

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

Introduction

1. This is the New Zealand Airports Association ("**NZ Airports**") 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. NZ Airports' contact for this submission is:

Kevin Ward
Chief Executive
PO Box 11 369
Wellington 6011

Executive Summary

3. NZ Airports welcomes the clarification of the starting position for zoning when undertaking a MVAU valuation. We have provided some suggestions on how Schedule A could be amended to better implement the Commission's decision that the starting point is the zoning most likely to be in place if the airport did not exist.
4. NZ Airports supports all other aspects of the draft decision, and so for the most part this submission is focused on proposed improvements to the more detailed or technical aspects of the draft decision, which NZ Airports considers will enhance the effectiveness of the Commission's proposed revisions to Schedule A.
5. A marked-up Schedule A ("**draft Schedule A**") is provided at Appendix One.

Zoning costs

Confirmation of existing approach to zoning costs

6. NZ Airports agrees with the draft decision that the cost (and time) of re-zoning land away from use for airport activities to notionally vacant is not required to be accounted for in the MVAU valuation.² The Commission has also clarified that the costs (if any) to re-zone from notionally vacant to the zoning for the highest and best alternative use ("**HBAU**") of the land are to be accounted for in the estimated value of the land. The draft decision is therefore consistent with NZ Airports' understanding of how the Commission intended Schedule A as it currently stands to be applied.
7. As the Commission notes, the lack of clarity on this issue has been the most significant driver of differences in MVAU land valuations.

¹ Draft decision, 10 November 2015

² Draft decision, 10 November 2015 at 2.2.1

8. It is important that the clarity to be provided going forward is consistent with the concept of opportunity cost (on which, see below), and in line with the Commission's IM Reasons paper. The draft decision achieves that outcome.

Opportunity cost and treatment of remediation costs

9. The Commission intends for land to be valued at opportunity cost; that is, the benefit that could be gained from an alternative use of the same resource.³ In assessing opportunity cost, the land must be assumed to be notionally vacant and clear of airport related improvements. Land that is vacant and clear of airport related improvements would be economically mobile. In workably competitive markets, investors earn a return on economically mobile assets, which reflects the value of the asset in an alternative use. As previously outlined by Sapere for NZ Airports, excluding the costs of moving away from airport zoning is the only way for the Commission to adhere to its intent of valuing the land as a non-specialised asset.
10. Sapere explained the reasons why zoning costs should be treated consistent with remediation costs in the MVAU calculation. Accordingly, NZ Airports welcomes the draft decision to exclude the zoning costs of changing from airport use to notionally vacant, which aligns the treatment of zoning costs with the treatment of remediation costs.
11. The Commission also notes that a cost allowance for re-zoning land to HBAU is consistent with the opportunity cost concept.⁴ NZ Airports agrees that only the time and cost (if any) of changing the zoning from notionally vacant to the HBAU zoning should be included in the MVAU.

Part 4 Purpose

12. Importantly, the approach to zoning costs outlined in the draft decision best meets the Part 4 purpose statement. As Sapere has previously explained, the Commission had arrived at a valuation methodology for land that it considered would result in valuation outcomes of workably competitive markets, and thus in line with the purpose of Part 4. The confirmation in the draft decision regarding zoning costs maintains this.

Special Assumptions

13. NZ Airports agrees with the key principle to determine the zoning of the airport land in its notionally vacant state - namely, that most likely to be in place if the airport did not exist.⁵ We agree this starting point is needed to ensure that the appropriate costs (if any) of re-zoning land to the HBAU (which may or may not be different to the most likely zoning in its notionally vacant state) are accounted for.⁶ If different, there will inevitably be costs and time required to obtain the HBAU zoning. It is these costs that will be accounted for in the MVAU valuation.
14. However, we have identified some issues with the way draft Schedule A seeks to implement this principle.
15. Draft Schedule A states that the zoning of the airport land in its notionally vacant state is either:
- (a) its current zoning; or
 - (b) that which would apply were the airport not to exist.⁷

³ Draft Decision at 2.10

⁴ Draft Decision at 2.12

⁵ Draft Decision, draft Schedule A, Special Assumption A4(3)

