# Assets held for future use - current Auckland Airport issues

### A. Proposal for an ex ante and ex post tracking mechanism?

- 1. We support the proposal for an ex ante and ex post tracking mechanism for AHFU. We think that ex ante transparency could be provided by using the existing tracking mechanism, but we can see advantages in simplifying this mechanism if possible.
- Some confusion has been created because the ex ante tracking mechanism contained in the Commission's stylised examples for assessing airport profitability (presented at the April workshop) does not match our understanding of how the current ex post ID future use tracking template operates.

#### 3. In more detail:

a. We think the stylised example presented by the Commission may have a possible error in its treatment of revaluations. The Commission's ex ante tracking mechanism was presented as follows:

#### Forecast LFHU balance

	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21
Opening Balance		100	104	108	112	117
Holding costs		7	7	8	8	8
Revaluations		2	2	2	2	2
Special levy		7	7	7	7	7
Costs		1	1	1	1	1
Closing Balance	100	104	108	112	117	122

- b. This mechanism does not reflect our understanding of the way the IM operates to track the value of future use assets over time. Our understanding is that:
  - i. Tracking revaluations from all prior disclosure years are added to the "base value" of the land in any given year.
  - ii. All tracking revaluations (including those in the disclosure year in question) are also added to the cumulative net revenue, which is then subtracted off the total holding costs that have accrued to date.
  - iii. Over time, revaluations therefore have a net zero position on the overall carrying value of the asset.
- c. Re-working the Commission's stylised example to match the current IM, the closing balance of the asset (in the IMs, the "cost of the excluded asset for a disclosure year") would remain steady over time, as follows:

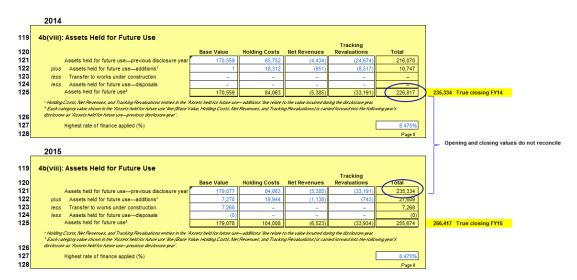
	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21
Base value		100	102	104	106	108
Holding costs		7	7	7	7	8
Revaluations		2	2	2	2	2
Special levy		7	7	7	7	7
Costs		1	1	1	1	1
Closing balance		100	100	100	100	100
MVAU	100					

If transferred to WUC at 1 April 21, would have:

Base value = land expenditure

Conversion cost = holding - net revenue - tracking revals

- d. We understand this is consistent with clause 12 of the IM determination and schedule 6 of the ID determination. On this basis, we think that ex ante transparency could be provided by using the existing tracking rules set out in the IM (although for this to work we would need a correction to the IM – discussed below).
- e. We would appreciate clarification about whether the Commission is intending to change the tracking mechanism for assets held for future use (on an ex ante and ex post basis) to align with the mechanism and layout presented in its stylised workshop examples.
- 4. In any event, we would like to discuss whether changes could be made to simplify the existing tracking mechanism/formula and the ID template. We think that interested parties would typically be interested in understanding how the opening balance and closing balance of the asset reconcile from year to year, which is made difficult by the current ID template:



5. As you can see the true closing balance for FY14, is shown as the opening value in FY15, but is not published transparently in the FY14 disclosure. We are keen to work with Commission staff to understand and explore solutions to these issues as part of the IM review and ID determination update process.

### B. Correction of tax error in the current IMs

6. We believe there is an error in the current IM with the treatment of tax on interim revenues associated with assets held for future use, which reduces its ability to track these revenues. We request that the Commission please clarify its position as soon as possible.

### 7. To expand:

- a. Clause 3.11(2) sets up the formula for calculating the cost of future use assets in any given disclosure year. Net revenue must be deducted from the base value + holding costs (tracking revaluations are also deducted). When the asset is transferred into works under construction, net revenue must be deducted from the holding costs.
- b. Clause 3.11(6(c) defines "net revenue" as revenue derived from the excluded asset (other than tracking revaluations) – operating costs incurred in relation to the excluded asset. This requires the pre-tax revenue to be subtracted from the cost of the assets. This means that:

- i. Holding costs are calculated using a post-tax WACC.
- ii. But the definition of "net revenue" a component of the overall cost of a future use asset in any given year, and a component of the holding costs calculation when the asset is transferred to works under construction – is pre-tax.
- iii. Currently "net revenue" is negative, as it represents a loss, and hence doesn't incur tax. However, in the future "net revenue" may be a positive number and we believe it is inconsistent for this to be calculated pre-tax. We consider a change is required to allow "net revenue" to be calculated post-tax, consistent with the use of a post-tax WACC.
- c. A possible solution is for the definition of "net revenue" to be changed to be post tax, as follows:
  - (c) 'net revenue' means the sum of amounts, other than those included in regulatory income under an **ID determination** or preceeding regulatory information disclosure requirements, for all **disclosure years** derived from holding the **excluded asset**, where the amount derived from the **excluded asset** in the **disclosure year** in question is determined in accordance with the formula—

<u>post-tax</u> revenue derived from the **excluded asset** (other than tracking revaluations) – **operating costs** incurred in relation to the **excluded asset**: and

## C. Recovery of holding costs under the current IMs?

- 8. The clear understanding at the time the IMs were developed was that airports would be entitled to earn a full return on assets held for future use, including the costs of holding land.
- 9. At the April profitability workshop, we indicated there may be an unintended error in the current IM that prevented holding costs from entering the RAB when the asset held for future use is eventually commissioned.
- 10. After a further review of the IM determination, we no longer understand this to be the case. We understand that holding costs can be included in the RAB as a non-land asset (as a land conversion cost) at the time of commissioning. This is consistent with the Commission's clearly expressed view that holding costs can be included in the RAB once the asset held for future use is commissioned into use.