Property Advisory

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22 December 2011

Attention: John Beckett

Board of Airline Representatives NZ
PO Box2779
Auckland 1140

RE: RESPONSE TO TELFER YOUNG MVAU CRITIQUE

1.0 INSTRUCTIONS

1. In accordance with your instructions we have reviewed Telfer Young Ltd's (TY) letter dated 15 November 2011, entitled "Response to Property Advisory Ltd's MVAU" for Wellington International Airport (WIA).

2. This letter provides comment on matters raised by TY.

2.0 LAND AREA

The Wellington Airport land areas adopted by Property Advisory Ltd (PAL) and TY are close.

A number of discrepancies were however identified by PAL and notified to TY on 28 October 2011.

3. A response to these questions and full area / certificate of title reconciliation has not been undertaken by WIA or TY.

3.0 METHODOLOGY

4. TY state that in assessing the market value alternative use (MVAU) of the Wellington Airport that PAL have only adopted a Discounted Cash Flow valuation approach.

5. This statement is correct however the comments made by TY are misleading.

6. In accordance with standard valuation practice PAL believe that it is preferable to assess the value of the WIA land (approximately 103.2 hectares), on the basis of comparable sales. Unfortunately however due to the scale, location and strategic

nature of the proposed MVAU development, there is a paucity of comparable block sales evidence from which to accurately assess its value.

7. PAL therefore used the hypothetical subdivision analysis and discounted cash flow valuation approach as the primary method to assess the MVAU value of the WIA land.

8. The "hypothetical subdivision analysis" is the method by which an individual would hypothetically calculate the development potential associated with the land being valued.

9. A prudent purchaser / valuer would use comparable sales or either a hypothetical subdivision budget, or a discounted cash flow model to assess the value of the development land.

10. The hypothetical subdivision budget is a steady state budget that simply deducts, from the expected realisation of the sale of allotments, all development expenses and a lump sum profit allowance for the purchaser. The residual sum then represents the sum a prudent purchaser would be prepared to pay for the land in its present state (block value).

11. The discounted cash flow approach simulates the subdivision and on-sale of land, taking into account the projected timing of all costs associated with the development and sale of lots, including a return to the purchaser for risk and other holding costs. The net present value of the free cash flows represents the price that a prudent purchaser would be prepared to pay for the subject land in its present state (block value).

12. It is well recognised that for a development period between eighteen months to two years both the hypothetical subdivision budget and discounted cash flow methods provide a reasonably reliable indicator of value. However for development periods of greater than two years, distortions in value occur using the subdivisional budget due to the timing of cash flows as the method fails to accurately account for the opportunity cost of capital.

13. Due to the size, scale and projected 11 year development horizon of the highest and best alternative use (HBAU) development of Wellington Airport, PAL has not undertaken a steady state hypothetical subdivision budget. Further we do not believe that PAL should be criticised for not undertaking this calculation

4.0 HIGHEST & BEST ALTERNATIVE USE

14. TY highlight the respective differences in the HBAU for the Wellington Airport and are of the opinion that PAL significantly understates the potential for commercial development in all forms, and unduly focuses on low density, low value, residential development.

15. In response PAL's assessment of the HBAU was determined by Zomac Planning Solutions after detailed population and demand analysis was carried out by Market Economics, and broad discussions had been held with Wellington City Council (WCC) planning and policy staff, plus local property professionals and developers.

16. This contrasts with TY's assessment of the HBAU which has been carried out without any consultation with Wellington City Council planning staff, or any reference to projected population or supply and demand analysis.

5.0 GROSS REALISATION

17. The gross realisations adopted by PAL and TY for allotments within the HBAU development mix for Town Centre and Large Format Retail are the same. However the assessment of the development mix, densities and values of apartment and medium density houses differ.

18. In this regard PAL has determined the allotment mix and development densities with reference to specialist planning advice from Zomac Planning Solutions and Market Economics. Correspondingly TY have sought planning advice from Boffa Miskell.