⁶ Draft Decision, at 2.16

⁷ Clause A4(3), draft Schedule A

16. In the event that the latter approach is pursued by a valuer, then draft Schedule A prescribes how to determine the relevant zoning (Clause A4(4)), either by having regard to:⁸
- (a) the existing zoning of the land surrounding the airport site; or
 - (b) the zoning that applied to the land prior to it being zoned for aeronautical use.
17. NZ Airports is concerned that those prescribed approaches may have some limitations in their ability to implement the Commission's intent for the valuer to ascertain the most likely zoning in the event that the airport did not exist:
- (a) In the case of the former, the zoning of the land in the area surrounding the airport may be influenced by the adjoining airfield activities; for example noise, height or density restrictions to ensure the efficient operation of the airport. Those considerations would not apply to the land in the surrounding area if the airport did not exist.
 - (b) In the case of the latter, as the airport is likely to have been in place for a substantial period, the zoning of the land prior to it being zoned for aeronautical use is likely to have little or no correlation with the zoning that would be in place today if the airport did not exist.⁹
18. We understand that the Commission agrees that determination of the zoning most likely to exist is a matter of expert judgement for the valuer, based on available evidence.¹⁰ In that context it would assist to clarify that the matters listed in clause A4(4) are included as matters that the valuer *may* have regard to, but not as an exhaustive list of the only matters it *must* have regard to. A valuer would in practice determine the answer to the primary question - what would be the zoning of the land if the airport did not exist? - by having regard to a variety of matters. As outlined in NZ Airports' suggested addition to clause A4(4) of draft Schedule A, these cover both the physical attributes of the land, as well as the approach to town planning in the relevant area.
19. It would be appropriate for the valuer to disclose how the zoning most likely to exist in the absence of the airport has been determined, and the evidence he or she has relied on.
- Alternative zoning and HBAU may be the same**
20. In that regard, NZ Airports notes that Clause A5 of draft Schedule A, as proposed, does not allow for situations where the likely alternative zoning and HBAU are the same. At present, clause A5 presumes that the zoning will be different for steps A5(1)(c) and A5(1)(d). This risks a valuer feeling compelled to make both a capital and timing allowance to comply with the steps outlined in A5, when in fact the zoning for the starting point and for the HBAU may be the same.
21. NZ Airports encloses a mark-up of draft Schedule A at **Appendix A**, with changes to address the above issues, as well as some other minor suggested amendments to improve its clarity.

⁸ Clause A4(4), draft Schedule A

⁹ We note that the Commission anticipates this approach is likely to be confined to being used for recently acquired land (draft decision, 2.19).

¹⁰ As put by the Commission: "*Professional judgment is required to determine the likely zoning of the land for the purposes of undertaking the MVAU valuation.*" (draft decision, 2.22)

Recent valuation standards

22. NZ Airports supports the draft decision to incorporate future standards by reference. This is a pragmatic solution to ensure that, going forward, Schedule A remains in line with the valuation standards and practices of the day.
23. More specifically, clause A2 of draft Schedule A correctly requires the valuer to comply with all mandatory standards and valuation guidance where practicable. Any deviation from best/good practice guidance should be fully disclosed and an explanation provided for the deviation. This requirement for disclosure and explanation is appropriately reinforced in A3(9).

Supporting economic analysis

24. Due to the uniqueness and complexity of calculating an airport MVAU valuation, NZ Airports accepts that Schedule A could be amended to include direction on the need to undertake economic analysis to support market demand assumptions (for notional subdivision / residual value approaches) **where appropriate** (emphasis added).¹¹ The requirement for the valuer to have recourse to economic analysis **where appropriate** strikes the right balance between clear guidance and not favouring prescription over the valuer's expert opinion.
25. NZ Airports also supports the requirement to include:
 - (a) all key assumptions and special assumptions made in the valuation report; and
 - (b) if special assumptions are not followed, the reasoning and impact this will have on the valuation.¹²

ID amendments

26. NZ Airports supports EY's recommendation that the explanation and/or reconciliation of:
 - (a) changes in subsequent valuations; and
 - (b) differences between MVAU land valuations and land value in an airport's RAB,is best addressed through amendments to the ID determination.

Decision not to make other IM amendments

27. NZ Airports also supports the Commission's draft decision not to propose IM amendments to:
 - (a) specify a standard valuation modelling approach or a standard valuation reporting structure or content;
 - (b) set a valuation "variation threshold" to assess whether valuations are appropriate; or
 - (c) specify the treatment of future maintenance costs or other potential liabilities associated with assets transferred to local authorities under HBAU plans.

¹¹ Draft Schedule A, clause A5(1)(g)(ii)

¹² Draft Decision, draft Schedule A, clause A3(8) and (9)

28. We would be happy to discuss any of the above submissions or the proposed amendments to draft Schedule A attached at **Appendix One**.

Yours faithfully

Kevin Ward
Chief Executive
New Zealand Airports Association

Appendix One

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 have regard to:](#)

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

[\(b\) 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; or and](#)

[\(d\) other matters relevant to determining the most likely zoning for the land, which may include:](#)

[\(i\) the physical attributes of the land;](#)

[\(ii\) transportation linkages;](#)

[\(iii\) anticipated population growth;](#)

[\(iv\) current and anticipated supply and demand; and](#)

(v) 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 include:

- (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.