative use** when undertaking the **MVAU** valuation.

(3) The **valuer** must, where appropriate, set out in the valuation report how they determined the **special assumption** for **land** zoning and the likelihood, timing, and costs (both direct and indirect if any) of moving from the **special assumption** for **land** zoning to the zoning required for the development of the **land** in its **highest and best alternative use**.

(4) The **valuer** can rely on evidence of sales of land as comparable market-based data only to the extent the sales were unaffected by the supply of **specified airport services** or can be adjusted to remove the impact of the supply of **specified airport services** on the sale.

(5) The **valuer** can rely on evidence of sales of land to, or by, **airports**, only to the extent the transactions in question occurred on an arm's-length basis and the price and other terms of the sales were unaffected by the supply of **specified airport services** or can be adjusted to remove the impact of the supply of **specified airport services** on the sale.

(6) The **valuer** must assume an orderly sale of the aggregated **land** (in economically manageable parcels) over such time as would likely be needed to achieve the **highest and best alternative use** of the **land**.

(7) The **valuer** must give consideration to the physical characteristics of the **land** (including contiguity), existing title and easement arrangements, zoning, any other restrictions or impediments and adjoining **land** uses, when determining the **highest and best alternative use(s)**, so as to maximise the value in the **land's** alternate use(s) and market value.

(8) All key assumptions and **special assumptions** made in undertaking such a valuation must be disclosed by the **valuer** in the valuation report.

(9) The **valuer** must explain the reason and the impact on the valuation of any [departure deviation](#) from the **special assumptions** set out in this Schedule.

A4 Special assumptions

(1) The **land** must be valued as an aggregated parcel (which may be made up of multiple titles) of a size equal to that attributed to the **supply of specified airport services**.

(2) The **land** must be valued as notionally vacant and clear of **airport** related improvements.

(3) The **land** zoning is the current zoning or the zoning that is most likely to apply if the **airport** did not exist.

(4) [When determining the land zoning most likely to apply if the airport did not exist, to the extent appropriate the valuer must be determined by should haveing](#) regard to:

[\(a\) the current zoning of the land;](#)

[\(b\) the zoning that applied prior to the land being zoned for aeronautical purposes;](#)

[\(c\) the existing zoning of the land in the surrounding areas surrounding the airport site; and/or](#)

[\(d\) other matters relevant to determining the most likely zoning for the land, which must be ascertained by having regard to:](#)

(i) the physical features of the **land**;

(ii) current and likely local authority planning objectives and policies,
including consistency with regional policy directions; and

(iii) likely permissibility under the Resource Management Act 1991,
and any other applicable statutory requirements or considerations.

(5) Relevant construction costs, holding costs, and the developer's or investor's profit and risk must be included in the **MVAU** valuation.

(6) The costs of converting the land to an **airport** that must be excluded from the **MVAU** valuation includeare:

- (a) costs of resource consents for **airport** development;
- (b) holding costs during **airport** development;
- (c) costs of earthworks necessary for the formation of the level **airport** platform;
- (d) costs of any **land** reclamation or dredging;
- (e) costs of sea-wall or other coastal protection systems;
- (f) cost of **airport**-specific drainage systems, including retention ponds;
- (g) professional fees, including those for surveyors, engineers, and planners, with respect to the above-mentioned activities; and
- (h) any other costs incurred in the conversion of **land** to provide **specified airport services**.

(7) Costs for remediation or demolition expenditure must be excluded from the **MVAU** valuation, including the costs of-

- (a) demolition, crushing and removal of concreted and sealed surfaces including runways, taxiways, aprons, roading, kerbs, and channels;
- (b) demolition and debris removal of **airport**-specific buildings and structures including terminals, hangars, fire rescue buildings, control towers, and fuel depots;
- (c) removing above- and below-ground utilities, including pipelines and cabling required for **airport** specific activities like fuel pipelines, tanks, runway drainage and lighting, and approach lighting; and
- (d) clean-up of potential site contamination including contamination occurring through aircraft and maintenance operations by spills of aircraft and vehicle fuels, paints/solvents, fire fighting foams, underground and above ground storage tanks, radioactive materials, asbestos, PCBs, pesticides and herbicides or battery acids, or through the operation of waste disposal facilities, vehicle storage, dredging operations, building construction and underground and above ground utility lines/pipes.

A5 MVAU valuation steps

(1) In undertaking an **MVAU** valuation the **valuer** must

(a) establish and compile a schedule of the **land** parcels that are to be included in the **MVAU** valuation;

(b) confirm ownership, tenure and aggregated **land** area;

(c) determine the **special assumption** for **land** zoning;

(d) consider and determine the **highest and best alternative use**;

(e) determine the zoning of the **land** for the **highest and best alternative use**, and [if different to the special assumption for land zoning](#) the likelihood, timing, and cost (both direct and indirect, if any) of moving from the **special assumption** for land zoning to the zoning required for the development of the land in its **highest and best alternative use**;

(f) consider resource management (including reserve contribution) requirements, amenities in the area, and access to services;

(g) for notional subdivision / residual value approaches:

(i) prepare a **land** development plan (in conjunction with a planner, where considered necessary by the **valuer**). This should demonstrate the **valuer's** view of the likely **highest and best alternative use** development of the **land**, and provide evidence for the assessment of inputs into the notional subdivision / residual value approaches;

(ii) determine market demand for the proposed development and the time period for the sale or realisation of the developed **land** in a notional subdivision or development, including, where appropriate, economic analysis to support the market demand and the time period for the sale or realisation of the developed **land**;

(iii) determine the direct costs of developing the **land**;

(iv) determine any indirect costs of developing the **land** e.g. the developer's holding costs, **local authority** rates etc.;

h) undertake market research and obtain comparable sales information to support the alternate **land** uses selected, including both block sales and developed **land** sales if both a direct sales comparison and notional subdivision / residual value approaches are to be used;

(i) apply suitable adjusted market evidence to **airport land** as required, and taking account of whether a direct sales comparison or notional subdivision / residual value approaches are to be used;

(j) reconcile the results of the valuation approaches used and determine a final value for the **highest and best alternative use**; and

(k) prepare a valuation report, incorporating all disclosures required by the relevant **valuation standards** and this Schedule.