19. The respective residential dwelling densities / yields proposed by Boffa Miskell and Zomac Planning Solutions are detailed in Table 3.

Table 3. HBAU Assessments – Residential Densities / Land Use Allocation

Land Use Allocation	Boffa Miskell		Zomac Planning Solutions	
	Area Ha	Development Density	Area Ha	Development Density
(d) Apartments / Retirement Housing	4.38	40 dwellings / ha = 175 @ 250m²	0.00	
(e) 3 – 4 Story Apartments	19.18	40 dwellings / ha = 767 @ 250m²	2.00	80 dwellings / ha = 160 @ 125m
(f) Townhouses	15.37	20 dwellings / ha = 304 @ 500m²	19.00	40 dwellings / ha = 760 @ 250m
(g) Detached Family Housing	6.64	20 dwellings / ha = 132 @ 500m²	45.20	20 dwellings / ha = 904 @ 500m
Totals	45.57	1,378 Residential Dwellings	66.20	1,824 Residential Dwellings

20. On review of market developments it is apparent that there are contradictions and inconsistencies in the Boffa Miskell advice and TY valuation. An example of this is where TY reported site coverage's for townhouses of up to 65%, and propose to 345 development blocks of 1,000m² to third parties for $535,000. Assuming the townhouses are 2 storied and have a floor area of approximately 175m² and site

coverage ratio of 40%, this implies a maximum dwelling density of say 45 dwellings per hectare. This contrasts with the planning advice given by Boffa Miskell in July 2011 where they recommend an average townhouse density of 20 dwellings per hectare, with each dwelling having 500m² of land.

21. From a valuation perspective, PAL analysis of transactions of similar zoned 1,000m² to 2,000m² blocks of development land, imply market site densities of between 40 and 60 townhouses per hectare.

22. We also note that Boffa Miskell recommend a land area for townhouses at 500m² per dwelling which is the same as the recommended land area for free standing / detached family homes. Given these identical site densities PAL do not see the rational in selling 1,000m² townhouse development sites suitable for two dwellings when they would effectively be developed as detached family homes. Further TY have adopted higher gross realizations for the townhouse land ($535,000 per 1,000m²) when compared to detached family home land ($500,000 per 1,000m²). Given the similar end use of the land this value differential does not seem appropriate.

23. Similar circumstances surround the assessment of apartment and rest home land. It is interesting however to see that the dwelling densities proposed by Boffa Miskell for the apartment and rest home land are at 40 dwellings per hectare. These are double those for townhouse and detached residences zones (20 dwellings per hectare), however the TY adopted land values remain the same at $535,000 per 1,000m². Given the increasing level of development costs per potential residential dwelling, and on the basis of comparable evidence we would have thought higher block values would have been achievable.

24. On the basis of the similar residential land values ($500,000 to $535,000 per 1,000m² for detached family homes, townhouse, apartment, and rest-home apartments), it appears that TY have placed little weight on the residential land use allocations proposed by BM.

25. PAL have adopted the residential densities and land use allocations recommended by Zomac Planning Solutions.

6.0 REALISATION PERIOD

26. TY correctly identify an error in paragraph 65 of PAL's valuation report. This sentence should read:

    "…After reviewing the sales evidence and discussing the state of the market with local property participants we have adopted a four and a half *(seven)* year sell down period for the retail town centre and large format retail land uses."

27. This error (seven changed to four and a half years), was merely an editorial error and did not effect the underlying calculations and resulting land value.

28. On the basis of our experience, a review of market conditions, and discussions with local commercial valuers and real estate / leasing agents, we confirm the realisation periods and 11 year development timeframe adopted.

29. With regard to TY proposal to develop and sell approximately 103 hectares of integrated development land into the Wellington market over 7 years, given the constraints in the market, we believe the development period proposed is too optimistic and too short.

7.0 DEVELOPMENT CONTRIBUTIONS

30. PAL sought advice from the WCC as to the level of development contributions payable.

8.0 SEA WALL

31. PAL sought advice from the WCC as the status of the sea wall.

32. In this regard PAL have been advised that even though the seawalls are located on public land, the benefit and hence maintenance responsibility lies with WIA. Furthermore if under the HBAU development scenario the airport land was to be converted to an integrated residential use, it is unlikely that the WCC would take over the management of these assets.

33. WIA estimate that the annualised sea wall maintenance costs over the next 10 years will be approximately $300,000 per annum.

34. From a practical valuation perspective PAL believe the costs of maintaining the seawalls must be taken into consideration when assessing the MVAU of the WIA land. On the basis of capitalised costs they could be vested to the WCC or alternatively the seawalls could be held in a body corporate by the residents. Either way a cash amount would be required to fund the maintenance of the sea walls.

9.0 ATTACHMENT 3

35. TY correctly identify an error in Table 9 of Attachment III of PAL's valuation report. This table should read:

Table 9 HBAU – Lot Realisations

Land Use Allocation		Net Area (ha)	Approximate Allotment Numbers / Size	Gross Realisations $ + GST	
				$/Lot	$/m²
(a)	Town Centre	2.00	20 x 1,000m²	1,000,000	1,000
(b)	Large Format Retail	5.00	10 x 5,000m²	3,750,000	750
(c)	Medium Density Residential Apartments	2.00	160 x 125m²	85,000	680 *(650)*
(d)	Medium Density Residential Townhouses	19.00	760 x 250m²	135,000	540 *(560)*
(e)	Detached Family Housing	49.72	904 x 500m²	225,000	450
(f)	Headland Park	5.0			
(g)	Neighborhood Open Space	5.00			
(h)	Roads	15.48			
	Total	103.20	1,854 lots		

36. Again this error was merely an editorial error in the table attachment, and did not effect the underlying calculations and resulting land value.

10.0 VALUE RECONCILIATION

37. TY state that PAL have used only the discounted cash flow valuation approach and that it is difficult to reconcile the value with comparable sales, or to Schedule A of Commerce Commission Decision 709 which requires the valuer to "..reconcile the results of the valuation approaches used to determine the value of the HBAU"

38. In response, due to the unique characteristics of the WIA land and paucity of comparable sales evidence, PAL used the hypothetical subdivision analysis and discounted cash flow valuation approach as the primary method to assess the MVAU of the WIA land.

39. If comparable sale value benchmarks were available, or development characteristics suited the use of a steady state hypothetical subdivision budget, then these approaches would have been adopted by PAL. From a practical perspective PAL have used the valuation approach that would most likely to be utilised by a prudent market purchaser to value the WIA land, and have not attempted to massage the data or valuation approaches.

40. TY have then apportioned the PAL valuation and state that the inferred land value rates are inconsistent with the sales evidence. In response without out making numerous and very subjective adjustments for size and scale, it is difficult to compare the value of a 1 hectare sale with a 103 hectare property.

41. Furthermore the basis for undertaking the hypothetical subdivision analysis and discounted cash flow valuation is that all inputs and development assumptions are based on market evidence. If the inputs and assumptions are accurate then the output will reflect the market.

11.0 SUMMARY

42. In summary TY identify three mains areas of difference. These include the assessment of the HBAU / form of development, the calculation of development costs, plus the development horizon.

43. Subject to the comments earlier in this report, we agree that these are the three main areas of difference which flow through to differences in valuer opinion.

44. On the basis of confirmed master planning advice received from Zomac Planning Solutions, Market Economic, and our review of market conditions, we confirm that it is our opinion that the MVAU of the 103.2 hectare WIA property as at 1 July is $98,000,000, plus GST if any.

45. We trust that these comment, meet you requirements. If you have any queries or require clarification on any matter please do not hesitate to contact us.

Yours faithfully
Property Advisory Ltd

KD Smith
B.Com VPM, MNZPI
Registered Valuer
Director